

<p>1 Monday, 16 November 2015</p> <p>2 (10.30 am)</p> <p>3 MR JUSTICE HILDYARD: Good morning.</p> <p>4 Submissions by MR ZACAROLI (continued)</p> <p>5 MR ZACAROLI: My Lord, good morning.</p> <p>6 Before I turn to the remaining two issues I have to</p> <p>7 deal with, 13 and 14, with my Lord's permission I would</p> <p>8 wish to just recap in seven sentences, or very short</p> <p>9 points, our case on issue 10, just to round off what</p> <p>10 I was saying on Wednesday afternoon, and to deal with</p> <p>11 one additional point which cuts across into part of the</p> <p>12 US issues my learned friend Mr Dicker will be dealing</p> <p>13 with, but it is the point about attorney's fees and the</p> <p>14 relevance of those to the assignment question under</p> <p>15 issue 10.</p> <p>16 Just to recap, as I say in seven short points what</p> <p>17 we say about issue 10.</p> <p>18 Number 1, in all but one context in which the</p> <p>19 default rate is used, "relevant payee" can only mean one</p> <p>20 or other of the parties to the agreement.</p> <p>21 Number 2, in all contexts in which it is used, the</p> <p>22 phrase "relevant payee" functions to identify the</p> <p>23 relevant party to the agreement whose cost of funding is</p> <p>24 relevant where any alternative such as "relevant party"</p> <p>25 or by using the defined term "defaulting party" or</p> <p>Page 1</p>	<p>1 Sixthly, the Senior Creditor Group's case requires</p> <p>2 the drafting to be materially altered because they</p> <p>3 contend "relevant payee" means not the person, assignor</p> <p>4 or assignee to whom the relevant amount is payable, but</p> <p>5 a combination of the assignor, the assignee or perhaps</p> <p>6 each successive assignee but only for the period for</p> <p>7 which the money was owed to each of them. That, we</p> <p>8 would say, requires substantial rewriting of the</p> <p>9 provision.</p> <p>10 Seventh and lastly it leads to perverse consequences</p> <p>11 and complications if "relevant payee" means each</p> <p>12 successive assignee, for each successive assignment the</p> <p>13 cost of funding needs to be calculated differently.</p> <p>14 My Lord, that encapsulates our case in seven points.</p> <p>15 The additional point then is to deal with the point</p> <p>16 my learned friend made where he relied upon the fact</p> <p>17 that under some US cases where there is a contractual</p> <p>18 entitlement to attorney's fees, remembering in the US of</p> <p>19 course there is not normally entitlement to attorney's</p> <p>20 fees, in those cases where there has been an assignment</p> <p>21 of the right to recover the amount, it has been held</p> <p>22 that the assignment carries with it the right to recover</p> <p>23 attorney's fees in the sense that it is the attorney's</p> <p>24 fees incurred by the assignee that is recoverable, not</p> <p>25 surprising given the assignor no longer entitled to so</p> <p>Page 3</p>
<p>1 "non-defaulting party" would simply not have worked.</p> <p>2 Thirdly, the term is used first of all in the 1987</p> <p>3 agreement, where it could in all circumstances mean only</p> <p>4 one or other party to the agreement.</p> <p>5 There is no reason for concluding that its meaning</p> <p>6 was intended to be expanded when the 1992 agreement</p> <p>7 allowed the transfer of the section 6(e) payment.</p> <p>8 Fourthly, the wording "to it" which appears in the</p> <p>9 1992 agreement indicates that it is limited to the cost</p> <p>10 of funding of the contracting party, because a default</p> <p>11 rate calculated by reference to the cost of funding of</p> <p>12 anyone else would never be an amount payable to it.</p> <p>13 Fifthly, the purpose of a general prohibition on</p> <p>14 assignment which appears in the beginning of section 7</p> <p>15 includes the protection of each party against unknown</p> <p>16 risks, including the credit risk in having to pay</p> <p>17 interest based on cost of funding of unknowable third</p> <p>18 parties to whom your counterparty might assign the</p> <p>19 section 6(e) amount. The other exceptions to the</p> <p>20 general prohibition one finds are consistent with that</p> <p>21 and it is unlikely we say at least that the draftsman</p> <p>22 intended to cut across that purpose and that protection</p> <p>23 when permitting the assignment of the section 6(e)</p> <p>24 amount, and the users' guide's explanation for that</p> <p>25 transfer is inconsistent with that suggestion.</p> <p>Page 2</p>	<p>1 will not incur any attorney's fees.</p> <p>2 My Lord, he says that was analogous and we say that</p> <p>3 is wrong. We agreed that attorney's fees might be</p> <p>4 analogous to interest per se, in the sense that both are</p> <p>5 ancillary rights to the right to payment and so when the</p> <p>6 right to payment passes, both the right to recover</p> <p>7 interest in respect of it and the right to recover costs</p> <p>8 incurred in forcing that payment would be transferred to</p> <p>9 the assignee.</p> <p>10 The question here is not whether the right to</p> <p>11 interest goes with the assignment, we accept that it</p> <p>12 does, but whether the identity of the person whose costs</p> <p>13 of funding are used to measure interest transfers with</p> <p>14 the assignment.</p> <p>15 Attorney' fees are not analogous here for one</p> <p>16 reason. The calculation of interest under the master</p> <p>17 agreement is dependent upon the personal characteristics</p> <p>18 of the counterparty, ie the cost to it of funding the</p> <p>19 relevant amount, whereas the personal characteristics of</p> <p>20 the person who incurs attorney's fees are irrelevant to</p> <p>21 the calculation of those fees. All that matters is that</p> <p>22 the fees are incurred in connection with enforcement of</p> <p>23 the assigned debt. It is the fact that the definition</p> <p>24 of default rate personalises the calculation to the</p> <p>25 characteristics of your counterparty that renders it not</p> <p>Page 4</p>

<p>1 capable of being assigned.</p> <p>2 My Lord, that is all I wish to say on issue 10.</p> <p>3 Moving then to issue 13, just to remind my Lord of the</p> <p>4 issue, because we are changing horses slightly, in</p> <p>5 bundle 1, the application appears behind tab 1B and</p> <p>6 issue 13 is dealing with the question whether the cost</p> <p>7 to the relevant payee if it were to fund --</p> <p>8 MR JUSTICE HILDYARD: Are you in the core bundle?</p> <p>9 MR ZACAROLI: I can be, my Lord, yes, core bundle. Tab 1 of</p> <p>10 the core bundle I am told. Issue 13 appears on page 6.</p> <p>11 Whether the cost to the relevant payee, if it were</p> <p>12 to fund or of funding the relevant amount should be</p> <p>13 calculated, then (1) by reference to the relevant payee</p> <p>14 circumstances on a particular date or, (2), on</p> <p>15 a fluctuating basis taking into account any changes in</p> <p>16 the relevant circumstances and if so whether the benefit</p> <p>17 of hindsight applies when taking into account such</p> <p>18 changes. In each case whether or not taking into</p> <p>19 account relevant market conditions.</p> <p>20 In short, we say the answer is, (2), taking into</p> <p>21 account hindsight and taking account of relevant market</p> <p>22 conditions.</p> <p>23 Just to develop that very briefly, the definition of</p> <p>24 the default rate does not prescribe any particular time</p> <p>25 for certifying for cost of funding. The problem with</p> <p style="text-align: center;">Page 5</p>	<p>1 remain 2 per cent or below for the rest of the six</p> <p>2 years. A certificate issued after one month could</p> <p>3 rationally and in good faith state that the cost of</p> <p>4 borrowing to the relevant payee is 6 per cent.</p> <p>5 Nothing happens then for six years until the</p> <p>6 principal sum is paid in full. It cannot possibly be</p> <p>7 right that the relevant payee can claim interest at</p> <p>8 6 per cent for six years, because it was rational to</p> <p>9 certify on the date that it did certify. It</p> <p>10 demonstrates that the certificate has to be put forward</p> <p>11 in good faith at the time it is being put forward for</p> <p>12 the purposes of payment.</p> <p>13 If after six years it is clear that the cost of</p> <p>14 funding for all but two months of that six-year period</p> <p>15 was substantially lower than that certificate, we say</p> <p>16 the relevant payee must be required to restate what its</p> <p>17 cost of funding for that entire period was, because it</p> <p>18 would not be rational or in good faith to rely upon</p> <p>19 an out of date certificate. Noting that there is</p> <p>20 nothing that says only one certificate can be issued and</p> <p>21 once issued that is the end of it, it is not like</p> <p>22 a third party coming in and saying that is the answer,</p> <p>23 unchallengeable. This is a certificate provided for</p> <p>24 a purpose, namely a purpose of obtaining payment.</p> <p>25 In those circumstances, it cannot be, we say, that</p> <p style="text-align: center;">Page 7</p>
<p>1 interest or a feature of interest of course is it is not</p> <p>2 necessarily a constant, it can change over time. In the</p> <p>3 run of the mill cases, where certification and payment</p> <p>4 would be expected to happen within short order, this</p> <p>5 will not usually be an issue. It matters more here</p> <p>6 where there is a delay of many years between the early</p> <p>7 termination date and the date upon which the final</p> <p>8 dividend was paid, some six years or so.</p> <p>9 In that case, we say, the critical time is when the</p> <p>10 party is actually seeking payment of interest, which is</p> <p>11 likely to be in practice at the end of the period. Not</p> <p>12 necessarily, but it would be very unlikely for interest</p> <p>13 to be payable at any time until the principal is being</p> <p>14 paid. Of course in an insolvency context that must be</p> <p>15 so because you cannot claim interest until all the</p> <p>16 principal debt has been paid.</p> <p>17 The reason the end of the period is likely to be</p> <p>18 important is because whenever a certificate may have</p> <p>19 first been issued, the time for assessing whether it is</p> <p>20 rational or in good faith to rely upon it is when it is</p> <p>21 relied upon to obtain payment.</p> <p>22 To illustrate that by a very simple example, let's</p> <p>23 assume that one month after the early termination date</p> <p>24 interest rates in the market are say 6 per cent. Then</p> <p>25 shortly thereafter interest rates fall to 2 per cent and</p> <p style="text-align: center;">Page 6</p>	<p>1 the certificate is by reference to one date only and</p> <p>2 that is it.</p> <p>3 As far as hindsight is concerned, we say, where</p> <p>4 a relevant payee does not go out and borrow in the</p> <p>5 market, it necessarily left itself open to react to</p> <p>6 changing market circumstances because it did not in fact</p> <p>7 tie itself down to any particular rate. Those changing</p> <p>8 circumstances must with hindsight be factored into the</p> <p>9 calculation of what it would have had to pay over the</p> <p>10 course of those six years from time to time had it gone</p> <p>11 to the market to borrow.</p> <p>12 My Lord, unless I can assist further, those are my</p> <p>13 submissions on 13.</p> <p>14 I am going to turn briefly to 14.</p> <p>15 MR JUSTICE HILDYARD: I was just reminding myself of the</p> <p>16 mechanics whereby the certificate triggers the</p> <p>17 obligation to pay in accordance with it.</p> <p>18 MR ZACAROLI: It is nothing more than the definition itself,</p> <p>19 which -- well 6(d) is where one starts, which merely</p> <p>20 refers you to the applicable rate so interest is payable</p> <p>21 under 6(d)(ii), the last three lines.</p> <p>22 The applicable rate, such interest, calculation on</p> <p>23 the basis of daily compounding and the actual number of</p> <p>24 days elapsed. Of course the applicable rate here is 1,</p> <p>25 which depends upon the cost of funding to the party, if</p> <p style="text-align: center;">Page 8</p>

<p>1 it were to fund or of funding that amount, as certified</p> <p>2 by it.</p> <p>3 MR JUSTICE HILDYARD: Anyway, you say that the operative</p> <p>4 certificate which requires that payment must be at the</p> <p>5 date at which by reference to which payment is to be</p> <p>6 made --</p> <p>7 MR ZACAROLI: Yes, in cases where there is a delay.</p> <p>8 MR JUSTICE HILDYARD: Yes, but in all cases but just in some</p> <p>9 cases it will matter and in some cases it won't?</p> <p>10 MR ZACAROLI: Yes, for the simple reason, the one put</p> <p>11 forward before at an early stage in the period. We</p> <p>12 don't suggest, as my learned friend suggested I think,</p> <p>13 that there has to be something monitoring interest rates</p> <p>14 or what it would have cost to fund throughout the</p> <p>15 period, that is not what we say. You are perfectly</p> <p>16 entitled to certify on day one and do nothing else until</p> <p>17 such time as, "Actually, now I am seeking payment", but</p> <p>18 when you come to seek payment, if you rely on</p> <p>19 a certificate that is six years out of date and clearly</p> <p>20 not a statement of what it would have cost you or what</p> <p>21 it did cost you to borrow for the whole of those six</p> <p>22 years, or the rate you borrowed at for those six years,</p> <p>23 it cannot be one you can rely on.</p> <p>24 My Lord, turning then to issue 14 --</p> <p>25 MR JUSTICE HILDYARD: Yes.</p> <p style="text-align: center;">Page 9</p>	<p>1 nevertheless seeks to rely upon the certificate stating</p> <p>2 it is 7 per cent, then the rationality and good faith</p> <p>3 test would be enough, because we would say it would</p> <p>4 clearly be in bad faith for a party to rely upon</p> <p>5 a certificate which it knew to be based on an error of</p> <p>6 fact.</p> <p>7 That does not cover all situations, because it would</p> <p>8 not be in bad faith and it would not be outside the</p> <p>9 bounds of rational conduct for someone to make</p> <p>10 an innocent or even negligent mistake. But in those</p> <p>11 circumstances, in our submission, the certificate that</p> <p>12 stated 7 per cent, based upon an error of fact, would</p> <p>13 then not in fact be a certificate of the costs to the</p> <p>14 relevant payee of funding or if it were to fund the</p> <p>15 relevant amount. It is a statement of something</p> <p>16 different, something which is based upon an error.</p> <p>17 My Lord, it may be worth just seeing the two rival</p> <p>18 formulations of the wording on this point. They are</p> <p>19 most easily found in Goldman Sachs' reply skeleton,</p> <p>20 bundle 3, tab 7, page 17, paragraph 35. The formulation</p> <p>21 which I think -- paragraph 35.</p> <p>22 MR JUSTICE HILDYARD: "It is on this basis ..."</p> <p>23 MR ZACAROLI: Yes. Yes. Because within this paragraph you</p> <p>24 will see the two different formulations in italics. The</p> <p>25 first one begins at the end of the second line:</p> <p style="text-align: center;">Page 11</p>
<p>1 MR ZACAROLI: -- issue 14 is, as my Lord knows,</p> <p>2 substantially agreed between the parties. What was left</p> <p>3 in disagreement were two points, one whether the phrase</p> <p>4 "manifest error" should be incorporated into the</p> <p>5 declaration the court will give. The other was the</p> <p>6 precise formulation that the administrators had put</p> <p>7 forward in their skeleton and which Goldman Sachs had</p> <p>8 taken issue with in theirs.</p> <p>9 We reflected on the exchanges between my Lord and my</p> <p>10 learned friends on this point. In our view, in our</p> <p>11 submission, the answer to this is not to be found in the</p> <p>12 use or otherwise of the phrase "manifest error", however</p> <p>13 actually everything comes down to the formulation as</p> <p>14 between the administrators and Goldman Sachs. I am</p> <p>15 going to focus on that aspect if I may and explain why</p> <p>16 it is that manifest error is not critical here.</p> <p>17 What we are concerned with here is where there is</p> <p>18 an error of fact in the calculation undertaken by the</p> <p>19 relevant payee. The simplest example is where the raw</p> <p>20 material relied upon by the relevant payee identifies</p> <p>21 a rate of 6 per cent, say, but an error in that</p> <p>22 calculation or in the final statement of it produces</p> <p>23 a rate of 7 per cent. That can be shown to be a simple</p> <p>24 arithmetic error.</p> <p>25 If the relevant payee realises that error and then</p> <p style="text-align: center;">Page 10</p>	<p>1 "The certification is something other than the</p> <p>2 relevant payee's costs if it were to fund or of funding</p> <p>3 the relevant amount as those words may be construed by</p> <p>4 the court".</p> <p>5 The Goldman Sachs wording is in paragraph 36 at the</p> <p>6 end of the paragraph where they suggest wording:</p> <p>7 "Where the certification does not fall within the</p> <p>8 scope of the expression, 'cost if it were to fund or of</p> <p>9 funding the relevant amount' as those words may be</p> <p>10 construed by the court."</p> <p>11 It is true that the debate between those two</p> <p>12 formulations or the reason that wording was put in in</p> <p>13 the first place was to capture the case where the</p> <p>14 relevant payee has identified the wrong construction of</p> <p>15 costs for funding. If my Lord for example were to</p> <p>16 decide that cost of equity is outside the scope of the</p> <p>17 clause and yet nevertheless someone certifies that then</p> <p>18 it is wrong, it is not a certificate within the meaning</p> <p>19 of the clause for that reason.</p> <p>20 However, we submit the wording does in fact cover</p> <p>21 this other issue, that is where the certificate that was</p> <p>22 put forward states a rate which is arrived at through</p> <p>23 the process of an arithmetical or other error of fact.</p> <p>24 Looking at the wording at the bottom of page 17</p> <p>25 first of all. This covers the case, we say, and if one</p> <p style="text-align: center;">Page 12</p>

<p>1 takes the cost of funding first it is a bit easier to 2 see how it works.</p> <p>3 There is an objectively ascertainable fact here, 4 what was the rate at which the relevant payee borrowed 5 funds and if it borrowed funds at 6 per cent, but the 6 certificate states 7 per cent, then the certificate is 7 clearly not a certificate of what it cost the relevant 8 payee to borrow the funds. The cost of funding is not 9 stated, it is something else that has been stated.</p> <p>10 The wording at the bottom of page 17 entirely covers 11 that case. We say without risk of encroaching on 12 anything else which it should not encroach upon, namely 13 errors in judgment, or differences in judgment, any 14 judgment call which the relevant payee is required to 15 make in calculating its cost of funding is a matter for 16 it and errors of judgment would be outside the scope of 17 this point. It is only where there is an error of fact, 18 such as an arithmetical error where the certificate 19 which states something which was different to that which 20 was in fact incurred by the relevant payee would then 21 not be a certificate which complies with the definition.</p> <p>22 If it is true for cost of funding, then it is 23 similarly true for cost if it were to fund in a case 24 where the calculations which the relevant payee has 25 relied upon contain a mistake, producing a wrong number.</p> <p style="text-align: center;">Page 13</p>	<p>1 MR JUSTICE HILDYARD: Or if there had been multiple 2 assignments, especially over the course of time.</p> <p>3 MR ZACAROLI: The multiplicity of assignments causes no 4 problem because you are only ever looking at one 5 person's cost of funding the relevant amount.</p> <p>6 MR JUSTICE HILDYARD: Yes.</p> <p>7 MR ZACAROLI: The answer to that question, my Lord, is if it 8 causes any difficulty, that is a matter to be identified 9 and dealt with at the point of the assignment. It lies 10 within the hands of the assignee when it buys the debt 11 to cater for the issue of what it would cost to fund, or 12 what it would cost to fund the original party for the 13 period the debt remains outstanding. For example some 14 sort of power of attorney so that the relevant assignee, 15 the assignee has power to certify based upon information 16 which the original party would provide.</p> <p>17 It involves an extra step where there has been 18 an assignment and there is a long period of time, 19 I accept that, but that is not a reason to deny the 20 words their proper meaning. Particularly as, on my 21 learned friend's case, it does also involve that same 22 problem in a case where the assignment takes place later 23 in the piece. If there is an assignment after say four 24 years and then there is another two years' delay, then 25 if the "relevant payee" means the assignee, it still has</p> <p style="text-align: center;">Page 15</p>
<p>1 For those reasons, we submit that the correct 2 approach to this question of error, not necessarily 3 manifest error, just error, is to adopt the form of 4 wording at the bottom of page 17 in Goldman Sachs' 5 skeleton argument.</p> <p>6 MR JUSTICE HILDYARD: I am working on a slightly different 7 page number, but do you mean -- which are the words?</p> <p>8 MR ZACAROLI: The words are:</p> <p>9 "The certification is something other than the 10 relevant payee's costs if it were to fund or of funding 11 the relevant amount as those words may be construed by 12 the court".</p> <p>13 MR JUSTICE HILDYARD: Those are the words you press for?</p> <p>14 MR ZACAROLI: My Lord, yes.</p> <p>15 MR JUSTICE HILDYARD: Your basic distinction is between 16 reviewable error of fact and an unreviewable error of 17 judgment?</p> <p>18 MR ZACAROLI: Yes.</p> <p>19 My Lord, unless I can assist further, those are now 20 our submissions on all the issues under English law.</p> <p>21 MR JUSTICE HILDYARD: Yes. On the relevant payee, does not 22 your construction involve quite a difficult exercise, if 23 the assignment is quite a lot prior to the date of 24 claim, if you like?</p> <p>25 MR ZACAROLI: My Lord --</p> <p style="text-align: center;">Page 14</p>	<p>1 the complication of identifying the cost of funding to 2 the prior party for all the years during which the debt 3 was owed to it. It is unlikely, very unlikely, unless 4 there was imminent payment likely at the end of that 5 four-year period which there would not have been -- or 6 on this case there has not been -- it is very unlikely 7 that that original party will have certified, will have 8 gone through the process of certifying its own costs at 9 the point in time at which it renders the assignment .</p> <p>10 The problem arises on both cases.</p> <p>11 MR JUSTICE HILDYARD: Doesn't yours pile hypothesis on 12 hypothesis? You have the position that you are entitled 13 to take into account not only actual funding costs but 14 if they had funded, what would have been those costs?</p> <p>15 MR ZACAROLI: It is not a hypothesis on a hypothesis, it 16 simply means you are in the realm of the hypothesis 17 throughout the period after the date of the assignment, 18 because it is only what it would have cost it to fund 19 during that period that can be relevant.</p> <p>20 MR JUSTICE HILDYARD: What I mean, and I may be muddled in 21 this, hypothesis -- you are not only not considering 22 whether there was an actual funding but you are 23 considering the position of someone who ex hypothesi 24 could not have funded.</p> <p>25 MR ZACAROLI: Yes, but the reason why the person does not</p> <p style="text-align: center;">Page 16</p>

<p>1 fund, I would submit, is not relevant to the question</p> <p>2 when you are identifying the hypothetical, when you are</p> <p>3 relying upon the hypothetical, it is just the costs --</p> <p>4 it doesn't matter why it has not funded, it may not have</p> <p>5 funded for its own commercial reasons.</p> <p>6 MR JUSTICE HILDYARD: That I understand, but the assignor</p> <p>7 will have obtained his money and will be out of the</p> <p>8 picture. On what rational footing can one imagine the</p> <p>9 hypothesis in its case?</p> <p>10 MR ZACAROLI: My Lord, the fact that it doesn't need to</p> <p>11 borrow anymore is precisely why you are looking at the</p> <p>12 hypothesis.</p> <p>13 MR JUSTICE HILDYARD: You are looking at it in that</p> <p>14 circumstances, not on the footing of some economic</p> <p>15 choice but on the footing of no exposure.</p> <p>16 MR ZACAROLI: My Lord, you are still looking at an exposure</p> <p>17 because, although it has been paid by someone else, the</p> <p>18 debt has not been paid by LBIE in this case, it just</p> <p>19 means you are looking at the hypothetical: what if it</p> <p>20 had to fact the relevant, which is the amount owed by</p> <p>21 LBIE? The fact that you have been paid that from</p> <p>22 somewhere else is irrelevant.</p> <p>23 MR JUSTICE HILDYARD: Would it encourage a rather odd market</p> <p>24 where you might have to pay more for debt from people</p> <p>25 whose funding costs are likely to be greater, because</p> <p style="text-align: center;">Page 17</p>	<p>1 MR JUSTICE HILDYARD: I accept on either footing there are</p> <p>2 oddnesses and that if you look only at that segment of</p> <p>3 the contractual entitlements there is a danger either</p> <p>4 way of a sort of -- I don't mean it rudely, but</p> <p>5 a trafficking in that particular element of the</p> <p>6 contractual right.</p> <p>7 In your case it looks particularly odd because the</p> <p>8 assignee then gets ex hypothesi more than it is entitled</p> <p>9 to if the assignor had a greater funding cost but</p> <p>10 I suppose you would say well may be the answer is that</p> <p>11 it may well have paid more for it, who knows, you say,</p> <p>12 in any event you cannot squash out the perversities.</p> <p>13 MR ZACAROLI: Yes. Remembering that this operates both ways</p> <p>14 so when you enter into the agreement you don't know</p> <p>15 which of you will be the paying party and which will be</p> <p>16 the receiving party in some event a long way down the</p> <p>17 line. For that reason it may be that balancing the</p> <p>18 oddities of the result is not the right way to analyse</p> <p>19 the construction of the clause, but to focus on the fact</p> <p>20 that, on my learned friend's construction, each party</p> <p>21 would be agreeing at the outset to expose itself to the</p> <p>22 risks of having to pay an increased amount by way of</p> <p>23 interest by reference to the circumstances of unknown</p> <p>24 third parties to whom its counterparty might transfer</p> <p>25 the debt. That is a sounder basis on which to identify</p> <p style="text-align: center;">Page 19</p>
<p>1 you are going to get the benefit of their greater</p> <p>2 hypothetical funding costs?</p> <p>3 MR ZACAROLI: My Lord, the latter is true, I would not agree</p> <p>4 that that would be a -- I forget the word my Lord used.</p> <p>5 MR JUSTICE HILDYARD: A funny market.</p> <p>6 MR ZACAROLI: A funny market. That is because that</p> <p>7 counterparty is entitled as a matter of contract to</p> <p>8 receive the principal amount plus an amount of interest</p> <p>9 by reference to its costs of funding, so --</p> <p>10 (Pause for a minute's silence)</p> <p>11 MR ZACAROLI: My Lord, I think my answer is it is not</p> <p>12 a funny market, it is a feature of the fact that the</p> <p>13 original payee is owed that amount by way of contract.</p> <p>14 If my Lord is concerned about the effects on the market</p> <p>15 in transferring debt, well then, as we have pointed out</p> <p>16 in our submissions, there is equal and opposite</p> <p>17 consequences if my learned friend is right, in that the</p> <p>18 debt can be transferred between different assignees with</p> <p>19 the consequence -- often transferred at a discount with</p> <p>20 the consequence that the relevant amount remains the</p> <p>21 same, ie the full nominal amount of the unpaid debt and</p> <p>22 the cost of funding that amount is then what identifies</p> <p>23 the default rate in the hands of an assignee with</p> <p>24 a greater cost of funding than the assignor, so there</p> <p>25 are equally perverse results in that direction.</p> <p style="text-align: center;">Page 18</p>	<p>1 the purpose behind the provisions.</p> <p>2 MR JUSTICE HILDYARD: Your fundamental legal point is that</p> <p>3 the only thing that is capable of assignment is the</p> <p>4 right that the assignor has against the counterparty?</p> <p>5 MR ZACAROLI: Yes.</p> <p>6 MR JUSTICE HILDYARD: There is no stepping into the shoes</p> <p>7 because you cannot, as a matter of -- you can accept in</p> <p>8 the context of (A) absorption or something like that,</p> <p>9 you cannot actually assign the agreement itself?</p> <p>10 MR ZACAROLI: Yes. My Lord, that is correct.</p> <p>11 MR JUSTICE HILDYARD: Yes.</p> <p>12 On the certification point, the problem identified</p> <p>13 is simply the problem that any such words, as you</p> <p>14 suggest, run the risk of a more frequent challenge on</p> <p>15 the footing of an alleged error of fact?</p> <p>16 MR ZACAROLI: The circumstances in which that challenge</p> <p>17 would get anywhere are limited because once the issue is</p> <p>18 raised it can be resolved fairly readily, one would have</p> <p>19 thought. There is no question of challenging judgments</p> <p>20 made, it is just --</p> <p>21 MR JUSTICE HILDYARD: The threat of litigation is in itself</p> <p>22 a discount factor, isn't it? It takes time.</p> <p>23 MR ZACAROLI: Except that whether there was an error of fact</p> <p>24 can be revealed very shortly.</p> <p>25 MR JUSTICE HILDYARD: It might be.</p> <p style="text-align: center;">Page 20</p>

<p>1 MR ZACAROLI: Certainly much more shortly than the sorts of</p> <p>2 challenges which are meant to be outlawed by the</p> <p>3 certification process, it may be challenging whether it</p> <p>4 was merely reasonable, ie saying, "We would have done</p> <p>5 this differently", those sort of challenges are clearly</p> <p>6 offside, but where you are identifying an error of fact</p> <p>7 then we say that the scope of the challenge would be</p> <p>8 much more limited and the identification of whether you</p> <p>9 are right or wrong a much quicker process.</p> <p>10 MR JUSTICE HILDYARD: The fact said to be in error will be</p> <p>11 revealed by the workings, would it, which have to be</p> <p>12 provided with the certificate?</p> <p>13 MR ZACAROLI: They haven't no, you would have to challenge</p> <p>14 this before anything became revealable, because the</p> <p>15 likelihood is a certificate would just say 5 per cent.</p> <p>16 MR JUSTICE HILDYARD: I thought there was some provision for</p> <p>17 some workings to be provided with the certificate. Have</p> <p>18 I imagined that?</p> <p>19 MR ZACAROLI: I think my Lord has imagined that.</p> <p>20 MR JUSTICE HILDYARD: It is just a "I promise it is this"?</p> <p>21 MR ZACAROLI: Yes. If it is a mistake which is not</p> <p>22 particularly -- well I will not go there.</p> <p>23 MR JUSTICE HILDYARD: No.</p> <p>24 MR ZACAROLI: Some mistakes can be more obvious than others</p> <p>25 but the more obvious the mistake, the more likelihood is</p> <p style="text-align: center;">Page 21</p>	<p>1 definition.</p> <p>2 Does a cost fall outside the definition if it has or</p> <p>3 lacks one of these characteristics? That was the</p> <p>4 purpose of the exercise. Your Lordship may or may not</p> <p>5 find it helpful. We hope it is helpful, but the answers</p> <p>6 to the questions help on two levels, as far as the</p> <p>7 administrators see it. The first is they help on the</p> <p>8 level of creditors being able to formulate their</p> <p>9 certificate in a manner that complies with the</p> <p>10 definition, giving a little bit more guidance on what</p> <p>11 properly can be included as part of the interest claim</p> <p>12 at the default rate, which I think my learned friends</p> <p>13 have both said, Mr Foxton and Mr Dicker, their clients</p> <p>14 would value. It is also of course to help LBIE and its</p> <p>15 Joint Administrators in testing whether the certificate</p> <p>16 complies: is the amount certified reflective of or</p> <p>17 derived from a cost falling within the definition.</p> <p>18 My Lord has heard many submissions which make clear</p> <p>19 that the primary battleground here is between what</p> <p>20 in English law one clearly and cleanly characteries as</p> <p>21 debt and what in English law one cleanly and clearly</p> <p>22 characteries as equity, borrowing and shareholder funds</p> <p>23 check. The Joint Administrators are keen to ensure that</p> <p>24 characterisation which may or may not in precisely the</p> <p>25 same form be attributes of a debt instrument or</p> <p style="text-align: center;">Page 23</p>
<p>1 the relevant payee has spotted it themselves so in</p> <p>2 a sense that falls into the bad faith category.</p> <p>3 MR JUSTICE HILDYARD: Mr Zacaroli, thank you very much.</p> <p>4 MR ZACAROLI: I'm grateful, my Lord.</p> <p>5 MR JUSTICE HILDYARD: Mr Trower.</p> <p>6 Submissions by MR TROWER</p> <p>7 MR TROWER: My Lord I hope I will not trespass over the</p> <p>8 ground that has already been covered and I shall</p> <p>9 certainly endeavour not to do so. Inevitably my</p> <p>10 submissions will be relatively short and in some</p> <p>11 respects will not be as elegantly structured as</p> <p>12 Mr Zacaroli's were, but I shall endeavour to make them</p> <p>13 easy to listen to if nothing else.</p> <p>14 My Lord, what I was going to start with was take</p> <p>15 my Lord to paragraph 65 and following of our skeleton,</p> <p>16 which is what one might describe as the characteristics</p> <p>17 point which goes to issue 11. I was going to deal with</p> <p>18 issue 11 first.</p> <p>19 What we have done in this section of our skeleton --</p> <p>20 my learned friend Mr Zacaroli has already taken your</p> <p>21 Lordship to it for the purpose of identifying what they</p> <p>22 say are their answers -- is something that is designed</p> <p>23 to elucidate the characteristics or attributes of any</p> <p>24 particular cost for the purposes of testing whether</p> <p>25 a cost is capable of falling within the default rate</p> <p style="text-align: center;">Page 22</p>	<p>1 an equity instrument are also examined to enable</p> <p>2 everyone to assess whether a particular form of funding</p> <p>3 has a costs falling within the definition, because we</p> <p>4 are dealing with attributes that may extend beyond</p> <p>5 English law.</p> <p>6 Mr Zacaroli gave answers to the questions as</p> <p>7 I indicated, and the Joint Administrators have not seen</p> <p>8 quite so clearly expressed answers from the -- nor has</p> <p>9 my Lord -- Senior Creditor Group and GSI. My Lord may</p> <p>10 or may not find it helpful to hear answers expressed in</p> <p>11 precisely the way Mr Zacaroli did from the Senior</p> <p>12 Creditor Group and GSI in reply.</p> <p>13 Looking at the characteristics, the underlying</p> <p>14 purpose, as I say, is to ensure that one does not get</p> <p>15 overly hung up on equity and debt, not fix on the labels</p> <p>16 but looks as at the underlying characteristics which</p> <p>17 comprise in English law those concepts.</p> <p>18 The essence of the first one, and it is developed</p> <p>19 a little bit -- some of these are self-explanatory so</p> <p>20 I hope I don't need to spend too long on them -- from</p> <p>21 paragraph 68 onwards of the skeleton. The essence of</p> <p>22 the first one is whether it is necessary for the</p> <p>23 claimant creditor to identify an obligation to pay a sum</p> <p>24 of money in order for a cost to arise.</p> <p>25 Does it require expenditure of something either now</p> <p style="text-align: center;">Page 24</p>

<p>1 or in the future in return for the provision of whatever</p> <p>2 it is that amounts to funding? That is what is being</p> <p>3 got at by this particular characteristic.</p> <p>4 The essence of the second characteristic, and</p> <p>5 perhaps I should say in relation to the cases that we</p> <p>6 referred to in paragraph 71 to 74 of the skeleton I am</p> <p>7 not going to take my Lord to them, I think at the end of</p> <p>8 the day they don't help a great deal in getting to the</p> <p>9 bottom line answer, they are examples of cases where in</p> <p>10 other contexts, the word "costs" has been examined.</p> <p>11 MR JUSTICE HILDYARD: Taking that and using your phrase</p> <p>12 "Require expenditure of something" --</p> <p>13 MR TROWER: Yes.</p> <p>14 MR JUSTICE HILDYARD: -- and just reminding oneself with the</p> <p>15 warning you have given not to get too hung up on the</p> <p>16 difference between shares and debentures for example --</p> <p>17 MR TROWER: Yes.</p> <p>18 MR JUSTICE HILDYARD: -- a preference share will require</p> <p>19 payment, it is just the requirement will be conditional?</p> <p>20 MR TROWER: Yes, that's right. You may find -- the</p> <p>21 preference share example clearly moves closer to the</p> <p>22 situation of borrowing than does dividends paid on --</p> <p>23 the bundle of rights that you have arising out of</p> <p>24 a preference share are closer to what you get in</p> <p>25 borrowing than the bundle of rights it gives rise to in</p> <p style="text-align: center;">Page 25</p>	<p>1 But there has been identified at the moment the</p> <p>2 obligation as incurred an amount and there is</p> <p>3 an obligation but it is a conditional obligation.</p> <p>4 Whereas in the case of interest, in the normal course,</p> <p>5 to use the labels which we are aware of, that is very</p> <p>6 unusual. One would not expect -- one may have</p> <p>7 circumstances in which this conditionality attached to</p> <p>8 an interest obligation, but in the normal course you</p> <p>9 undertake the obligation to pay interest at a certain</p> <p>10 rate in respect of a borrowing.</p> <p>11 MR JUSTICE HILDYARD: Again, with your warning ringing in</p> <p>12 one's ears, you would not seek to distinguish the right</p> <p>13 conferred under cumulative preference shares being</p> <p>14 a right of participation rather than incurring of</p> <p>15 an obligation?</p> <p>16 MR TROWER: It could be so characterised and it plainly is</p> <p>17 in the sense that it is a participation in the</p> <p>18 distribution of the profits of a company. That is</p> <p>19 plainly right, that is an element of it. The question</p> <p>20 for my Lord is whether or not that element of it is</p> <p>21 an element that takes it out of being a cost of funding</p> <p>22 the relevant amount.</p> <p>23 MR JUSTICE HILDYARD: That I can see is the slightly wider</p> <p>24 question, but on one view, and taking the Farwell</p> <p>25 definition check all a coupon and even a cumulative</p> <p style="text-align: center;">Page 27</p>
<p>1 entitlement to a dividend if declared where you have</p> <p>2 an ordinary share.</p> <p>3 There is no doubt about that, but that is quite</p> <p>4 a good example of how far the concept of obligation</p> <p>5 assists when one is looking at the word "Cost". There</p> <p>6 are other elements which will come in to the definition</p> <p>7 in order to ascertain whether taken together that is or</p> <p>8 is not determinative, but the purpose of this exercise</p> <p>9 is to give my Lord a number of things to think about</p> <p>10 when looking at a particular instrument and asking the</p> <p>11 question whether or not it falls within an instrument</p> <p>12 that is the funding that has a cost within the meaning</p> <p>13 of the definition.</p> <p>14 MR JUSTICE HILDYARD: That I can see, but you would accept,</p> <p>15 just looking at 1 alone, that in issuing a preference</p> <p>16 share with a stated coupon, let us take the nearest to</p> <p>17 debt in terms of a cumulative preference share --</p> <p>18 MR TROWER: Yes.</p> <p>19 MR JUSTICE HILDYARD: -- that that does entail</p> <p>20 an obligation, an incurring of an obligation to pay</p> <p>21 a sum of money.</p> <p>22 MR TROWER: Yes, the difference is that it is a conditional</p> <p>23 obligation in the sense that one of the conditions that</p> <p>24 has to be satisfied is whether there are profits out of</p> <p>25 which it can be paid, distributable profits.</p> <p style="text-align: center;">Page 26</p>	<p>1 preference share entitles you to is a right to</p> <p>2 participation in any declaration of dividend which the</p> <p>3 directors see fit to make measured by the percentage as</p> <p>4 stated in the coupon.</p> <p>5 MR TROWER: Yes, so ... and that is right although the</p> <p>6 reason I hesitate in relation to that is that that may</p> <p>7 be looking at it purely through English eyes.</p> <p>8 MR JUSTICE HILDYARD: Yes.</p> <p>9 MR TROWER: What one has to be a little bit careful of is</p> <p>10 leaping, is what we are on here is the relevance of</p> <p>11 conditions that have to be satisfied in order for the</p> <p>12 claimant concerned to get into a position where he has</p> <p>13 an accrued existing right to recovery of an amount, that</p> <p>14 being the amount that constitutes the cost.</p> <p>15 Of course even in relation to ordinary equity,</p> <p>16 ordinary shares, once the dividend has actually been</p> <p>17 declared, he will get a bundle of rights at the time he</p> <p>18 acquires his interest but once the dividend has been</p> <p>19 declared, he will then have an accrued cause of action</p> <p>20 for recovery of the dividend against the company, so at</p> <p>21 that moment in time --</p> <p>22 MR JUSTICE HILDYARD: Once that is declared, that translates</p> <p>23 the coupon into an obligation as established by the</p> <p>24 declaration.</p> <p>25 MR TROWER: Indeed, and that is the point that we are</p> <p style="text-align: center;">Page 28</p>

<p>1 driving at in the second characteristic, actually.</p> <p>2 MR JUSTICE HILDYARD: Yes.</p> <p>3 MR TROWER: What we were trying to tease out from these two</p> <p>4 was when it is for cost purposes, the obligation and the</p> <p>5 consideration has to accrue. That is why they were</p> <p>6 formulated in the way they were as two different points.</p> <p>7 (1), you look at the characteristics at the outset,</p> <p>8 whether the costs must involve the incurring of</p> <p>9 an obligation, actual or hypothetical, to pay a sum of</p> <p>10 money.</p> <p>11 (2), whether the obligation must be incurred when</p> <p>12 obtaining the funding as part of the bargain entered</p> <p>13 into to obtain such funding. Now the incurring of the</p> <p>14 obligation, there is of course a company can see in the</p> <p>15 case of ordinary equity that at some stage in the</p> <p>16 future, the bundle of rights may lead to an entitlement</p> <p>17 of the shareholder to recover a dividend.</p> <p>18 That conceptually is different both in the context</p> <p>19 of participation as in the profits as my Lord has</p> <p>20 identified, but also in the context of working out how</p> <p>21 many steps have to be gone through until such time as</p> <p>22 a cost has been incurred in the sense of an accrued</p> <p>23 obligation to pay.</p> <p>24 MR JUSTICE HILDYARD: In strictest theory, this would be</p> <p>25 only through English spectacles, a coupon is in a sense</p> <p style="text-align: center;">Page 29</p>	<p>1 respects is just another aspect of the same point that</p> <p>2 we have been looking at. Does the concept of cost</p> <p>3 import a commitment to pay a sum now? Again, it is</p> <p>4 really the extent to which thinking about this kind of</p> <p>5 concept is helpful to my Lord in working out where to</p> <p>6 draw the line.</p> <p>7 The amount which may or may not vary in the future</p> <p>8 depending on certain events is one way of thinking about</p> <p>9 it, including the exercise of a discretion. Can it</p> <p>10 still be a cost if the recipient of the funding is able</p> <p>11 to exercise a discretion as to whether or not the cost</p> <p>12 is paid, is what is being said here.</p> <p>13 Of course it again is reflected, as we have touched</p> <p>14 on, in the English law distinction between debt and</p> <p>15 equity, where normally the obligation to pay dividends</p> <p>16 depends on the board's discretion.</p> <p>17 Whereas that is not the case normally in the context</p> <p>18 of interest, but that may not be an adequate distinction</p> <p>19 in other contexts.</p> <p>20 That is really what we were driving at in the third</p> <p>21 and fourth of the characteristics. When one moves on to</p> <p>22 the fifth characteristic, the slightly more detailed</p> <p>23 description of it starts at page 24 of the skeleton, we</p> <p>24 are doing a slightly different exercise here where we</p> <p>25 are seeking to test the importance of the word "Relevant</p> <p style="text-align: center;">Page 31</p>
<p>1 a restriction rather than a right, it is saying that</p> <p>2 your participation in the company is capped.</p> <p>3 MR TROWER: Yes.</p> <p>4 MR JUSTICE HILDYARD: And capped in a curious way in the</p> <p>5 case of cumulatives, because the cap will roll up but it</p> <p>6 is nevertheless in strictest theory a cap.</p> <p>7 MR TROWER: Yes.</p> <p>8 MR JUSTICE HILDYARD: That may not apply if other spectacles</p> <p>9 are deployed is your point?</p> <p>10 MR TROWER: Is the point, because in a way, my Lord, if we</p> <p>11 were simply looking at this question in terms of the</p> <p>12 conventional English approach to what constitutes debt</p> <p>13 and what constitutes equity, we would probably not need</p> <p>14 to ask these questions at all in this form. What we are</p> <p>15 concerned about is to ensure that any way the court is</p> <p>16 able to go through the thinking process of examining the</p> <p>17 underlying characteristics of what may be advanced as</p> <p>18 a type of instrument, not looked at whose</p> <p>19 characteristics cannot be analysed in quite that way.</p> <p>20 That is our concern and to do as much as we can to tie</p> <p>21 these points down.</p> <p>22 I think broadly speaking that exchange my Lord has</p> <p>23 had with me just now covers the first two of the</p> <p>24 characteristics.</p> <p>25 We then go on to look at discretion, which in some</p> <p style="text-align: center;">Page 30</p>	<p>1 amount" within the phrase, "Cost to the relevant payee</p> <p>2 of funding the relevant amount".</p> <p>3 On the face of it, where the funding in issue is</p> <p>4 raised for some other purpose, either together with or</p> <p>5 separate from the funding of the relevant amount, it</p> <p>6 doesn't fit within the definition. Because it is not</p> <p>7 funding the relevant amount. What we sought to do here</p> <p>8 is just -- there is a small very simplistic, perhaps</p> <p>9 overly simplistic, example given in paragraph 94. Then</p> <p>10 the conclusion that we seek to draw from it in 95 is the</p> <p>11 nature of the link between the deficiency caused by</p> <p>12 non-payment of the sum under the ISDA and the funding to</p> <p>13 remedy the cash flow deficiency. It ties in with a lot</p> <p>14 of the arguments about whether the funding of the</p> <p>15 relevant amount here is not a focus on the funding of</p> <p>16 the amount of money rather than a funding for broader</p> <p>17 enterprise purposes.</p> <p>18 I am going to say a little bit more about the sixth</p> <p>19 characteristic, which focuses on the difference between</p> <p>20 what might amount to a cost to the payee of funding the</p> <p>21 relevant amount where it appears in the default rate</p> <p>22 definition and the cost of funding where it appears as</p> <p>23 a concept in the definitions of loss is and is not</p> <p>24 linked to a relevant amount.</p> <p>25 Can I just spend a moment or two with my Lord --</p> <p style="text-align: center;">Page 32</p>



<p>1 I know you have been taken through some of this, but  2 I thought it might be helpful to just go back over  3 a couple of points in relation to the interrelationship  4 between loss and the default rate under the 1992 and  5 2002 agreements.  6 If my Lord would just take up the 1992 and the 2002  7 agreements, in whichever form my Lord has them. Just to  8 remind you of course that there are three concepts that  9 underpin the quantification of the closeout amount in  10 the 1992 and 2002 agreements. Two arise under the 1992  11 agreement and one arises under the 2002 agreement. We  12 have "market quotation" under the 1992 and "loss". The  13 market quotation is the settlement amount plus the  14 unpaid amounts and then there is the loss definition.  15 In the 2002 agreement one has the concept of the  16 closeout amount. You would then add to that the unpaid  17 amounts in order to get the amount payable.  18 In the case of loss and closeout amount, the  19 definitions include costs of funding as being something  20 that is capable of being included within the recoverable  21 losses and costs or gains. If we turn that up, first of  22 all in the 1992 agreement. It is on page 161 anyway in  23 the core bundle version, page 15 of the agreement  24 itself. The important point to focus on whenever one is  25 looking at it in the cost of funding in a context other</p> <p style="text-align: center;">Page 33</p>	<p>1 sub-sub-phrase. What it is doing is it is using the  2 words, "including a category" of something which is  3 capable of falling within losses and costs or gains in  4 the primary part of the definition.  5 The type of cost of funding that the draftsman may  6 well have had in mind is for example the borrowing costs  7 incurred by the non-defaulting party in funding the  8 necessary replacement transaction.  9 That is the sort of cost of funding that the  10 draftsman might have had in mind. He might have had in  11 mind the ability to include as a loss and cost or gain  12 in connection with the agreement the funding cost of  13 having to borrow the amount required to post as  14 collateral for the replacement transaction or any  15 premium required to be paid on the repayment  16 transaction, all of which may have required to be funded  17 by borrowing and is capable of falling within the  18 concept of a cost of funding for loss purposes.  19 None of this is connected directly to a cost of  20 funding the relevant amount in the way that it is  21 connected within the definition of "default rate". It  22 is carrying out an entirely different exercise, or it is  23 doing an entirely different job from the job that has  24 been done in relation to cost of funding in the default  25 rate definition, but it does not detract in any way from</p> <p style="text-align: center;">Page 35</p>
<p>1 than the default rate definition check is the fact that  2 the cost of funding is not of the relevant amounts, and  3 is simply included as an inclusionary category of loss  4 or cost by way of example of what is capable of being  5 the amount of a party's total losses, costs and gains.  6 What you get when you look at the beginning of the  7 definition of loss on page 15, is it is:  8 "... with respect to this agreement or one or more  9 terminated transactions as the case may be and a party,  10 the termination currency equivalent of an amount that  11 party reasonably determines in good faith to be its  12 total losses and costs or gain (in which case expressed  13 as a negative number) in connection with this agreement  14 or that terminated transaction or group of terminated  15 transactions as the case may be, including any loss of  16 bargain, cost of funding or at the election of such  17 party but without duplication loss or costs incurred as  18 a result of its terminating ..."  19 There are two points that come out from that way of  20 looking at it. The first is one is dealing here in the  21 context of loss and costs, as losses and costs in  22 connection with the agreement or the terminated  23 transaction. That is the overarching definitional area  24 that one is in and one then has the sub-phrase in which  25 costs of funding occurs, which is an inclusionary</p> <p style="text-align: center;">Page 34</p>	<p>1 the possibility that the draftsman may still have had in  2 mind by the phrase "cost of funding", borrowing as  3 a concept. That is what he is thinking about, is  4 borrowing costs for the purposes, for example, of  5 funding necessary collateral that is required in respect  6 of a replacement transaction.  7 So --  8 MR JUSTICE HILDYARD: You don't read that phrase as if there  9 were -- which there is not -- a comma after the words  10 "Lost or cost"? It is not in other words in your  11 submission intended to be an illustration of the sort of  12 loss which is to be included, which is:  13 "... the loss of bargain, costs of funding, or  14 election of such party but without duplication loss or  15 cost, incurred as a result of its terminating,  16 liquidating, obtaining or re-establishing any hedge or  17 related trading position"?  18 MR TROWER: No.  19 MR JUSTICE HILDYARD: You don't say it is restricted in that  20 way?  21 MR TROWER: No, I don't.  22 No, I don't, my Lord.  23 MR JUSTICE HILDYARD: It goes broader, it could be a cost of  24 funding related to something other than the costs of  25 funding a hedge or related trading position?</p> <p style="text-align: center;">Page 36</p>

<p>1 MR TROWER: That is right.</p> <p>2 MR JUSTICE HILDYARD: Yes.</p> <p>3 MR TROWER: It could certainly do that, but it still has to</p> <p>4 be something that amounts to a loss and cost or gain in</p> <p>5 connection with the agreement or the terminated</p> <p>6 transaction, because those are the opening words.</p> <p>7 MR JUSTICE HILDYARD: Yes.</p> <p>8 MR TROWER: Then, my Lord sees, if one goes on to the 2002</p> <p>9 master agreement and looks at the closeout amount --</p> <p>10 MR JUSTICE HILDYARD: On that footing though, Mr Trower, the</p> <p>11 inclusion is almost a restatement of the general</p> <p>12 population, isn't it? Rather than cutting it down by</p> <p>13 example of the costs which might otherwise not be</p> <p>14 contemplated.</p> <p>15 MR TROWER: It may be. One suspects that this is a form of</p> <p>16 inclusionary language where the draftsman has genuinely</p> <p>17 sat down to try and --</p> <p>18 MR JUSTICE HILDYARD: Define.</p> <p>19 MR TROWER: -- find the answer, but he didn't want to define</p> <p>20 it in a way which was complete.</p> <p>21 MR JUSTICE HILDYARD: Yes.</p> <p>22 MR TROWER: I was then going to go on to closeout amount and</p> <p>23 just show my Lord, again in that context, how it works</p> <p>24 there. I know my Lord has seen this, but it is</p> <p>25 sometimes helpful to look at these things again.</p> <p style="text-align: center;">Page 37</p>	<p>1 "... standards and procedures described in the</p> <p>2 definition, quotations pursuant to clause 1 above or</p> <p>3 relevant market data pursuant to clause 2 above, unless</p> <p>4 the determining party reasonably believes in good faith</p> <p>5 ... that such quotations or relevant market data are not</p> <p>6 readily available or would produce a result that would</p> <p>7 not satisfy those standards."</p> <p>8 Then the critical sentence is:</p> <p>9 "When considering information described in clauses</p> <p>10 1, 2 or 3 above [ie the particular categories of data]</p> <p>11 the determining party may include cost of funding to the</p> <p>12 extent costs of funding are not and would not be</p> <p>13 a component of the other information being utilised."</p> <p>14 Again, what you of here is an ability to utilise and</p> <p>15 include costs of funding within the quantification,</p> <p>16 "costs of funding" being equally capable within this</p> <p>17 definition as being read as "costs of borrowing".</p> <p>18 In a sense, exactly the same submission can be made</p> <p>19 in relation to the use of the concept of costs of</p> <p>20 funding in the closeout amount definition as is made in</p> <p>21 relation to the cost of funding in the loss definition.</p> <p>22 My Lord, that was really all I wanted to say in</p> <p>23 addition to what has already been said about how it is</p> <p>24 that cost of funding is utilised in the concept of the</p> <p>25 various definitions of closeout amount and loss which</p> <p style="text-align: center;">Page 39</p>
<p>1 Page 192 in the bundle, page 22 of the print. The</p> <p>2 starting words you have again, in the second line:</p> <p>3 "The amount of the losses or costs of the</p> <p>4 determining party that are or would be incurred under</p> <p>5 then prevailing circumstances, expressed as a positive</p> <p>6 number or gain ..."</p> <p>7 It is slightly more wordy the definition, which is</p> <p>8 equivalent to the opening few lines of the definition of</p> <p>9 loss. One does not then get the reference to cost of</p> <p>10 funding until much later on, it is in -- we have seen</p> <p>11 this already, I know, but it is sort of about three</p> <p>12 paragraphs up from the bottom of page 23 as to what the</p> <p>13 determining party will consider when determining the</p> <p>14 closeout amount.</p> <p>15 Just so my Lord sees the way this reminds you of the</p> <p>16 way the structure of this clause works. You have the</p> <p>17 bit immediately above the paragraph beginning, "The</p> <p>18 determining party will consider ..." Which is:</p> <p>19 "In determining a closeout amount the determining</p> <p>20 party may consider any relevant information including</p> <p>21 without limitation one or more of the following types of</p> <p>22 information."</p> <p>23 Then you have the three types of information, which</p> <p>24 are quotations, market data and so on. Then you go onto</p> <p>25 the next paragraph, what you will consider is:</p> <p style="text-align: center;">Page 38</p>	<p>1 are required for computing the closeout amount.</p> <p>2 MR JUSTICE HILDYARD: On that footing, Mr Trower, is this</p> <p>3 right, under loss you can include more generalised costs</p> <p>4 of funding, but under the interest provisions you can in</p> <p>5 addition recover the costs of funding the relevant</p> <p>6 amount?</p> <p>7 MR TROWER: Yes, but it is -- well, under the interest</p> <p>8 provisions, of course, when you are using the default</p> <p>9 rate provision for the purposes of calculating how much</p> <p>10 you are entitled to once the amount has fallen due and</p> <p>11 been payable in those circumstances. Yes, you use the</p> <p>12 cost of borrowing approach -- actually, I am sorry I am</p> <p>13 not sure I have quite grasped your Lordship's question.</p> <p>14 MR JUSTICE HILDYARD: I am worried about duplication, I am</p> <p>15 worried about including within the loss recovery the</p> <p>16 more generalised cost of funding and then adding to that</p> <p>17 by way of interest a more specific cost of funding of</p> <p>18 the relevant amount, which is the certified amount.</p> <p>19 MR TROWER: Yes, well there is a provision in the closeout</p> <p>20 amount definition that requires you not to duplicate.</p> <p>21 What I am just -- where is it? There is</p> <p>22 a non-duplication provision somewhere that someone is</p> <p>23 just looking for.</p> <p>24 It is in the 1992 provision in the definition of</p> <p>25 loss:</p> <p style="text-align: center;">Page 40</p>

<p>1 "Loss includes loss of costs or gains in respect of 2 any payment or delivery required to be made ..." 3 That is the -- my Lord, can I come back to that 4 point in a moment -- 5 MR JUSTICE HILDYARD: Yes. 6 MR TROWER: -- just when I have sorted that out. 7 There is a non-duplication provision. 8 No, it does appear in the definition of loss, in the 9 fifth line: 10 "Including any loss of bargain costs for funding ... 11 without duplication, loss or cost incurred as a result 12 of its terminating, liquidating, obtaining or 13 re-establishing ..." 14 MR JUSTICE HILDYARD: That is not allowing you to double 15 count for the general cost of funding and the cost of 16 funding, termination, liquidation, obtaining or 17 re-establishing a hedge or related trading. 18 MR TROWER: Yes. 19 MR JUSTICE HILDYARD: It does cut out that duplication, what 20 about the duplication with interest recovery? 21 MR TROWER: Once the closeout amount has actually been 22 formulated? 23 MR JUSTICE HILDYARD: Yes, or do you say -- 24 MR TROWER: That is at the later stage in the process, 25 because -- I have just been handed -- that is at a later</p> <p style="text-align: center;">Page 41</p>	<p>1 MR TROWER: I am not sure about that. It might do, yes, it 2 might do. Yes, I can see that it might actually. I had 3 not thought of it quite like that. 4 If there is an enterprise cost of funding and 5 then -- well, it rather throws up the need to ensure 6 that the cost of funding in the definition of loss is 7 a cost of funding that is in connection with the 8 agreement or the terminated transactions. You don't 9 have to relate it to the relevant amount in the way that 10 you do in relation to the definition of loss, but it 11 still has to be a cost of funding that is capable of 12 constituting a loss or cost in connection with the 13 agreement and the terminated transactions, because 14 otherwise you don't get there in the first place, you 15 don't get into loss in the first place, so to that 16 extent there is a link. 17 MR JUSTICE HILDYARD: I do find this quite difficult. I am 18 not quite sure about the varying consequences of cost of 19 funding in the two contexts. 20 MR TROWER: Yes. The very simple point is that the cost of 21 funding in the default rate is the cost of funding the 22 relevant amount. 23 MR JUSTICE HILDYARD: Yes. 24 MR TROWER: It is not in the loss definition, it is not 25 linked in quite that way. What you are looking at in</p> <p style="text-align: center;">Page 43</p>
<p>1 stage in the process, because that is actually an amount 2 that is payable on the closeout amount which will 3 already by then have been established. 4 MR JUSTICE HILDYARD: You are allowed generalised costs of 5 funding in establishing, as it were, the principal 6 loss -- 7 MR TROWER: Yes, which is -- 8 MR JUSTICE HILDYARD: -- and only restricted costs of 9 funding tied to the relevant amount thereafter? 10 MR TROWER: The cost of borrowing definition in the default 11 rate is applicable to the closeout amount as the amount 12 of principal once that amount has actually been 13 identified. The closeout amount cost of funding element 14 comes in at the stage of quantifying the loss that has 15 been incurred as a result of entering into the 16 transaction, as a result of the transaction having 17 terminated early. 18 Yes, one way of thinking about it is that the 19 closeout amount is the principal sum which becomes 20 payable, includes an element of cost of funding in 21 relation to it, for example where you have to borrow in 22 order to provide replacement collateral. 23 MR JUSTICE HILDYARD: There will be duplication if the first 24 part, cost of funding, included a long term enterprise 25 funding cost?</p> <p style="text-align: center;">Page 42</p>	<p>1 the loss definition is you are asking yourself the 2 question: what is a recoverable loss in connection with 3 the agreement in the terminated transaction? What is 4 the loss and cost or gain in respect of the terminated 5 transaction? 6 It is not limited to the funding of the non-payment 7 of a sum in the form of the relevant amount. That is 8 the simple point. 9 It may or may not be the case that the draftsman 10 intended in the loss definition to restrict the concept 11 of cost of funding to cost of borrowing. My Lord does 12 not ultimately have to decide that point. Largely 13 because of the inclusionary language. The draftsman 14 probably had in mind the cost of borrowing, but even if 15 he didn't have in mind the cost of borrowing and had in 16 mind a slightly wider concept for loss purposes, that 17 does not affect the answer in relation to default rate. 18 MR JUSTICE HILDYARD: It doesn't, but it would render one 19 uneasy to suppose that the draftsman had different 20 concepts in relation to the same basic phrase, 21 especially as there is still a bit of a quandary -- 22 subject to the historical explanation Mr Zacaroli has 23 offered -- as to why the draftsman did not use the word 24 "borrowing" if that is what he meant. 25 MR TROWER: Yes, we have one very short submission on that</p> <p style="text-align: center;">Page 44</p>

<p>1 which may or may not help my Lord on that point. I will</p> <p>2 come on to that in a moment.</p> <p>3 I have just noticed the time. I don't know whether</p> <p>4 my Lord would want to rise for the shorthand writers'</p> <p>5 break?</p> <p>6 MR JUSTICE HILDYARD: Would that be a convenient moment.</p> <p>7 Are you thirsting for a break?</p> <p>8 (11.45 am)</p> <p>9 (A short adjournment)</p> <p>10 (11.50 am)</p> <p>11 MR TROWER: My Lord, just to finish off on that point, just</p> <p>12 to remind my Lord that in relation to the definitions of</p> <p>13 loss and closeout amount, the exercise that is being</p> <p>14 carried out is expressly provided to be an exercise that</p> <p>15 is carried out as of the early termination date. So</p> <p>16 that when you are quantifying the closeout amount --</p> <p>17 that is apparent if we look on the closeout amount</p> <p>18 definition, the first main paragraph at the top of</p> <p>19 page 23, the last sentence:</p> <p>20 "Each closeout amount will be termed as of the early</p> <p>21 termination date."</p> <p>22 You get exactly the same point in the definition of</p> <p>23 loss in the fourth last line.</p> <p>24 My Lord, that is all I was going to say in relation</p> <p>25 to that interrelationship between -- I am going to come</p> <p style="text-align: center;">Page 45</p>	<p>1 Federal Funds floating rate option.</p> <p>2 The index, as my Lord saw, from the code reflects</p> <p>3 average rates at which banks lend to each other, it is</p> <p>4 what you would expect as an index or rate of that form,</p> <p>5 it seems to be sort of Libor type. What you are doing</p> <p>6 is you have excess funds and they are being leant by one</p> <p>7 financial institution to another. The consequence of</p> <p>8 that is what is a cost of borrowing for one bank will be</p> <p>9 a return on a loan for another.</p> <p>10 Because there is not in effect a spread when you are</p> <p>11 looking at these rates, what you are looking at is</p> <p>12 a fixed rate. If you start from the proposition that</p> <p>13 the rate is being used in its general sense in the</p> <p>14 market, both for quantifying an amount which a bank will</p> <p>15 pay to borrow and the rate a bank will get from lending,</p> <p>16 the expression "Funding" has a little bit more sense to</p> <p>17 it.</p> <p>18 It may have been thought -- I accept this is</p> <p>19 speculation -- by the draftsman that it covered more</p> <p>20 accurately the use of what was regarded as a borrowing</p> <p>21 rate as far as the borrower was concerned, but was</p> <p>22 a rate which you are looking at from only one side of</p> <p>23 the equation when you describe it as a borrowing rate.</p> <p>24 We suggest that it is quite possible that the</p> <p>25 draftsman might have had that kind of concept in mind</p> <p style="text-align: center;">Page 47</p>
<p>1 back to a possible suggestion in relation to why the</p> <p>2 draftsman used "cost of funding" not "borrowing". In</p> <p>3 fact actually it might be convenient to do it now, given</p> <p>4 my Lord has raised that point.</p> <p>5 What we simply say about that is this. One has to</p> <p>6 bear in mind first of all that as a matter of language,</p> <p>7 it is clear beyond doubt that the word "Funding" taken</p> <p>8 alone can mean borrowing, I mean there is no doubt about</p> <p>9 that. That is obvious, but it is worth remembering it.</p> <p>10 It is also clear that used in juxtaposition with the</p> <p>11 word "cost", the funding must be of a form that has</p> <p>12 a cost and one importantly that is readily</p> <p>13 ascertainable, because if it is not readily</p> <p>14 ascertainable, it would cut across what everyone seems</p> <p>15 to accept is the draftsman's desire for clarity,</p> <p>16 certainty and predictability. That is the background in</p> <p>17 which we are looking at this.</p> <p>18 My learned friend Mr Zacaroli showed you the 1987</p> <p>19 users' guide explanation for why the cost of funding</p> <p>20 phrase was introduced into what was described as the</p> <p>21 multicurrency form. That was essentially because there</p> <p>22 is no published index existing which covers all possible</p> <p>23 currencies. It is worth noting what the form of the</p> <p>24 published index was that was used in the code based</p> <p>25 form, the interest swap agreement. What it used was the</p> <p style="text-align: center;">Page 46</p>	<p>1 when he was using the cost of funding definition rather</p> <p>2 than the cost of borrowing definition. He was using</p> <p>3 a phrase which flowed from what one might most</p> <p>4 accurately describe as ultimately a funding rate,</p> <p>5 because it is a rate that is used or quantified by</p> <p>6 reference to both borrowing and lending.</p> <p>7 That does not detract in any way from the fact that</p> <p>8 when the payee is certifying its cost of funding, it is</p> <p>9 certifying it as a borrowing rate. What it may explain</p> <p>10 is why the word "funding" was used rather than</p> <p>11 "borrowing". The sort of juxtaposition, the other side</p> <p>12 of the same coin point, it chimes a little bit with what</p> <p>13 one ends up with in the 2002 agreement which is in the</p> <p>14 context of non-default rates one ends up with the loss</p> <p>15 of funds on a deposit by the time one gets to the 2002</p> <p>16 agreement.</p> <p>17 That chimes to an extent with this idea of looking</p> <p>18 at either side of the same coin. We just put that</p> <p>19 forward to my Lord as a possible explanation as to why</p> <p>20 it was the word "funding" was used rather than</p> <p>21 "borrowing".</p> <p>22 My Lord, that is all I was going to say about that.</p> <p>23 Just going back to the questions in our skeleton, the</p> <p>24 seventh question, which is developed a little bit at</p> <p>25 paragraph 103, raises the issue of what is capable of</p> <p style="text-align: center;">Page 48</p>

<p>1 being a cost. We simply raise the point that it would  2 be very helpful for the administrators to have as much  3 guidance as possible on how far particular categories of  4 costs go, there is an issue here as to whether  5 professional fees for example are covered in respect of  6 lending. Plainly in the case of borrowing the interest  7 cost is the cost of the money, it is covered, it may be  8 the case that arrangement fees are covered as well, but  9 whether professional fees are covered seems to be  10 slightly more open to doubt. Wentworth say they are  11 a cost of the professional service not of the borrowing  12 and that remains an issue and we would very much welcome  13 guidance on that.</p> <p>14 We simply make the point, it is a fairly obvious  15 point, that the more remote the cost is from the  16 relevant amount the less likely it is to form a cost of  17 funding that relevant amount.</p> <p>18 Put another way, it may be of assistance to consider  19 that the relevant cost is the cost of the money itself  20 that is obtained in order to replace the non-payment of  21 the relevant amount and it doesn't go any wider than  22 that.</p> <p>23 MR JUSTICE HILDYARD: Arrangement fees looks rather more  24 like costs of funding than professional fees, because it  25 may simply be a different wrapper for the same charge.</p> <p style="text-align: center;">Page 49</p>	<p>1 MR JUSTICE HILDYARD: Yes.</p> <p>2 MR TROWER: The eighth question, paragraphs 106 to 108,  3 I think in the light of Mr Zacaroli's submissions and  4 the way he put it, the issue here is quite an important  5 one, but it is simply this: is it necessary for the  6 claimant to have to pay, in the sense of being required  7 to pay, the cost in order to obtain the funding? If it  8 is, it is capable of being cost of funding, if it is  9 not, it is not. It is only in that sense that the  10 question that we asked is helpful.</p> <p>11 I mean I think Mr Zacaroli thought that maybe his  12 position had been mischaracterised in putting it in  13 terms of whether the cost of funding includes only the  14 lowest cost of funding and the necessity test, do you  15 have to pay, is a satisfactory way of approaching it,  16 certainly from the Joint Administrators' point of view.  17 That as a helpful test and Mr Zacaroli's test obviously  18 is it is only if you have to pay that it is capable of  19 being a cost.</p> <p>20 MR JUSTICE HILDYARD: Does that not open up quite  21 an extensive potential line of enquiry?</p> <p>22 MR TROWER: It may well be that if there are lots of  23 possibilities and they come in with one of the higher  24 ones, there will be some investigation required as to  25 whether or not they had to. It is not an open line of</p> <p style="text-align: center;">Page 51</p>
<p>1 MR TROWER: I can quite see that, I mean banks dress up the  2 way they price the money, if I can put it like that, in  3 different ways. I think that is right and I cannot  4 quite remember where my learned friend Mr Zacaroli was  5 on arrangement fee.</p> <p>6 MR JUSTICE HILDYARD: My note is, and it may be inaccurate  7 and I will have to go back to what he said, "no", by 7,  8 but I think that may be too glib.</p> <p>9 MR TROWER: Yes, I think 7 --</p> <p>10 MR ZACAROLI: My Lord, it may have been no then, but that  11 was very much shorthand. In my submissions on the  12 point --</p> <p>13 MR JUSTICE HILDYARD: You elaborated.</p> <p>14 MR ZACAROLI: -- I accept that fees payable to the bank  15 would be a price of the borrowing.</p> <p>16 MR JUSTICE HILDYARD: Yes, because they may just be  17 a capitalised form of interest?</p> <p>18 MR ZACAROLI: Precisely, yes.</p> <p>19 MR TROWER: That must be right. On the assumption the  20 arrangement fee is properly to be characterised as the  21 price of the money, that is right, I mean one can  22 conceive of circumstances in which banks may charge fees  23 which are not actually the price of the money, they are  24 actually provided for some other service, but, subject  25 to that qualification, that must be right.</p> <p style="text-align: center;">Page 50</p>	<p>1 enquiry in the form of a judgment call, or --</p> <p>2 MR JUSTICE HILDYARD: Isn't it? I mean lowest costs  3 available may be an objective factor. What you have to  4 pay, which as I understood Mr Zacaroli's argument, is  5 the test -- which you call a necessity test -- and  6 involves, does it not, some element of subjectivity if  7 it means something other than the lowest cost?</p> <p>8 MR TROWER: Yes, I mean to be perfectly honest we had  9 a little bit of difficulty seeing exactly where the  10 distinction lay between the two ways of putting the  11 point, because you don't normally have to pay more than  12 the lowest amount that you can get away with, but  13 I quite accept that it is ultimately a separate  14 question. It seems that it would be an odd circumstance  15 in which you had to pay more than the lowest costs that  16 it was appropriate for you to go for.</p> <p>17 That is the way we would think it might be helpful  18 to think about it.</p> <p>19 MR JUSTICE HILDYARD: Yes.</p> <p>20 MR TROWER: My Lord, I was then going to simply fill my Lord  21 in -- I think this is really the best way of putting  22 it -- in relation to the creditor unable to borrow  23 point, which we raised in paragraph 52 of our skeleton.  24 In which we do invite the court to address the question  25 of what should happen if the creditor has no access to</p> <p style="text-align: center;">Page 52</p>

<p>1 borrowing to fund the relevant amount.</p> <p>2 My Lord does just need to know that it may not</p> <p>3 arise, is the situation, because we don't know whether</p> <p>4 or not anyone who is in that position is actually going</p> <p>5 to try and certify or claim more than 8 per cent. What</p> <p>6 I do know is that there are a number of creditors whose</p> <p>7 status is such that they may be unable to borrow, so</p> <p>8 that is a real point in that sense.</p> <p>9 As I say, we don't know whether they would seek to</p> <p>10 certify at a rate in excess of 8 per cent, but if the</p> <p>11 court is able to do so, we would invite it to consider</p> <p>12 the solutions advanced by Mr Zacaroli, which are either</p> <p>13 you get thrown back on 1 per cent and therefore in at</p> <p>14 8 per cent and in an insolvency context. Or the</p> <p>15 hypothetical solution, which is that the clause assumes</p> <p>16 that you did not have the disability preventing</p> <p>17 borrowing that you in fact have, which is a sort of</p> <p>18 double hypothesis point.</p> <p>19 Those are the two arguments which Mr Zacaroli has</p> <p>20 addressed and I don't intend to go over them again.</p> <p>21 I just wanted my Lord to know what the position was</p> <p>22 in fact.</p> <p>23 MR JUSTICE HILDYARD: Yes.</p> <p>24 MR TROWER: Can I then turn as my next topic to the form of</p> <p>25 certification, which is broadly speaking an issue 14</p> <p style="text-align: center;">Page 53</p>	<p>1 susceptible to challenge if there is an error in the</p> <p>2 sense that the certificate does not reflect what must be</p> <p>3 taken to have been the certifiers' intention, which</p> <p>4 would cover arithmetic errors and other errors of fact.</p> <p>5 If to continue to rely on the certificate would then</p> <p>6 not be in good faith or would be irrational once the</p> <p>7 error was ascertained, the certificate cannot be binding</p> <p>8 we would suggest. That is a sensible, relatively</p> <p>9 straightforward test to apply, which reflects</p> <p>10 an appropriate balance between, on the one hand, getting</p> <p>11 finality in relation to issues where it is possible to</p> <p>12 have reasonable room for disagreement, but not providing</p> <p>13 finality in relation to issues where it is just plain</p> <p>14 wrong. We do respectfully submit that if the</p> <p>15 certificate is just plain wrong in terms of an issue of</p> <p>16 fact, it would be a strong construction to say, on the</p> <p>17 wording of this particular clause, that it is binding.</p> <p>18 One would need rather clearer words to get to that</p> <p>19 result.</p> <p>20 We do suggest that where matters of judgment and</p> <p>21 discretion are concerned, yes, there is an intention</p> <p>22 that it should be binding, but to the extent that --</p> <p>23 anyway to the extent there is room for rational</p> <p>24 disagreement but not otherwise.</p> <p>25 MR JUSTICE HILDYARD: Do you adopt or do you wish to say</p> <p style="text-align: center;">Page 55</p>
<p>1 point, which is a point of some practical significance</p> <p>2 for the Joint Administrators for obvious reasons,</p> <p>3 because they are going to be getting certificates and</p> <p>4 they have to know from a practical point of view what</p> <p>5 the position is.</p> <p>6 It is both a form point and a substance point.</p> <p>7 I mean, as far as the substance is concerned, we seem to</p> <p>8 be in a position now where it is common ground that</p> <p>9 there is no ability to go behind the certificate where</p> <p>10 there is more than one reasonable answer and the</p> <p>11 certifier chooses the answer which the court would not</p> <p>12 have chosen, but which is rational in good faith.</p> <p>13 I think that was the way it was put by Mr Foxton in</p> <p>14 an exchange with my Lord.</p> <p>15 It is also common ground that it must be possible to</p> <p>16 go behind the certificate where the certifier has</p> <p>17 certified so as to fall outside the scope of the</p> <p>18 definition, but he reasonably thinks it was within it.</p> <p>19 That was the point that was originally made or we</p> <p>20 thought it was made anyway by GSI but which is not</p> <p>21 anymore.</p> <p>22 We also suggest, and this is picking up the point</p> <p>23 which my learned friend Mr Zacaroli took my Lord to</p> <p>24 towards the episode of his submissions in paragraph 35</p> <p>25 of GSI's skeleton. We suggest that the certificate is</p> <p style="text-align: center;">Page 54</p>	<p>1 anything further by way of qualification of the</p> <p>2 essential distinction drawn by Mr Zacaroli which is, as</p> <p>3 I understand it, between a demonstrable and reviewable</p> <p>4 error of fact and an error of judgment where, absent bad</p> <p>5 faith, or irrationality, you just have to put up with</p> <p>6 it.</p> <p>7 MR TROWER: Yes, we don't add anything, I don't have any</p> <p>8 extra to add to that.</p> <p>9 There is one point that sort of touches on this,</p> <p>10 I think, as a matter of construction touches on this</p> <p>11 area which is within the default rate definition,</p> <p>12 because I am not sure -- and I cannot now remember who</p> <p>13 it was, but I am not sure this point was made in quite</p> <p>14 the right form. If we go to the default rate</p> <p>15 definition, and it matters not whether it is the 1992 or</p> <p>16 the 2002, the words in parenthesis on the first line --</p> <p>17 MR JUSTICE HILDYARD: Where are you looking?</p> <p>18 MR TROWER: The default rate definition, it doesn't matter,</p> <p>19 whichever one comes to hand, they are both the same, in</p> <p>20 the 1992 and the 2002:</p> <p>21 "A rate per annum equal to the costs (without proof</p> <p>22 or evidence of any actual cost)."</p> <p>23 As a matter of construction, those words do not</p> <p>24 exclude the need for proof and evidence in relation to</p> <p>25 other issues. All that they exclude is the need for</p> <p style="text-align: center;">Page 56</p>

<p>1 proof or evidence that any cost was actually incurred.</p> <p>2 Two things follow from that, one is that that is</p> <p>3 actually quite a limited exclusion as to what by way of</p> <p>4 proof or evidence is required, but the second point is</p> <p>5 the other side of the coin. On one view, and we</p> <p>6 respectfully submit this is probably correct, the</p> <p>7 definition actually contemplates that evidence and proof</p> <p>8 may be appropriate to enable the recipient of the</p> <p>9 certificate on the other issues, because it is not</p> <p>10 excluded in circumstances where the draftsman has</p> <p>11 considered excluding it in relation to a particular</p> <p>12 issue.</p> <p>13 That point bears on the question of what it is that</p> <p>14 one might rationally consider the draftsman considered</p> <p>15 ought to have been open to challenge.</p> <p>16 If you had a completely non-speaking certificate</p> <p>17 where the draftsman specifically excluded the ability to</p> <p>18 look at any evidence that underpinned it. In those</p> <p>19 circumstances, one might be a bit more cautious about</p> <p>20 drawing the distinction that we suggest is the</p> <p>21 appropriate distinction between evidence of fact and</p> <p>22 evidence of opinion -- or errors of fact, I am sorry,</p> <p>23 and disagreements of opinion.</p> <p>24 I wanted to make that point, just both so my Lord</p> <p>25 sees how limited the exclusion of proof or evidence is</p> <p style="text-align: center;">Page 57</p>	<p>1 I am suggesting that the draftsman contemplated that</p> <p>2 sufficient evidence, depending on what the certificate</p> <p>3 is, should be adduced in order to justify it.</p> <p>4 MR JUSTICE HILDYARD: In some contexts -- I am just</p> <p>5 wondering how far you take this -- the failure to give</p> <p>6 any reasons leads to the supposition you had none?</p> <p>7 MR TROWER: Yes.</p> <p>8 MR JUSTICE HILDYARD: A dread of the first instance judge</p> <p>9 for example, in the Court of Appeal.</p> <p>10 Do you submit it goes as far as that? That is to</p> <p>11 say, unless there is an express carve out, such as in</p> <p>12 the words in parenthesis, the general rule that you are</p> <p>13 bound to state your reasons for fear of it being</p> <p>14 inferred you were proceeding without any, do you say it</p> <p>15 goes that far?</p> <p>16 MR TROWER: I mean, perhaps one way of thinking of this is</p> <p>17 that the clause contemplates that if a certificate comes</p> <p>18 in in that form, it is open, as one would expect, to the</p> <p>19 non-defaulting party to ask. Inferences may arise</p> <p>20 depending on the level of the certification and the</p> <p>21 absence of any reasons being given, the court may, or</p> <p>22 the defaulting party may be entitled to draw inferences</p> <p>23 and proceed from there. What I do say is that the</p> <p>24 clause does contemplate something which constitutes</p> <p>25 sufficient evidence if required.</p> <p style="text-align: center;">Page 59</p>
<p>1 and also because it does bear a little bit on the point</p> <p>2 that we were on just before I took my Lord to that</p> <p>3 definition.</p> <p>4 MR JUSTICE HILDYARD: Does either of those get anywhere</p> <p>5 close to specifying the form of certificate?</p> <p>6 MR TROWER: No, not that we have seen.</p> <p>7 MR JUSTICE HILDYARD: Nor any of them in your submission</p> <p>8 incorporate, expressly or implicitly, any requirement</p> <p>9 to state the reasons for the amounts certified?</p> <p>10 MR TROWER: Those words were the closest we could get. I do</p> <p>11 submit --</p> <p>12 MR JUSTICE HILDYARD: By reference to you are only</p> <p>13 obliged -- sorry, you are not obliged only as regards</p> <p>14 the parenthesis words?</p> <p>15 MR TROWER: Yes.</p> <p>16 MR JUSTICE HILDYARD: And by interpolation you are required</p> <p>17 as regards other matters?</p> <p>18 MR TROWER: Yes.</p> <p>19 MR JUSTICE HILDYARD: Is that right?</p> <p>20 MR TROWER: Yes, that is the submission, my Lord.</p> <p>21 MR JUSTICE HILDYARD: Yes.</p> <p>22 MR TROWER: The draftsman may have contemplated a sort of</p> <p>23 incremental process. I am not suggesting that it is</p> <p>24 necessary in all cases for the certificate to be</p> <p>25 produced with vast reams of evidence in support of it.</p> <p style="text-align: center;">Page 58</p>	<p>1 It may be difficult to go too far on this but what</p> <p>2 we certainly -- because some of the answer to these,</p> <p>3 I think one accepts, will be a little bit fact specific.</p> <p>4 What we certainly do say, and would invite my Lord to</p> <p>5 conclude, is that this does not amount to a certificate</p> <p>6 in the form of a sort of non-speaking valuation, where</p> <p>7 a valuer simply comes up with a figure and is not</p> <p>8 required and the draftsman intended should not be</p> <p>9 required to give reasons. It does not fall into that</p> <p>10 category.</p> <p>11 MR JUSTICE HILDYARD: A process of interrogation is not</p> <p>12 excluded?</p> <p>13 MR TROWER: No.</p> <p>14 Would your Lordship just give me a moment?</p> <p>15 MR JUSTICE HILDYARD: Of course. (Pause)</p> <p>16 MR TROWER: Yes, it is of some tangential assistance, it is</p> <p>17 in the 1992 ISDA master agreement, when looking at</p> <p>18 market quotation.</p> <p>19 MR JUSTICE HILDYARD: Yes.</p> <p>20 MR TROWER: Page 9, 6(d) ...</p> <p>21 MR JUSTICE HILDYARD: That is what I was saying, yes -- do</p> <p>22 you mean showing a statement?</p> <p>23 MR TROWER: No, in fact I was on the final sentence, but</p> <p>24 my Lord may find the whole paragraph convenient. Let me</p> <p>25 just read the first bit, but I was actually just on the</p> <p style="text-align: center;">Page 60</p>

15 (Pages 57 to 60)

<p>1 last sentence which was an example of a case where the</p> <p>2 draftsman has applied his mind specifically to the</p> <p>3 conclusive nature of evidence of the instance and</p> <p>4 accuracy of the quotation, and has spelt it out.</p> <p>5 MR JUSTICE HILDYARD: Your statement with respect to your</p> <p>6 alleged amounts payable under section 6(e) and 2 must</p> <p>7 show in reasonable detail --</p> <p>8 MR TROWER: The calculations.</p> <p>9 MR JUSTICE HILDYARD: -- the calculations.</p> <p>10 MR TROWER: Yes, this is the closeout amount quantification.</p> <p>11 You have to show how it is that you calculated the</p> <p>12 closeout amount.</p> <p>13 MR JUSTICE HILDYARD: Yes. Do you say that the inference</p> <p>14 from that is that when specifying the hypothetical cost</p> <p>15 of funding in relation to the relevant amount, that you</p> <p>16 should give like detail?</p> <p>17 MR TROWER: Specifying --</p> <p>18 MR JUSTICE HILDYARD: Or hypothetical no or --</p> <p>19 MR TROWER: All I say about this is that this is the</p> <p>20 quantification of the market -- well, no, the first bit</p> <p>21 of the clause is dealing with the calculations for the</p> <p>22 purposes of quantifying the amount payable under 6(e).</p> <p>23 Then you have to read it together with the second bit of</p> <p>24 the clause, which shows that there is conclusive</p> <p>25 evidence in relation to market quotations, one aspect of</p> <p style="text-align: center;">Page 61</p>	<p>1 MR JUSTICE HILDYARD: It may be best to have both, but if</p> <p>2 you only have one, that would be okay?</p> <p>3 MR TROWER: That is okay.</p> <p>4 MR JUSTICE HILDYARD: Yes.</p> <p>5 MR TROWER: The same does not apply in relation to the</p> <p>6 calculations that are actually made for the purposes of</p> <p>7 assessing the closeout amount itself.</p> <p>8 MR JUSTICE HILDYARD: No.</p> <p>9 MR TROWER: There you have an example of a case where the</p> <p>10 draftsman has thought about the bits that he would wish</p> <p>11 to give people ammunition to have a look at and the bits</p> <p>12 which he would wish they should not have ammunition to</p> <p>13 have a go at. The bits that you have ammunition to have</p> <p>14 a go at are the actual quantification provision and the</p> <p>15 bits that you don't is the material which is advanced as</p> <p>16 the actual market quotations themselves.</p> <p>17 MR JUSTICE HILDYARD: Extrapolating from that, if you can</p> <p>18 what ammunition do you say the draftsman gave with</p> <p>19 respect to the certificate of the hypothetical funding</p> <p>20 cost?</p> <p>21 MR TROWER: What we say is that there is nothing specific on</p> <p>22 the face of the clause. There is probably a very good</p> <p>23 reason for that, which is that it is not possible to be</p> <p>24 definitive in the way that it is in the market quotation</p> <p>25 bit as to what falls into what category. What we do say</p> <p style="text-align: center;">Page 63</p>
<p>1 it. What that demonstrates is that the draftsman has</p> <p>2 been through the process of thinking as to the</p> <p>3 circumstances in which, and aspect of a quantification</p> <p>4 for which particular category of evidence is to</p> <p>5 constitute conclusive evidence.</p> <p>6 There were doubtless good market reasons for</p> <p>7 ensuring that on that aspect of the quantification of</p> <p>8 the closeout amount, as opposed to the internal</p> <p>9 calculation, but on the aspect dealing with the actual</p> <p>10 market quotation bit, the record of the person</p> <p>11 obtaining, or the records of the person obtaining the</p> <p>12 market quotation have to be conclusive evidence.</p> <p>13 MR JUSTICE HILDYARD: That is a very narrow conclusive</p> <p>14 evidence clause, isn't it?</p> <p>15 MR TROWER: It is.</p> <p>16 MR JUSTICE HILDYARD: All that is saying is: if you cannot</p> <p>17 show the other side of the market deal, as it were, you</p> <p>18 can rely on your unilateral record of what was offered</p> <p>19 to you.</p> <p>20 MR TROWER: Yes, so when you go out into the market to get</p> <p>21 your three market quotations, or four, or whatever it</p> <p>22 is --</p> <p>23 MR JUSTICE HILDYARD: Yes.</p> <p>24 MR TROWER: -- it is what you get back and your recording of</p> <p>25 that that the other party cannot go behind.</p> <p style="text-align: center;">Page 62</p>	<p>1 is that the words in parenthesis do contemplate that</p> <p>2 sufficient proof or evidence anyway is required in</p> <p>3 relation to other aspects --</p> <p>4 MR JUSTICE HILDYARD: That is really where you base your</p> <p>5 inference, rather than --</p> <p>6 MR TROWER: I think I have to, yes.</p> <p>7 MR JUSTICE HILDYARD: -- rather than the possibly weak</p> <p>8 analogy with --</p> <p>9 MR TROWER: I think that is right.</p> <p>10 MR JUSTICE HILDYARD: Yes.</p> <p>11 MR TROWER: I think that is right.</p> <p>12 My Lord, the only other point I wanted to address</p> <p>13 my Lord on in relation to certification was</p> <p>14 a certification point that was touched on by Mr Zacaroli</p> <p>15 but which again may be of some significance for</p> <p>16 practical reasons as it relates to issue 10, which is</p> <p>17 the practical question: who has to give the certificate?</p> <p>18 Plainly it is the relevant payee, whoever my Lord</p> <p>19 decides is going to be the relevant payee. If it is the</p> <p>20 original counterparty who is the relevant payee, the</p> <p>21 certificate will need to be one of the documents which</p> <p>22 the original counterparty passes to the assignee on</p> <p>23 transfer. You would expect that to be part of the</p> <p>24 process of making the transfer is that the assignor</p> <p>25 equips the assignee with that which is required in order</p> <p style="text-align: center;">Page 64</p>

16 (Pages 61 to 64)



<p>1 to make a recovery of whatever it is that has been</p> <p>2 assigned.</p> <p>3 If it is whoever happens to have the benefit of the</p> <p>4 claim for the period in respect of which the cost of</p> <p>5 funding is sought to be recovered, there will of course</p> <p>6 inevitably need to be more than one certificate for each</p> <p>7 relevant period because you have to have the</p> <p>8 certification given by whoever is the relevant payee.</p> <p>9 Depending on how many assignments have taken place, that</p> <p>10 may or may not give rise to some complexity from</p> <p>11 a practical point of view but what the administrators do</p> <p>12 need to know is what certification they are entitled to</p> <p>13 have and rely on from whom in respect of each element.</p> <p>14 Either as far as Mr Zacaroli's case is concerned it</p> <p>15 is essentially one certificate. As far as Mr Dicker and</p> <p>16 Mr Foxton's case is concerned, it is probably more than</p> <p>17 one certificate where there has been an assignment,</p> <p>18 ie in the context in which issue 10 is concerned.</p> <p>19 I think all we really wanted to say about that was</p> <p>20 just to draw my Lord's attention to the practical</p> <p>21 consequences on that particular issue of one solution or</p> <p>22 another and inviting my Lord to consider those in the</p> <p>23 way you express yourself.</p> <p>24 My Lord, that was all I was going to say on the sort</p> <p>25 of more substantive points in relation to the issues.</p> <p style="text-align: center;">Page 65</p>	<p>1 This, my Lord will recall, is a case where there were</p> <p>2 lots of claimants.</p> <p>3 MR JUSTICE HILDYARD: Yes.</p> <p>4 MR TROWER: Then, what you do is in paragraph 21 you</p> <p>5 summarise what was said by the claimants in contending</p> <p>6 that a rate of 5 per cent over base was the appropriate</p> <p>7 rate.</p> <p>8 They go through some of the authorities. There are</p> <p>9 a series of propositions that you derive from the</p> <p>10 claimant's submissions. Probably the two bits that</p> <p>11 matter are at paragraph 30, where you identify what you</p> <p>12 had to decide. Then paragraphs 36 and 37, where you</p> <p>13 describe the approach that you intend to adopt.</p> <p>14 What you were actually doing was having analysed the</p> <p>15 authorities, you were looking for a proxy rate to cover</p> <p>16 all the claimants, is was what was going on.</p> <p>17 What you do is you disclaim the task of working out</p> <p>18 the position of each individual claimant, which is not</p> <p>19 the task that you said was appropriate to carry out.</p> <p>20 It is helpful in the sense that it identifies the</p> <p>21 sort of exercise that is taking place in normal</p> <p>22 litigation in the context of a multi-claimant case, but</p> <p>23 it probably does not help, we submit, in this case</p> <p>24 because one thing that is clear is that in the present</p> <p>25 case the individual position of each claimant, ie the</p> <p style="text-align: center;">Page 67</p>
<p>1 I mean our skeleton does address where we are in</p> <p>2 relation to each of the other issues, but there does not</p> <p>3 seem to be anything either significantly with which the</p> <p>4 parties are in disagreement or where there are, for</p> <p>5 example in relation to issue 13, the administrators do</p> <p>6 not have anything to add to what has already been said,</p> <p>7 unless my Lord would like any further assistance which</p> <p>8 we could try to give you.</p> <p>9 The only other point I was just going to tell</p> <p>10 my Lord about is we did dig out for you Challinor v</p> <p>11 Bellis.</p> <p>12 MR JUSTICE HILDYARD: It may be completely irrelevant.</p> <p>13 MR TROWER: It is not completely irrelevant, but I think it</p> <p>14 is probably tangential.</p> <p>15 Perhaps we can put it behind the authorities volume</p> <p>16 at tab 44. Sorry, volume 4A, tab 144.</p> <p>17 MR JUSTICE HILDYARD: Right.</p> <p>18 MR TROWER: Just three sections of the judgment for my Lord</p> <p>19 to remind you of what was going on. The opening</p> <p>20 paragraph explains that this is a consequential judgment</p> <p>21 and it is issue B, the appropriate rate of interest.</p> <p>22 MR JUSTICE HILDYARD: Yes.</p> <p>23 MR TROWER: The way this works is there is a detailed</p> <p>24 description, starting at paragraph 13, as to what rate</p> <p>25 of interest on the judgment sums would be appropriate.</p> <p style="text-align: center;">Page 66</p>	<p>1 words "to it" is the core.</p> <p>2 My Lord, that was all I was going to say at this</p> <p>3 stage, unless there is anything else that my Lord would</p> <p>4 like any further assistance I can give.</p> <p>5 MR JUSTICE HILDYARD: No, Mr Trower, thank you. I reserve</p> <p>6 the right to quiz any and all of you as points occur,</p> <p>7 but I am very grateful to you.</p> <p>8 Reply submissions by MR ZACAROLI</p> <p>9 MR ZACAROLI: My Lord, just a couple of points if I may by</p> <p>10 sort of reply to what Mr Trower has dealt with.</p> <p>11 The first is just to refer to the questions the</p> <p>12 administrators have asked as elements of what is</p> <p>13 required by the definition of default rate.</p> <p>14 My Lord, as my Lord knows, I went through and gave</p> <p>15 answers to all those but our primary point remains --</p> <p>16 I am reiterating this just for emphasis -- that the core</p> <p>17 features of the cost of funding language necessitates</p> <p>18 something which is repayable after a period and where</p> <p>19 the cost is referable to the time that you have had use</p> <p>20 of that money during that period. Those are the core</p> <p>21 elements of the definition, they are obviously the core</p> <p>22 elements of borrowing, they are not core elements of</p> <p>23 equity, because equity is a right to participate,</p> <p>24 a right of participation. First of all in the assets of</p> <p>25 the company on a winding up you may or may not get back</p> <p style="text-align: center;">Page 68</p>

<p>1 what you put in, it may be more, it may be less.</p> <p>2 Secondly, participation in profits to the extent</p> <p>3 that profits are made and are distributable.</p> <p>4 Importantly the return therefore on equity is not</p> <p>5 measurable by reference to the time value of money; it</p> <p>6 is referable to profits.</p> <p>7 Those are essential features of equity, of</p> <p>8 shareholder funding. My Lord is being asked in issue 11</p> <p>9 to decide whether the phrase, the expression, extends to</p> <p>10 shareholder funding, cost of equity, those are the words</p> <p>11 used in the question. My Lord, my Lord has to look at</p> <p>12 those through English spectacles, those are well known</p> <p>13 English concepts. I would submit actually well known</p> <p>14 throughout the common law world. In the event certainly</p> <p>15 they are English concepts. Of course my Lord cannot</p> <p>16 decide whether a particular form of enterprise funding</p> <p>17 in some completely random third country whose system of</p> <p>18 law has nothing to do with ours, whether that would be</p> <p>19 within or without the definition. You would need to see</p> <p>20 what it was before you could make that decision. Any</p> <p>21 definition my Lord comes up with is going to suffer from</p> <p>22 the problem that at the edges unknown quantities may or</p> <p>23 may not fit within it.</p> <p>24 That is not of concern to my Lord. What my Lord is</p> <p>25 being asked in particular to determine is whether it</p> <p style="text-align: center;">Page 69</p>	<p>1 that the challenged person is entitled to say that is</p> <p>2 it, I am not going to explain further.</p> <p>3 The same with the default rate, if challenged, there</p> <p>4 will be a requirement to justify it. There is one</p> <p>5 authority, which my Lord has already seen, where that</p> <p>6 indeed was the position taken. It is the Sal Oppenheim</p> <p>7 case. My Lord may remember, I will just read the</p> <p>8 sentence. It is paragraph 52 of Mr Justice Burton's</p> <p>9 judgment. He says there:</p> <p>10 "Mr Bayfield submits that the defendant can only go</p> <p>11 behind a certificate in the event of bad faith, but in</p> <p>12 my judgment also if there is no evidence to support the</p> <p>13 certificate."</p> <p>14 Clearly some evidence is required, if challenged, to</p> <p>15 support the certificate and if you cannot do that, then</p> <p>16 it is open to challenge.</p> <p>17 MR JUSTICE HILDYARD: Where was that?</p> <p>18 MR ZACAROLI: That was volume 2 of the authorities, tab 60,</p> <p>19 paragraph 52.</p> <p>20 My Lord, subject to my Lord's right to quiz me on</p> <p>21 any matter now or later, that is all I propose to say at</p> <p>22 this stage.</p> <p>23 MR JUSTICE HILDYARD: I will have to think about your</p> <p>24 irreducible criteria, as it were, and the necessary</p> <p>25 requirement for it to qualify as a cost of funding that</p> <p style="text-align: center;">Page 71</p>
<p>1 extends to cost of equity, cost of shareholder funding.</p> <p>2 For the core reasons we give it does not extend to that.</p> <p>3 The only other point, my Lord, is the question of</p> <p>4 what the certificate needs to express as far as the</p> <p>5 default rate is concerned. We agree with my learned</p> <p>6 friend Mr Trower that there is nothing on the face of</p> <p>7 the agreement which requires any particular form of</p> <p>8 certificate, anything particular to be stated by way of</p> <p>9 the certificate. I just add this, and we agree that</p> <p>10 this really comes down to if a certificate is</p> <p>11 challenged, what would a challenged relevant payee be</p> <p>12 required to say in support. Could they say, "You can</p> <p>13 ask me for no further information because all I am</p> <p>14 required to do is state the number"?</p> <p>15 We would say no, that is not sufficient, if they</p> <p>16 were challenged they would need to justify what it was</p> <p>17 they had stated.</p> <p>18 In the same way that calculation of loss is only</p> <p>19 challengeable in cases of irrationality or bad faith,</p> <p>20 that doesn't mean if you challenge it, the challenged</p> <p>21 party can say, "I have not got to give you anything",</p> <p>22 indeed, as my Lord has seen, the agreement requires them</p> <p>23 to give details there. The requirement to go behind the</p> <p>24 stated number of what my loss is, the requirement to go</p> <p>25 behind that you have to show irrationality does not mean</p> <p style="text-align: center;">Page 70</p>	<p>1 the cost should be referable to time. Of course day in,</p> <p>2 day out, the board of directors will be assessing the</p> <p>3 costs over time, for example of allowing preference</p> <p>4 shares to remain outstanding, because they will want to</p> <p>5 know whether it remains worthwhile to fork up on the</p> <p>6 coupon or whether it would be better to replace it by</p> <p>7 borrowing, just as an example. You, I suppose, say that</p> <p>8 models or proxies, although illuminating, are not the</p> <p>9 same as an actual time cost?</p> <p>10 MR ZACAROLI: Yes, I think I put it in my opening</p> <p>11 submissions that the coupon on a preference share may</p> <p>12 mimic the rate of interest --</p> <p>13 MR JUSTICE HILDYARD: Mimic is the word you used, yes.</p> <p>14 MR ZACAROLI: Yes.</p> <p>15 MR JUSTICE HILDYARD: You hold fast to that, will not be</p> <p>16 enough?</p> <p>17 MR ZACAROLI: Yes.</p> <p>18 MR JUSTICE HILDYARD: Thank you.</p> <p>19 Who is going next.</p> <p>20 Reply submissions by MR FOXTON</p> <p>21 MR FOXTON: My Lord, as per Wednesday afternoon's</p> <p>22 indication, Mr Dicker has very kindly allowed me to go</p> <p>23 first.</p> <p>24 My Lord I am going to follow the same order as</p> <p>25 Mr Zacaroli took in his submissions in the hope that</p> <p style="text-align: center;">Page 72</p>

<p>1 that will make it easier for your Lordship when it comes 2 to seeing which point is replying to what. 3 My Lord, it is always interesting to see what 4 parties take as their point of departure on 5 a construction argument. We for our part, old 6 traditionalists that we are, took the words used in the 7 agreement to which we are parties. I think it is fair 8 to say that approaching issues of construction from the 9 perspective of the natural meaning of the words used has 10 come back into fashion somewhat of late. We will be 11 looking at a couple of authorities that rather stress 12 that. It is certainly, we say, what the users, the 13 commercial community using this 1992 master agreement in 14 our case, would do. 15 Mr Zacaroli's submissions took as their point of 16 departure the 1987 US dollar interest rate swap master 17 form and the users' guide to the two ISDA master forms 18 generally. Your Lordship was taken to those, we can 19 perhaps look at them in a moment but your Lordship will 20 recall there were two forms of ISDA master agreement in 21 1987, you had one that was both specific as to a form of 22 transaction, interest rate swaps, and a form of 23 currency, US dollars. Then you had another that applied 24 to currency swaps as well as interest rate swaps and to 25 other currencies, multiple currencies. Your Lordship</p> <p style="text-align: center;">Page 73</p>	<p>1 rate swap master and the other master. 2 We have the fact that one specifies a base rate in 3 very great detail, the other doesn't. One has provision 4 for the parties to bespoke an add on, the other doesn't. 5 One has a rate of general application, regardless of the 6 of the circumstances of the receiving party, the other 7 by contrast looks at the cost to that party of funding. 8 (1), the interest rate swap actually is not 9 concerned with actual cost of funding at all, that is 10 a completely irrelevant enquiry, whereas under the 11 multicurrency agreement, that is something that is very 12 much concerned with. 13 Those differences are all we would say very much 14 fortified by the fact that in the multicurrency 15 agreement one has the concept of certification and 16 without proof or evidence of actual borrowing. 17 My Lord, we quite accept that if you are comparing 18 the two agreements as a whole, those differences would 19 not fairly be described as substantial. Of course we 20 are spending five to eight days simply looking at the 21 question of what happens when money is paid late and 22 when one has that very narrow and specific focus the 23 difference between the approach adopted in the two 24 master agreements is, we would submit, very significant 25 indeed.</p> <p style="text-align: center;">Page 75</p>
<p>1 has seen that the approach taken to what happens when 2 someone pays money late differed as between those two. 3 The extent of the difference is a matter that is in 4 dispute between Wentworth and ourselves. 5 As far as the US dollar interest rate swap approach 6 was concerned, you had the very prescriptive 7 identification of a specific rate, but then provision 8 for the parties in a schedule to have a bespoke add on 9 in the form of the default spread. 10 The degree to which it was prescribed was such that 11 your Lordship may recall when Mr Zacaroli took you to 12 the supporting definitions, there were a whole series of 13 fall backs in case, for any reason, the Fed Funds rate 14 was not available on a specific date. It was about as 15 prescriptive an approach as a draftsman could take. 16 As far as the multicurrency form was concerned in 17 1987, one had no attempt to prescribe anything, one had 18 these words "Any cost of funding". At that stage we did 19 not have the "if it were to fund" language, that comes 20 in 1992. You don't have the provision for the bespoke 21 add on in the schedule, you simply have this, we say, 22 open textured language. 23 My Lord, if one stands back, one has a number of 24 differences, significant differences, we would say, in 25 the approach taken, as between the US dollar interest</p> <p style="text-align: center;">Page 74</p>	<p>1 All of that, we say, makes the argument that cost of 2 funding in the multicurrency form is intended to achieve 3 something by prescribes the specification of the prescribed 4 base rate in the US dollar interest rate swap form, 5 a very unlikely submission. It is quite interesting to 6 look at where one is. We have in the IRS form, the 7 interest rate swap form, the prescription of 8 an overnight interbank borrowing rate. When we come to 9 the multicurrency form, there is no attempt by the 10 draftsman to say it is an interbank rate or it is 11 an overnight rate or even it is a borrowing rate, none 12 of those appear. 13 Mr Zacaroli, for reasons we understand, relies on 14 the users' guide and the comment it made. We have that 15 in bundle 5, tab 4, page 97. Your Lordship was taken to 16 the language in the multicurrency form: 17 "The rate is equal to the payee's costs of funding 18 plus 1 per cent since no published index exists covering 19 all possible currencies." 20 My Lord, that in a sense tells you the draftsman 21 tells you he or she was not, or they were not, going to 22 seek to replicate the approach of the prescribed rate 23 for the reasons there given and it is very clear that no 24 such attempt was made. What it doesn't tell you is that 25 they therefore decided to include words, the intended</p> <p style="text-align: center;">Page 76</p>

<p>1 contractual effect of which was to get something very</p> <p>2 similar or identical to that.</p> <p>3 We would say that the language that was used would</p> <p>4 very much suggest the contrary.</p> <p>5 So much for 1987 --</p> <p>6 MR JUSTICE HILDYARD: I understand the cy pres suggestion,</p> <p>7 but my understanding of what Mr Zacaroli was saying,</p> <p>8 possibly inaccurate, is one has to try and identify the</p> <p>9 genus that the draftsman had in mind. By reference to</p> <p>10 1987, and the two forms of the agreement that you have</p> <p>11 reminded me of, that the genus appears to be</p> <p>12 demonstrated by the sort of exercises that the 1987</p> <p>13 agreement prescribes, or the 1987 agreements prescribe.</p> <p>14 Cy pres is not quite his argument, is it? It is</p> <p>15 delving into the mind of his draftsman to see what he</p> <p>16 meant in terms of the qualifying genus.</p> <p>17 MR FOXTON: My Lord, I think our response is if the genus</p> <p>18 were overnight rates or interbank rates or even</p> <p>19 borrowing rates --</p> <p>20 MR JUSTICE HILDYARD: The cost of money in the market of</p> <p>21 borrowing is the genus I think he suggests.</p> <p>22 MR FOXTON: My Lord, that is the language we would have seen</p> <p>23 used. We would suggest that in fact what one sees</p> <p>24 happening here is that, as far as the multicurrency form</p> <p>25 is concerned, the cost of funding language shows that</p> <p style="text-align: center;">Page 77</p>	<p>1 party to fund the gap or the hole in its balance sheet</p> <p>2 that follows from non-payment of sums that are due.</p> <p>3 All of that focuses on the 1987 form. As far as the</p> <p>4 1992 wording is concerned, you once again had two forms</p> <p>5 of ISDA agreement. One of them I think has found its</p> <p>6 way into the bundle since we were last here on Wednesday</p> <p>7 in the light of the argument. My Lord, that is the</p> <p>8 single currency form, which is in bundle 5 again,</p> <p>9 tab 2(a), beginning at page 44A.</p> <p>10 MR JUSTICE HILDYARD: This was introduced at the end of last</p> <p>11 week, was it?</p> <p>12 MR FOXTON: It was, my Lord. Simply to show you that you</p> <p>13 once again had two forms of agreement in 1992, as you</p> <p>14 did in 1987, not the same two forms but you did have one</p> <p>15 that envisaged the application of a single currency.</p> <p>16 My Lord, it adopted the same language as the</p> <p>17 multicurrency master, as far as the default rate is</p> <p>18 concerned, one sees that at page 44K.</p> <p>19 My Lord, one point one notes for both of these 1992</p> <p>20 master agreements is the draftsman has revisited the</p> <p>21 default rate wording with language of, "If it were to</p> <p>22 fund".</p> <p>23 MR JUSTICE HILDYARD: Yes.</p> <p>24 MR FOXTON: My Lord, with the local currency option, it</p> <p>25 would have been perfectly possible to say the borrowing</p> <p style="text-align: center;">Page 79</p>
<p>1 there is not an attempt to include some identified</p> <p>2 species of cost of -- subset if you like of cost of</p> <p>3 lending, and the attempt to rely upon really a rather</p> <p>4 different approach to addressing late payment of money</p> <p>5 in the US dollar interest rate swap format does not get</p> <p>6 you a controlling genus in the other form, unless you</p> <p>7 have language that is capable of identifying what that</p> <p>8 genus is.</p> <p>9 All one can say is the genus is now cost of funding</p> <p>10 at large. In a sense that does not answer the question</p> <p>11 that we have answered, which is: what do those words</p> <p>12 mean? In circumstances in which I think it is accepted</p> <p>13 that at least from perspective of commercial users of</p> <p>14 this form, you can incur a cost of funding as much by</p> <p>15 raising equity as you can by raising debt.</p> <p>16 My Lord, even if -- probably in a poor attempt to</p> <p>17 try and clothe myself with the appearance of a chancery</p> <p>18 practitioner -- the cy pres reference is inappropriate,</p> <p>19 we would say that the problem with the genus argument is</p> <p>20 that the language used does not look as though it is</p> <p>21 trying to ape some genus defined in the 1987 US dollar</p> <p>22 form.</p> <p>23 The contrast is between a very prescriptive approach</p> <p>24 and what looks to be a very flexible and potentially</p> <p>25 wide ranging approach to what it costs the receiving</p> <p style="text-align: center;">Page 78</p>	<p>1 rate for that currency from the relevant central bank or</p> <p>2 overnight borrowing rate for the currency in question,</p> <p>3 but that is not the way in which the manner proceeds in</p> <p>4 1992 one has a commitment for both forms of master</p> <p>5 agreement to what we say was the broader language,</p> <p>6 albeit adjusted, initially adopted in the multicurrency</p> <p>7 form in 1987.</p> <p>8 My Lord, in circumstances in which 1992 adopts this</p> <p>9 wording for both, in which the draftsman has revisited</p> <p>10 the definition and adjusted it, we would say the</p> <p>11 suggestion that the 1987 US dollar interest rate swap</p> <p>12 form should control the meaning of those words is really</p> <p>13 just too remote, it is too remote a factor to override</p> <p>14 what we say is the natural meaning of the words used.</p> <p>15 We are often told by courts that businessmen</p> <p>16 construe documents in a non-complex and reasonably</p> <p>17 straightforward way. I accept that if one is talking</p> <p>18 about a user guide for the agreement in question, one</p> <p>19 has a degree of proximity between the relevant part of</p> <p>20 the factual matrix and the construction task. The</p> <p>21 further away one moves from that, so when one has a user</p> <p>22 guide commenting on a distinction between two forms of</p> <p>23 agreement in an earlier form, one of which is no longer</p> <p>24 in use anyway. We would say that that really has a very</p> <p>25 weak pull on the court as far as determining the meaning</p> <p style="text-align: center;">Page 80</p>

<p>1 of this expression is concerned.</p> <p>2 My Lord, we made our point before that the word</p> <p>3 "borrowing" does appear in the 1992 master agreements.</p> <p>4 It appears in the same context in the 1987 master</p> <p>5 agreements as well; the word is very much in the</p> <p>6 draftsman's mind at that stage.</p> <p>7 My Lord, the concept of specified indebtedness or</p> <p>8 borrowing serves an important function, because it goes</p> <p>9 to the cross default provisions which are rather</p> <p>10 significant both commercially and legally as</p> <p>11 consequences of the ISDA form.</p> <p>12 One then had the concept of borrowing being used in</p> <p>13 a context where the draftsman would have had every</p> <p>14 reason to think about the word used and yet no attempt</p> <p>15 to use similar language when addressing the consequences</p> <p>16 of late payment of sums due.</p> <p>17 My Lord, we do ascribe a great deal of significance</p> <p>18 to that.</p> <p>19 Your Lordship was handed, possibly on Wednesday</p> <p>20 after lunch, the extract from Lewison on the</p> <p>21 interpretation of contracts and how it is never helpful</p> <p>22 to say if is that is what was meant, they could have</p> <p>23 said so.</p> <p>24 My Lord, certainly one is dealing with potentially</p> <p>25 ambiguous wording. The argument that it could have been</p> <p style="text-align: center;">Page 81</p>	<p>1 Appeal reported in the same context. My Lord, there are</p> <p>2 other reasons why it is interesting to look at the facts</p> <p>3 of this case because they rid one of any possible</p> <p>4 misconception as to the simplicity of debt instruments</p> <p>5 and as to the readiness with which one can identify the</p> <p>6 amounts payable. The case was all about the meaning of</p> <p>7 the London Market Association terms on the sale and</p> <p>8 purchase of loans, the transfer of loans between two</p> <p>9 parties.</p> <p>10 My Lord, the judgment of the Court of Appeal, Lord</p> <p>11 Justice Longmore, I think begins on page 894. Like</p> <p>12 Mr Zacaroli, he begins with a quotation from</p> <p>13 Sir William Blackstone's commentaries. My Lord, the</p> <p>14 case was about something called "payment premium". Your</p> <p>15 Lordship will see this is described in paragraph 1 and</p> <p>16 it is an amount that the borrower pays to the lender at</p> <p>17 the repayment of the loan, as well as having paid his</p> <p>18 interest along the way.</p> <p>19 My Lord that is summarised just over to the top of</p> <p>20 page 895 in paragraph 1 of Lord Justice Longmore's</p> <p>21 judgment.</p> <p>22 Simply pausing there, that is one of a number of</p> <p>23 charges that you can be required to pay under loans that</p> <p>24 are not themselves simply the interest rate payable for</p> <p>25 the time that money is outstanding.</p> <p style="text-align: center;">Page 83</p>
<p>1 made clear with some extra wording is often of no use,</p> <p>2 not least because it is something that each side can say</p> <p>3 to the other and it effectively becomes a sort of</p> <p>4 self-neutralising point.</p> <p>5 MR JUSTICE HILDYARD: I think Mr Zacaroli tended to accept</p> <p>6 that while that passage might be relevant to</p> <p>7 a collection of words, when you are looking at</p> <p>8 a specific word it is quite important to try and</p> <p>9 determine why that word, as opposed to some other word,</p> <p>10 was deployed.</p> <p>11 MR FOXTON: My Lord, we would say that he is absolutely</p> <p>12 right to accept that and indeed the point becomes much</p> <p>13 stronger when the other word is used elsewhere within</p> <p>14 the same document.</p> <p>15 MR JUSTICE HILDYARD: Yes.</p> <p>16 MR FOXTON: My Lord, we did want to refer your Lordship just</p> <p>17 to a recent Court of Appeal and Supreme Court decision</p> <p>18 in the Tael One Partners case, which we will hand up.</p> <p>19 I hope everyone else in court has copies of this?</p> <p>20 My Lord, it is one of a number of cases where the</p> <p>21 primacy attached to the words used has perhaps been</p> <p>22 re-emphasised by recent decisions. My Lord, first of</p> <p>23 all there is the Court of Appeal decision, which I think</p> <p>24 your Lordship has in the format from the CLCs, we have</p> <p>25 the judgment of Mr Justice Popplewell and the Court of</p> <p style="text-align: center;">Page 82</p>	<p>1 My Lord, from paragraph 2, the purpose of that</p> <p>2 premium was to enable the lender to achieve required</p> <p>3 internal rates of return. Your Lordship will see in the</p> <p>4 last three lines at paragraph 2, that was to be paid so</p> <p>5 as to enhance the rate of return to the lenders to</p> <p>6 a total of either 20 per cent or 17 per cent, depending</p> <p>7 upon which particular set of circumstances applied.</p> <p>8 The short point in the case was, where you had the</p> <p>9 transfer of a loan at some point between when it was</p> <p>10 initially made and when it was finally repaid, how, if</p> <p>11 at all, did you divvy up the premium payment between</p> <p>12 assignor and assignee? My Lord, that argument focused</p> <p>13 on two provisions in the LMA terms. One was condition</p> <p>14 11.3, which is quoted in paragraph 24 of the judgment of</p> <p>15 the Court of Appeal.</p> <p>16 Your Lordship initially clause 11.1 is quoted at</p> <p>17 page 900(b), then 11.2 and then condition 11.3. What</p> <p>18 was significant for present purposes about condition</p> <p>19 11.3 are first of all that it included pretty clear</p> <p>20 language imposing --</p> <p>21 MR JUSTICE HILDYARD: Where are you now? Sorry, I got a bit</p> <p>22 muddled --</p> <p>23 MR FOXTON: Does my Lord have page 900 of the judgment -- of</p> <p>24 the report, I should say. My Lord, it is paragraph 24</p> <p>25 of the judgment, that is the best way of going to it.</p> <p style="text-align: center;">Page 84</p>

<p>1 MR JUSTICE HILDYARD: I have it, yes.</p> <p>2 MR FOXTON: It is setting out various terms from condition</p> <p>3 11, there is 11.1, 11.2 as summarised and then there is</p> <p>4 a quotation of 11.3. My Lord, that was a quotation that</p> <p>5 used language of payment, so your Lordship will see:</p> <p>6 "The buyer shall pay."</p> <p>7 And (b), amounts are paid, but only on its face</p> <p>8 covered fees that had accrued up to a certain date. The</p> <p>9 difficulty with the payment premium is that that was</p> <p>10 something that was payable when the loan came to be</p> <p>11 repaid at the end of its life.</p> <p>12 You then had at condition 11.9, a clause dealing</p> <p>13 with allocation of interest and fees. My Lord, that, as</p> <p>14 one sees from paragraph 25, said:</p> <p>15 "Interest or fees which are payable under the credit</p> <p>16 agreement and which are expressed to accrue by reference</p> <p>17 to lapse of time shall ..."</p> <p>18 Then missing out the words in between:</p> <p>19 "... be for the account of the seller insofar as</p> <p>20 they have accrued before the settlement date, and to the</p> <p>21 extent they accrue in respect of the period after the</p> <p>22 settlement date be for the account of the buyer."</p> <p>23 The issue for the court is whether condition 11.9</p> <p>24 could impose, as it were, a right in the seller to some</p> <p>25 part of the payment premium that the buyer of the loan</p> <p style="text-align: center;">Page 85</p>	<p>1 why the construction of this clause urged by Wentworth</p> <p>2 is wrong.</p> <p>3 My Lord, the decision was upheld in the Supreme</p> <p>4 Court. I don't think it is necessary to go to it, save</p> <p>5 that once again the natural meaning of the words used</p> <p>6 was very much stressed by Lord Reed in paragraph 41, if</p> <p>7 one looks for example at the last four lines.</p> <p>8 My Lord, just one final point on this topic. My</p> <p>9 learned friend Mr Trower for the Joint Administrators</p> <p>10 said, "Well, the language may reflect the fact that one</p> <p>11 party's borrowing rate is another party's lending rate".</p> <p>12 My Lord, with respect, it is very, very difficult to</p> <p>13 see how that could provide an explanation in the context</p> <p>14 in which the language appears, namely addressing a party</p> <p>15 to whom an amount is payable but has not been paid, the</p> <p>16 lending rate would never be relevant at all. It is very</p> <p>17 difficult to see how a cost of funding could ever be</p> <p>18 relevant to consider the return that the recipient would</p> <p>19 have received from lending out the money itself. It</p> <p>20 will always as a cost be concerned with what he has had</p> <p>21 to pay to plug the hole. We suggest to your Lordship</p> <p>22 that that does not provide a satisfactory answer for why</p> <p>23 the most obvious phrase, if this was the meaning</p> <p>24 intended, is not used when one sees it used elsewhere.</p> <p>25 My Lord, I don't know if that is a convenient</p> <p style="text-align: center;">Page 87</p>
<p>1 would have to pay over to it on the basis that it had</p> <p>2 accrued by reference to a period of time before the</p> <p>3 settlement date, even though the payment premium itself</p> <p>4 was only payable at the end.</p> <p>5 Mr Justice Popplewell has said yes, the Court of</p> <p>6 Appeal and the Supreme Court disagreed. If one looks at</p> <p>7 paragraph 29 of the judgment of the Court of Appeal, one</p> <p>8 of the points to which the court attached particular</p> <p>9 significance is that, whilst condition 11.3 had language</p> <p>10 of pay, which was ordinarily where you would look to go</p> <p>11 to to find an obligation that someone had to hand over</p> <p>12 money to someone else, that wording was absent and</p> <p>13 instead you had the phrase, "Shall be for the account</p> <p>14 of" in condition 11.9. That distinction in the language</p> <p>15 used led the court to conclude that condition 11.9 did</p> <p>16 not itself create some further payment obligation as</p> <p>17 between the buyer and the seller of the loan. It simply</p> <p>18 was a method of allocating how sums already addressed</p> <p>19 elsewhere in the LMA terms should be dealt with in some</p> <p>20 form of accounting exercise.</p> <p>21 My Lord, the fact that words you would naturally</p> <p>22 expect to find if the concept being aimed at was that</p> <p>23 for which one party contends are missing, a fortiori</p> <p>24 when those words are to be found elsewhere within the</p> <p>25 same document, we say represent very powerful reasons</p> <p style="text-align: center;">Page 86</p>	<p>1 moment.</p> <p>2 MR JUSTICE HILDYARD: Indeed.</p> <p>3 Can I mention this, I am going to mark this, "Not</p> <p>4 before 2.00". The reason is that Mr Justice David</p> <p>5 Richards is being sworn in as a member of the Court of</p> <p>6 Appeal and I want to attend that. I should think it</p> <p>7 would be about 2.00, but it might be just seconds</p> <p>8 afterwards.</p> <p>9 MR TROWER: Before your Lordship rises, there may be other</p> <p>10 people in court who would quite like to attend that.</p> <p>11 Would your Lordship bear that in mind before coming back</p> <p>12 into court at 2.00?</p> <p>13 MR JUSTICE HILDYARD: That was rude of me. I meant to</p> <p>14 signify by that that we will all be in it together and</p> <p>15 will assemble at the same time.</p> <p>16 (1.01 pm)</p> <p>17 (The Luncheon Adjournment)</p> <p>18 (2.10 pm)</p> <p>19 MR FOXTON: My Lord, I was going to move to the second</p> <p>20 matter that Mr Zacaroli prayed in aid in support of his</p> <p>21 construction, which is that the language of interest</p> <p>22 rate per annum and daily compounding in clause 6(d)(ii)</p> <p>23 were all matters suggestive of an interest rate and</p> <p>24 therefore of borrowing.</p> <p>25 My Lord, we quite accept that the default rate finds</p> <p style="text-align: center;">Page 88</p>

<p>1 its ultimate expression in the form of a rate. What</p> <p>2 that does not mean is that everything that feeds into it</p> <p>3 must itself take the form of a rate. Indeed, we don't</p> <p>4 understand that to be in dispute. Mr Zacaroli I think</p> <p>5 accepted that an arrangement fee payable to a bank forms</p> <p>6 part of the cost of funding, if paid for a loan, and</p> <p>7 I think he said you would amortise that fee over the</p> <p>8 life of the loan so as to incorporate it in an annual</p> <p>9 rate.</p> <p>10 We say that as equally true of a number of other</p> <p>11 costs which one sees associated with loans, we have seen</p> <p>12 premium payment figures but break costs, commitment</p> <p>13 fees, all of these matters are amounts that are not</p> <p>14 themselves an interest rate, but a capable of being</p> <p>15 reflected and amortised over a period so you can reflect</p> <p>16 them in an interest rate.</p> <p>17 My Lord, break costs are sort of quite</p> <p>18 an interesting example because what you are often paying</p> <p>19 those for is to reflect the fact that the lender may</p> <p>20 himself through a swap or a hedge of some kind, have</p> <p>21 incurred some other costs in the event of early payment</p> <p>22 that will need to be reflected in the costs of the loan</p> <p>23 if you pay it back before it would otherwise be payable.</p> <p>24 My Lord, once one has derived an annual interest</p> <p>25 rate from the inputs, there is no difficulty in applying</p> <p style="text-align: center;">Page 89</p>	<p>1 If one is doing it prospectively, one has the same</p> <p>2 sort of issues where if you are trying to prospectively</p> <p>3 work out what the cost of borrowing at a floating rate</p> <p>4 would be, there are elements of prediction or borrowing</p> <p>5 on a limited recourse basis where you might similarly</p> <p>6 have to be entering into the question about: what is our</p> <p>7 best modelled estimate of what would be payable?</p> <p>8 I am anticipating a point I will come on to, but</p> <p>9 very much the difficulties that are raised in this</p> <p>10 context are not difficulties of debt versus equity but</p> <p>11 issues raised by predictive analysis versus the ability</p> <p>12 to retrospectively certify.</p> <p>13 The same difficulties arise on forms of debt as on</p> <p>14 equity if one is looking ahead, and they are</p> <p>15 correspondingly much easier to answer if one has the</p> <p>16 benefit of hindsight and the question is what has it</p> <p>17 actually cost or what would it have actually cost now</p> <p>18 that I have, you know, reached the stage where I have</p> <p>19 been paid and I know the period.</p> <p>20 MR JUSTICE HILDYARD: The certificate would have to certify</p> <p>21 what in good faith you consider to have been the method</p> <p>22 of funding, and therefore its costs, at day one. If</p> <p>23 over the course of, in this case, years, it transpired</p> <p>24 that, as a matter of fact the preference shares were not</p> <p>25 capable of being serviced, you would have just made</p> <p style="text-align: center;">Page 91</p>
<p>1 any of that language one sees in the ISDA master</p> <p>2 agreement of a rate and day by day accrual in</p> <p>3 compounding.</p> <p>4 My Lord, if one did have to be expressed in</p> <p>5 a percentage rate to be capable of being an ingredient</p> <p>6 in the eventual rate derived from a cost of funding,</p> <p>7 then we would say in any event that the fix the</p> <p>8 cumulative coupon of the Goldman Sachs preference equity</p> <p>9 ticks that box, that is expressed as a 10 per cent</p> <p>10 annual fee. The reality is that the rate stage of this</p> <p>11 analysis comes at the end of the process, it is not</p> <p>12 a separate requirement to be satisfied by every</p> <p>13 ingredient feeding into the cost of funding.</p> <p>14 MR JUSTICE HILDYARD: What would be the rate to be derived</p> <p>15 from, say, a 10 per cent cumulative preference share in</p> <p>16 a case of a company whose distributable profit was</p> <p>17 doubtful or insufficient?</p> <p>18 MR FOXTON: My Lord, if one is certifying, I think in terms</p> <p>19 of the final certification, this is even the position on</p> <p>20 Wentworth's case you certify at the end of the process,</p> <p>21 you will then in fact know what has been paid over the</p> <p>22 course of the relevant period and, if the answer is that</p> <p>23 nothing has been paid because no profits have been made,</p> <p>24 then you have not incurred a cost of funding that amount</p> <p>25 over that period.</p> <p style="text-align: center;">Page 90</p>	<p>1 a bad choice, is that right?</p> <p>2 MR FOXTON: My Lord, rather in the way that if you had taken</p> <p>3 a view on what the borrowing rate would be at the start</p> <p>4 and certified and it turned out that it had been much</p> <p>5 higher one might say that you had made a bad choice as</p> <p>6 well.</p> <p>7 MR JUSTICE HILDYARD: Yes.</p> <p>8 MR FOXTON: We say that is a problem that is not intrinsic</p> <p>9 to the debt versus equity question, but to the question</p> <p>10 of whether you certify it prospectively or</p> <p>11 retrospectively.</p> <p>12 MR JUSTICE HILDYARD: Turning to a different point earlier</p> <p>13 in your argument, taking the various costs which might</p> <p>14 be so closely associated with the transaction that they</p> <p>15 would form part of the cost of funding, in the case of</p> <p>16 the example you gave of an arrangement fee to take that</p> <p>17 example, it would be a standard technique to translate</p> <p>18 that into what might be called an APR, there is no</p> <p>19 perceived difficulty. Whereas as a matter of instinct</p> <p>20 one would feel the greater difficulty in effecting such</p> <p>21 a calculation or description in the case of, say, equity</p> <p>22 capital. Would you think that?</p> <p>23 MR FOXTON: My Lord, in each case one is taking a figure</p> <p>24 that is not itself expressed as a rate and which may not</p> <p>25 actually be premised on a measure of time. I mean</p> <p style="text-align: center;">Page 92</p>

<p>1 because there will be an element of fixed costs that</p> <p>2 a bank is looking to cover itself for in an arrangement</p> <p>3 fee.</p> <p>4 The process of turning that into an APR really</p> <p>5 involves simply saying this is the period of the loan</p> <p>6 and we are therefore going to amortise it even though it</p> <p>7 may all have been incurred, as far as the lender is</p> <p>8 concerned, up front at the point the transaction is</p> <p>9 entered into. We would say from that respect that</p> <p>10 turning something into an APR is really a mathematical</p> <p>11 or computational exercise, it tells one nothing about</p> <p>12 the inherent nature of that which one is turning into</p> <p>13 an APR. For that reason we would say the position on</p> <p>14 costs associated with equity are no different from those</p> <p>15 associated with debt.</p> <p>16 In each case, once one has calculated those costs or</p> <p>17 come up with a good faith and rational determination of</p> <p>18 them, and one knows the period of time, one can amortise</p> <p>19 and, as with, you know, costs associated with obtaining</p> <p>20 borrowing, the fact that those costs themselves are not</p> <p>21 premised upon, you know, an hourly or daily rate does</p> <p>22 not present any difficulty in presenting them in the</p> <p>23 final analysis in the form of a rate.</p> <p>24 MR JUSTICE HILDYARD: Does it make a difference that in that</p> <p>25 case, you at least have the basic commitment, if you</p> <p style="text-align: center;">Page 93</p>	<p>1 concerned.</p> <p>2 MR JUSTICE HILDYARD: Would you say it is too amorphous or</p> <p>3 inaccurate an approach to reduce it to something like</p> <p>4 this: that the draftsman had in mind a transaction which</p> <p>5 naturally put you in mind of a rate, rather than one</p> <p>6 which had to be equivalated by proxy or mimicry,</p> <p>7 whatever you might call it, to achieve an equivalent?</p> <p>8 MR FOXTON: My Lord, the expression "mimic a rate" is one</p> <p>9 that resonated with us when Mr Zacaroli put it forward,</p> <p>10 I suspect for rather different reasons than it appealed</p> <p>11 to him. The truth is that one very often finds</p> <p>12 financial instruments which, I think, synthesise rather</p> <p>13 than mimic the economic effects of other financial</p> <p>14 instruments taking a different legal form. We would say</p> <p>15 from the perspective of the user of this form, their</p> <p>16 concern and interest would be with that issue of</p> <p>17 economic substance and not with the question of legal</p> <p>18 form.</p> <p>19 My Lord has no evidence to know whether, if I say to</p> <p>20 someone cumulative fixed preference equity, they</p> <p>21 naturally think of a rate. I would put my own money on</p> <p>22 the fact that they would do so, but it is quite</p> <p>23 a difficult test to apply. It keeps bringing us back to</p> <p>24 our starting point which is these are all distinctions</p> <p>25 which one only needs to get into if one is undertaking</p> <p style="text-align: center;">Page 95</p>
<p>1 like, being a rate, with add ons of various kinds,</p> <p>2 whereas with the preference share, to take that example,</p> <p>3 there is nothing that immediately looks like a rate, it</p> <p>4 is all a matter of computation.</p> <p>5 MR FOXTON: My Lord, I think that raises, I suppose, two</p> <p>6 problems. One of which is this: if what is said is,</p> <p>7 well, you must have some core element of cost that takes</p> <p>8 the form of a rate but if you have that you can add on</p> <p>9 other forms of costs that don't take the form of a rate,</p> <p>10 that becomes sort of quite a diffuse and uncertain</p> <p>11 notion and in any event insofar as the preferred equity</p> <p>12 is concerned, we would say you do have a core cost that</p> <p>13 takes the form of a rate being a coupon that is required</p> <p>14 to be paid. There are objections based upon</p> <p>15 conditionality and discretion, which I will come back to</p> <p>16 later on in the analysis, but if what is said, and</p> <p>17 I have to say, we would say, my Lord, it would be quite</p> <p>18 a simplistic approach, to get this to work you have to</p> <p>19 have something which in its original formulation is</p> <p>20 a percentage. If you have that you can have a whole lot</p> <p>21 of tag along add ons which do not take the form of</p> <p>22 a percentage. We would very much say that would be the</p> <p>23 wrong approach, but if it is the right approach we would</p> <p>24 say nonetheless it is one we are able to satisfy insofar</p> <p>25 as the Berkshire Hathaway preference equity is</p> <p style="text-align: center;">Page 94</p>	<p>1 the process of trying to delineate within the expression</p> <p>2 of costs of funding some forms of funding and not</p> <p>3 others.</p> <p>4 My Lord, if there is that line, we would say that</p> <p>5 the fixed coupon preference equity falls on the</p> <p>6 "naturally makes you think of a rate" side of the</p> <p>7 divide.</p> <p>8 My Lord, the other point made was that the</p> <p>9 definition naturally brings to mind something that is to</p> <p>10 be repaid at the end of the period. My Lord, true it is</p> <p>11 that the default rate is only payable for the period</p> <p>12 when the relevant amount is outstanding but what brings</p> <p>13 it to an end is the payment of the relevant amount, the</p> <p>14 ISDA master agreement and the default rate definition,</p> <p>15 we would say, are not remotely concerned with looking</p> <p>16 for some activity in the underlying funding transaction</p> <p>17 to signal when the moment when you are paid your cost of</p> <p>18 funding comes to an end. It is much less sophisticated</p> <p>19 and much more obvious than that; it comes to an end when</p> <p>20 the relevant amount is paid. There is no feed for the</p> <p>21 draftsman to concern himself or herself at all with the</p> <p>22 issue of when the underlying funding is paid back or</p> <p>23 whether it is ever paid back, the funding will simply</p> <p>24 come to an end when the relevant amount is paid.</p> <p>25 My Lord, again, if it is relevant, if it is</p> <p style="text-align: center;">Page 96</p>



<p>1 intrinsic to a cost of funding that there must be some</p> <p>2 facility within it for it to be redeemed, we would say</p> <p>3 that that is a very frequent characteristic of</p> <p>4 preference shares in the Berkshire Hathaway ones,</p> <p>5 Goldman Sachs itself had the right to redeem them. One</p> <p>6 can have preference shares with an obligation to redeem</p> <p>7 or a time period after which they must be redeemed, so</p> <p>8 none of this we would submit helps on the more</p> <p>9 fundamental question my Lord has been asked to answer at</p> <p>10 least in this hearing, which is: is there some useable,</p> <p>11 workable means of distinguishing between debt type and</p> <p>12 equity type transactions that makes sense and is somehow</p> <p>13 implicit within the cost of funding language used in the</p> <p>14 master agreement?</p> <p>15 My Lord, that brings us in some ways to</p> <p>16 Mr Zacaroli's two core features, and I have anticipated</p> <p>17 some of these submissions.</p> <p>18 My Lord, we have dealt with the inherently repayable</p> <p>19 core feature. It is not true of some forms of debt,</p> <p>20 perpetual debt for example, and it is true of some forms</p> <p>21 of borrowing where there is either an option to redeem</p> <p>22 on the part of the company that issues the preference</p> <p>23 shares or in some cases there can be an obligation to do</p> <p>24 so.</p> <p>25 The second core feature I think was that the cost of</p> <p style="text-align: center;">Page 97</p>	<p>1 the issue as a matter of substance, one is fairly close</p> <p>2 we would say to the sort of debitum in praesenti</p> <p>3 solvendum in futuro concept there. The holder of the</p> <p>4 preference shares is accumulating a conditional</p> <p>5 entitlement which does not go away, but absent the</p> <p>6 directors exercising a discretion, it is not payable at</p> <p>7 that point in time. There may well be consequences to</p> <p>8 a company that does not declare a dividend, as far as</p> <p>9 its preference shareholders are concerned, we have seen</p> <p>10 I think with the Goldman Sachs ones that you couldn't</p> <p>11 pay dividends to anyone else, you could not redeem</p> <p>12 stock. If you did it for a sufficient period, people --</p> <p>13 there was a right to appoint directors to the board and</p> <p>14 matters of that nature.</p> <p>15 There is, you know, very considerable commercial</p> <p>16 consequence to not paying a dividend.</p> <p>17 If one looks at debt, there are species of debt in</p> <p>18 which the borrower is able to postpone the point of</p> <p>19 payment of principal through the exercise of an option</p> <p>20 or through rolling up or by way of options to extend the</p> <p>21 term of a loan. Whilst formally one can draw</p> <p>22 a distinction perhaps at the level of what we would</p> <p>23 submit would be a fairly legal technical analysis, if</p> <p>24 one looks at it from the perspective of economic</p> <p>25 substance, the parallels between the entitlement of the</p> <p style="text-align: center;">Page 99</p>
<p>1 funding must be related to the time for which it is</p> <p>2 used. I think we have fully anticipated that submission</p> <p>3 to some extent as well. That is not true of any of the</p> <p>4 fees which Mr Zacaroli accepts, at least insofar as they</p> <p>5 are payable to the lender, are in. In any event, the</p> <p>6 fixed coupon on preferred equity is an amount which is</p> <p>7 linked to a period of time, invariably expressed as</p> <p>8 a percentage per annum.</p> <p>9 I might even pray in aid my own error, my Lord, it</p> <p>10 has been suggested I may have said "debt" when I meant</p> <p>11 "equity", which illustrates the dangers of confusing the</p> <p>12 two. I think what I was saying is in term of some forms</p> <p>13 of equity, there is either an option on the part of the</p> <p>14 company to redeem or in some cases there can be</p> <p>15 an obligation to do so. The inherently repayable core</p> <p>16 test, we say, doesn't draw the distinction which</p> <p>17 Mr Zacaroli needs it to draw.</p> <p>18 My Lord, as far as the discretionary nature of the</p> <p>19 payment is concerned, I accept that under English and</p> <p>20 American preference shares, at least, the directors have</p> <p>21 to exercise their discretion to render the dividend</p> <p>22 payable. Albeit as your Lordship has seen, and knows</p> <p>23 from elsewhere, with the cumulative preference share,</p> <p>24 payable or not, the right accumulates and remains to be</p> <p>25 satisfied from future payments. If one is looking at</p> <p style="text-align: center;">Page 98</p>	<p>1 preference shares to their 10 per cent coupon and the</p> <p>2 holder of subordinated debts entitlement to payment of</p> <p>3 principal and interest, we say they really are very</p> <p>4 close indeed.</p> <p>5 My Lord one of the benefits of not being burdened</p> <p>6 with expert evidence in this case is that it is not</p> <p>7 necessary for the court to range through the numerous</p> <p>8 types of financial instrument that are out there and</p> <p>9 which the ingeniousness of market practitioners in</p> <p>10 corporate finance are able to devise. One downside of</p> <p>11 that is it is difficult to know whether distinctions</p> <p>12 your Lordship is being asked to draw are going to</p> <p>13 actually work, given the realities of how the market</p> <p>14 operates.</p> <p>15 There are forms of debt called participation debt,</p> <p>16 which we are understand from our own researches, but</p> <p>17 this is not in evidence before the court, are very</p> <p>18 popular for example in Germany, practised as an</p> <p>19 alternative to a preference share approach, where there</p> <p>20 is a coupon payable under the debt, but there is also</p> <p>21 amount payable by reference to the profits of the</p> <p>22 borrowing enterprise.</p> <p>23 Whether in wide use or not probably does not matter,</p> <p>24 because simply as lawyers contemplating the prospect, we</p> <p>25 can see that one can have debt instruments in which the</p> <p style="text-align: center;">Page 100</p>

25 (Pages 97 to 100)

<p>1 coupon payable may itself be influenced by the</p> <p>2 profitability of the borrower.</p> <p>3 Certainly one has examples in which the rate</p> <p>4 applicable to the loan may vary depending upon a whole</p> <p>5 series of things, the value of collateral held from time</p> <p>6 to time, the degree of leverage on the part of the</p> <p>7 borrower and so forth and move around fairly</p> <p>8 significantly.</p> <p>9 If participation in profit is said to be the key to</p> <p>10 distinguishing between debt and equity, we sort of pose</p> <p>11 the hypothetical question, where would a loan which</p> <p>12 included an element of remuneration linked to</p> <p>13 profitability come? To some extent, we would say that</p> <p>14 if that was not a capped amount but simply gave the</p> <p>15 lender an unlimited additional upside dependent upon the</p> <p>16 level of profitability of the borrower, that might be</p> <p>17 rather further away from usual debt than a preference</p> <p>18 share with a fixed percentage coupon.</p> <p>19 My Lord, it is very difficult we say to start trying</p> <p>20 to draw the divides which your Lordship is being asked</p> <p>21 to draw. I am conscious we are in the business of</p> <p>22 making it difficult for your Lordship in that respect,</p> <p>23 but we do say we submit for good reason, which is that</p> <p>24 one has to remember one is doing all this not because</p> <p>25 one is struggling with wording that the parties face and</p> <p style="text-align: center;">Page 101</p>	<p>1 MR FOXTON: My Lord, it is a very difficult hypothesis to</p> <p>2 test without expert evidence.</p> <p>3 MR JUSTICE HILDYARD: I don't think it is a hypothesis I can</p> <p>4 proceed on, is it? I just have to look at the words in</p> <p>5 the context that they are and determine what their best</p> <p>6 available meaning is. I can't measure it according to</p> <p>7 people's surprise, can I?</p> <p>8 MR FOXTON: My Lord, there is no metric there but I would</p> <p>9 submit what your Lordship is entitled to say is that if</p> <p>10 distinctions are to be drawn in an agreement that is</p> <p>11 a commercial agreement, then ordinarily one would expect</p> <p>12 that those distinctions that are being drawn would</p> <p>13 reflect matters of substance to the users rather than,</p> <p>14 in a sense, matters of legal form that could lead to two</p> <p>15 commercially substantially identical transactions being</p> <p>16 treated differently.</p> <p>17 MR JUSTICE HILDYARD: In an age of synthetic instruments, it</p> <p>18 is true that the synthetic instruments may so closely</p> <p>19 mimic the actual genus that the draftsman had in mind</p> <p>20 that the commercial men may indicate some surprise that</p> <p>21 the law should draw a distinction. Maybe they will</p> <p>22 maybe they won't, but what is the relevance?</p> <p>23 MR FOXTON: I accept your Lordship is not concerned with</p> <p>24 a surprise barometer, and perhaps that was not the right</p> <p>25 way to put it. I would submit it should give your</p> <p style="text-align: center;">Page 103</p>
<p>1 the court has had imposed on it, saying distinguish</p> <p>2 between debt and equity. One is doing it based on</p> <p>3 an allegation that this is somehow implicit and unstated</p> <p>4 in the clause. When the implicit limitations cause</p> <p>5 quite as much difficulty as these do, we say that is</p> <p>6 a very strong sign that they are not there, and that the</p> <p>7 court is being asked to head down the wrong road in</p> <p>8 embracing them.</p> <p>9 We made the point in opening that there is no</p> <p>10 necessary link between the funding transaction and</p> <p>11 English or New York law. We do submit it would be very</p> <p>12 unsatisfactory if instruments that, from a commercial</p> <p>13 purpose, were essentially similar in structure and in</p> <p>14 outcome were treated as falling on opposite sides of</p> <p>15 whatever divide your Lordship is being asked to draw.</p> <p>16 That is something that would have come as a great</p> <p>17 surprise to users of the ISDA master agreement and to</p> <p>18 those responsible for drafting it.</p> <p>19 My Lord, there are some points that have been raised</p> <p>20 in the course of argument before your Lordship which may</p> <p>21 have been --</p> <p>22 MR JUSTICE HILDYARD: On what footing do you really say</p> <p>23 that? I mean, "That is something that would have come</p> <p>24 as a great surprise to users of the ISDA master</p> <p>25 agreement", am I to take account of that?</p> <p style="text-align: center;">Page 102</p>	<p>1 Lordship pause for thought if instruments which served</p> <p>2 the same commercial purpose and which in their economic</p> <p>3 effects are the same fall to be treated differently for</p> <p>4 the purpose of this clause.</p> <p>5 I think your Lordship is entitled to ask: is this</p> <p>6 a distinction that a draftsman or the users of the form</p> <p>7 would have had in mind, would have believed was intended</p> <p>8 by that broad cost of funding language?</p> <p>9 My Lord, I accept that your Lordship cannot measure</p> <p>10 in abstract --</p> <p>11 MR JUSTICE HILDYARD: I just think it is dangerous to think</p> <p>12 what might be the general view or what might be the</p> <p>13 level of surprise if for some reason the court were not</p> <p>14 to fall in with that asserted general view. I just</p> <p>15 think it complicates matters a little bit and possibly</p> <p>16 it sets me on a course which is not really appropriate.</p> <p>17 You have clarified it, thank you.</p> <p>18 MR FOXTON: My Lord, I am grateful.</p> <p>19 My Lord there were two points which we have been</p> <p>20 discussing which may have been subsumed within the debt</p> <p>21 versus equity argument, but in fact raise freestanding</p> <p>22 issues that arise on both. I just wanted to bring that</p> <p>23 out.</p> <p>24 We have the argument: do fees paid to third parties</p> <p>25 rather than the funds provider fall within the</p> <p style="text-align: center;">Page 104</p>

<p>1 definition of costs of funding? Mr Zacaroli says they 2 don't, because they are paid for a wholly separate 3 service.</p> <p>4 My Lord, we say he is wrong about that because this 5 was not a service that the funding party had any desire 6 to acquire in its own right as some sort of freestanding 7 benefit, it is something that had to be done to get the 8 funding away, but if we are wrong about that, then what 9 that means is that the funding parties' legal costs for 10 example are not recoverable as part of the cost of 11 funding, whether that is the cost of arranging 12 a syndicated loan or the cost of issuing preference 13 shares, it is not an issue that arises only on one side 14 of that divide.</p> <p>15 My Lord, the other example we say fits into the same 16 category is when the requirement to fund this gap in the 17 balance sheet has impacts on costs of funding other 18 aspects.</p> <p>19 Again, that can happen with debt or equity. It may 20 be that the need to fund the further amount by debt and 21 the knock-on effect on leverage means that existing debt 22 facilities become more expensive because there is 23 a covenant that links the amount payable to, you know, 24 the degree to which the borrower is leveraged or they 25 may increase the cost of equity funding.</p> <p style="text-align: center;">Page 105</p>	<p>1 rate. Your Lordship will recall reference was made to 2 the judgment of think Mr Justice Forbes in Tate and Lyle 3 v GLC and your Lordship mentioned your own decision in 4 Bellis v Challinor, which we were taken to this morning.</p> <p>5 Your Lordship, we submit it is important to note 6 that those are decisions concerned with the 7 discretionary procedural award of interest as part of 8 the law of the English forum. That is a discretion not 9 an entitlement. It falls to be exercised by reference 10 to the general criteria that applied to the exercise of 11 discretions. You may award interest under the statutory 12 provision even if it is not recoverable on the debt as 13 a matter of the lex causae and it is a question which, 14 like other procedural entitlements such as costs, tends 15 to arise at the end of the fact finding process and has 16 always been dealt with in a fairly rough and ready 17 manner. In part we would say because it does form part 18 of the final disposal order made at the end of 19 proceedings.</p> <p>20 We submit, my Lord, that it provides really very 21 little guidance to the questions before your Lordship 22 which are as a matter of substantive entitlement rather 23 than procedural discretion and it is not common law, 24 properly so-called. I accept the phrase has probably 25 been used in a wider sense, but the technical</p> <p style="text-align: center;">Page 107</p>
<p>1 Your Lordship can in a sense answer that as 2 a freestanding question. I will give my answer to that 3 in a moment but it is not, again, a debt versus equity 4 question, it is a freestanding question that arises on 5 either analysis.</p> <p>6 My Lord, our answer to it in each context is that 7 one is not helped by applying the notion of 8 consequential loss and that exclusion from the 9 calculation of loss. One has the cost of funding 10 definition. One could characterise any amount recovered 11 by reason of the late payment of money, as in some sense 12 consequential but no one is suggesting that that leads 13 to it being subject to a knock out blow.</p> <p>14 We say that where the cost of plugging this further 15 gap manifests itself, not simply in whatever you have to 16 pay in respect of that amount but has an impact on what 17 you have to pay in respect of other amounts, that is 18 part of the cost of funding, but if we are wrong about 19 that, once again that does not have any impact on the 20 issue about whether equity funding can fall within the 21 clause, it is a separate freestanding point.</p> <p>22 My Lord, the third topic relied upon was the context 23 of the general English law relating to interest and it 24 was said that that forms part of the factual matrix and 25 illuminates the meaning of the definition of default</p> <p style="text-align: center;">Page 106</p>	<p>1 distinction is also a meaningful distinction because its 2 discretionary procedural character means it is 3 inevitably going to allow a rather more rough and ready 4 and broad brush and short summary approach than would be 5 appropriate when dealing with substantive rights.</p> <p>6 My Lord, as far as common law as factual matrix is 7 concerned, I made the point in my opening submissions 8 that it is not an area where the English common law has 9 been seen at its best, the issue about how you 10 compensate a party for late payment of money.</p> <p>11 My Lord, it might be worth just having a brief look 12 at Semptra Metals, which we have in the authorities 13 bundle 2, tab 37. My Lord, if we go to Lord Nicholls' 14 speech at paragraphs 74 and 75 initially. One sees the 15 traditional English approach described as, "anomalous", 16 "unprincipled" and, in the case of the late Dr Mann, 17 "The common law at its worst". I think Lord Nicholls 18 himself describes it as "not impressive".</p> <p>19 The House of Lords in that case described themselves 20 as, "Erasing the remains of this blot on English common 21 law jurisprudence".</p> <p>22 My Lord, if one asks what the common law is now, we 23 say it is to be found in the passage we cited in our 24 skeleton in paragraph 95 of Lord Nicholls's speech. 25 My Lord, it noted that, you know, loss flowing from late</p> <p style="text-align: center;">Page 108</p>

<p>1 payment may take a number of forms, certainly borrowing</p> <p>2 of money was described as one, loss of investment</p> <p>3 opportunity was described as a second or it was</p> <p>4 recognised the loss might take some other form.</p> <p>5 Certainly as far as common law in 2008 and depending</p> <p>6 upon how far one subscribes to the fiction of discovered</p> <p>7 or made law theory, perhaps earlier on, that link is not</p> <p>8 there. Mr Zacaroli I think when he went to this</p> <p>9 paragraph in our skeleton said, "Well, look here the</p> <p>10 parties have plainly chosen the first". But that, with</p> <p>11 respect, is an assertion of what he seeks to prove. Not</p> <p>12 something that can establish that he is right in</p> <p>13 asserting it.</p> <p>14 If one looks at the position in 1992, or 1996 when</p> <p>15 Goldman Sachs entered into this master agreement, we</p> <p>16 would say the idea they were looking to ape the English</p> <p>17 common law as far as the late payment of money is</p> <p>18 concerned is a very improbable assertion, given quite</p> <p>19 how unsatisfactory and hidebound by historical legacy</p> <p>20 that common law history was.</p> <p>21 My Lord, we would say either what is properly common</p> <p>22 law provides no relevant factual context at all or if it</p> <p>23 does it provides something which it was far more likely</p> <p>24 the parties were looking to draft out of, rather than to</p> <p>25 replicate. (Pause)</p> <p style="text-align: center;">Page 109</p>	<p>1 I know that English law is not the answer here,</p> <p>2 necessarily, but Lord Nicholls would not have turned</p> <p>3 a hair, as it were, if you had said actually what we</p> <p>4 would have done is issued preference shares?</p> <p>5 MR FOXTON: My Lord, yes, it is fair to say I rely on this</p> <p>6 really to neutralise a point. I would submit that the</p> <p>7 assistance the court gets from English common law in any</p> <p>8 of its forms is very limited indeed. I would not want</p> <p>9 your Lordship to think that I was treating this as</p> <p>10 a sort of powerful factor pointing a particular way. We</p> <p>11 say insofar as it is suggested the common law is</p> <p>12 a powerful factor pointing the other way, it certainly</p> <p>13 is not.</p> <p>14 My Lord, there was then Wentworth's argument</p> <p>15 concerning the word "cost", with cost being, I think it</p> <p>16 was said, a price payable under a transaction.</p> <p>17 My Lord, each I think of Wentworth and Goldman Sachs</p> <p>18 have cited their rival dictionary definitions. I can</p> <p>19 give you references to each of them. I have to say, for</p> <p>20 my part, I really question quite how much assistance the</p> <p>21 court will get from dictionary definitions of the word</p> <p>22 "cost". One can postulate the wording being used in</p> <p>23 a number of contexts, many of those would include what</p> <p>24 level of detriment have you suffered in order to do what</p> <p>25 you wanted to do. Some of the dictionary definitions,</p> <p style="text-align: center;">Page 111</p>
<p>1 MR JUSTICE HILDYARD: I mean the statement of principle, as</p> <p>2 I understand it, which ameliorates the old English</p> <p>3 approach is in 94:</p> <p>4 "... to this end if your Lordship is agreed the ...</p> <p>5 that in principle it is always open to a claimant to</p> <p>6 plead and prove his actual interest loss is caused by</p> <p>7 late payment of a debt."</p> <p>8 Is that the bottom line of Sempra, as it were?</p> <p>9 MR FOXTON: My Lord, it would very much depend on what the</p> <p>10 word "interest" meant.</p> <p>11 MR JUSTICE HILDYARD: That is what I was going to ask you.</p> <p>12 MR FOXTON: If one looks at the following paragraph, it</p> <p>13 plainly contemplates that it can mean more than</p> <p>14 "borrowing", because borrowing is identified as one of</p> <p>15 three means of compensating the interest loss.</p> <p>16 I would suggest the interest loss is there being</p> <p>17 used as a shorthand for the loss caused by the late</p> <p>18 payment of money. Plainly the loss of opportunity to</p> <p>19 invest is not an interest loss in the sense of, "My</p> <p>20 complaint is that I didn't receive an interest rate".</p> <p>21 We would say the recognition that it may take some other</p> <p>22 form is similarly not so limited.</p> <p>23 (Pause)</p> <p>24 MR JUSTICE HILDYARD: In any event, 95 you say is broad</p> <p>25 enough to cover, for example, and please understand</p> <p style="text-align: center;">Page 110</p>	<p>1 including those cited by Mr Zacaroli, would embrace</p> <p>2 that. As indeed would some popular uses of the phrase.</p> <p>3 My Lord, we have given references in our reply</p> <p>4 submissions, but I don't think it is a matter that it is</p> <p>5 worth taking your Lordship's time with now.</p> <p>6 If it does mean the amount payable under</p> <p>7 a transaction to a counterparty, then we would say that,</p> <p>8 you know, a preference share issue involves exactly</p> <p>9 that. If we have had to pay dividends, at the coupon</p> <p>10 rate for the purposes of this funding, then when we come</p> <p>11 to certify, we do meet exactly those issues of what has</p> <p>12 had to be paid by way of the price of raising the</p> <p>13 funding and we have paid it under a transaction.</p> <p>14 My Lord, there is a related question of: transaction</p> <p>15 for what? Are we talking about a specific transaction</p> <p>16 to raise exactly the relevant amount subsequently agreed</p> <p>17 or determined to be payable or can a cost of funding</p> <p>18 calculation proceed from the costs of raising a larger</p> <p>19 amount of money, but then through a good faith and</p> <p>20 rational calculation deriving part of that cost that is</p> <p>21 referable to the specific amount, the relevant amount.</p> <p>22 My Lord, no one is suggesting that at that final</p> <p>23 stage you are not concerned with a calculation that</p> <p>24 relates to the relevant amount. That is what you will</p> <p>25 end up certifying. We say that does not prevent you</p> <p style="text-align: center;">Page 112</p>

<p>1 from getting there by saying, well, the funding I have 2 raised or would have raised would have been general 3 purpose funding, because that is how businesses fund 4 themselves, albeit, it is obviously necessary to 5 allocate or prorate a specific portion of that to this 6 specific hole in the balance sheet.</p> <p>7 My Lord, there is nothing in the definition we say 8 that requires that the transaction be for this specific 9 amount, some freestanding transaction. In terms of how 10 entities fund themselves in practice, they are going to 11 fund themselves not on a basis that involves going out 12 into the market, be it the debt market or the equity 13 market, to raise a series of hypothecated specific 14 purpose funding but they are far more likely to have 15 regard to their whole funding need and raise funds 16 accordingly.</p> <p>17 Once again, this is not a debt and equity issue 18 because as one saw for example in the Sal Oppenheim case 19 you may have a party that raises its death funding in 20 a much larger amount than the relevant amount, but then 21 certifies based on the costs of that funding. There is 22 an element of artificiality, if one looks at a position 23 in which for example the party faces a series of 24 defaults by ISDA market counterparties which may or may 25 not be part of the same corporate group. The idea that</p> <p style="text-align: center;">Page 113</p>	<p>1 contemplation of the draftsman dealing with bankruptcy. 2 True it is that in LBIE's administration, 3 Goldman Sachs are proving for a -- I think have 4 a recoverable amount calculated, from recollection of 5 about \$54 million. If one looked at Goldman Sachs 6 exposure across the Lehman empires, one is at a much 7 larger figure. I mean it is certainly over 1 billion, 8 so one cannot really, we would say, have any sort of 9 assumption either as to the inherent likelihood that you 10 will only be raising equity rather than debt funding in 11 circumstances that would fall outside the contemplation 12 of the draftsman or fall outside the possible range of 13 defaults you may get under the ISDA master agreement.</p> <p>14 MR JUSTICE HILDYARD: It is a difficult one in a way, isn't 15 it? Speaking generally, the more it is capable of 16 rationally and good faith being a rate which underwrites 17 the problems of the past and the hopes for the future, 18 the more uncomfortable one feels. You may have long 19 term enormous funding, perfectly rationally undertaken, 20 perfectly good faith and it has been undertaken in the 21 certificate which is then given in respect of it, which 22 is allocatable to the particular relevant amount in that 23 the greater will include the lesser, but actually is 24 a rate which reflects disasters of the past and 25 expectations of the future which are completely apart</p> <p style="text-align: center;">Page 115</p>
<p>1 it should be going out and for each separate master 2 agreement having a separate transaction to raise that 3 amount, as opposed to looking at its overall funding 4 need, raising funds accordingly and then allocating it 5 we would say is an uncommercial argument.</p> <p>6 I think allied to this point I think was the 7 suggestion that you would naturally associate or more 8 naturally associate equity funding with raising of 9 larger amounts than debt funding, although I think it is 10 accepted that you can have debt facilities of a very 11 substantial size.</p> <p>12 My Lord, obviously the ISDA draftsman probably 13 contemplated a very wide range of scenarios in which 14 questions of default and default rate might arise. One 15 of those was the bankruptcy of the counterparty, that is 16 an event of default. Certainly in 1992 that would have 17 included within it the possible bankruptcy of financial 18 institutions, because they have always been significant 19 ISDA players and one suspects at the time of the 1992 20 master, would have been a very significant body of ISDA 21 users.</p> <p>22 Even if one does have to test it, saying: would you 23 have contemplated that there might have been gaps in the 24 balance sheet of a very substantial size? That 25 certainly would not have been outside, we say, the</p> <p style="text-align: center;">Page 114</p>	<p>1 from the transaction giving rise to the right to claim. 2 One feels so uncomfortable with that.</p> <p>3 MR FOXTON: My Lord, it is an interesting question. If one 4 looks at the position of a party who, first of all, who 5 actually goes out in the market to borrow 6 specifically -- I regard this as a very artificial and 7 uncommercial example -- this amount, what the market 8 will charge that to borrow will undoubtedly reflect the 9 past in terms of, you know, the market to date, how the 10 company is --</p> <p>11 MR JUSTICE HILDYARD: The confined past, relevant to the 12 actual problem.</p> <p>13 MR FOXTON: It will reflect, my Lord, the future in the 14 sense of the market's expectations of how this company 15 will perform and the risk of repaying.</p> <p>16 MR JUSTICE HILDYARD: Ability to repay et cetera.</p> <p>17 MR FOXTON: If one does not go out into the market because 18 one is drawing on a facility that has been entered into 19 in advance, and a general purpose facility, that will 20 have reflected market conditions and perceptions at the 21 time it was concluded. It will, in your Lordship's 22 phrase, have no obvious connection as to its terms with 23 this specific default now, because it was anterior to it 24 in time. We would suggest to your Lordship that there 25 could be nothing wrong in a party certifying its cost of</p> <p style="text-align: center;">Page 116</p>

<p>1 funding by reference to the cost of drawing on that</p> <p>2 facility.</p> <p>3 My Lord, if that is right, if the terms of the</p> <p>4 facility can actually be so separate from the default</p> <p>5 because they precede it in time, we would submit that</p> <p>6 there is no problem with factors dictating what the cost</p> <p>7 of funding is, that are not, you know, wholly the result</p> <p>8 of the particular default.</p> <p>9 MR JUSTICE HILDYARD: I accept that every lender will</p> <p>10 measure the borrower and the measurement will take into</p> <p>11 account the future ability to repay and the past in</p> <p>12 terms of the problems which that may suggest about the</p> <p>13 future. You are admitting the possibility of the</p> <p>14 particular clause enabling what I might call the</p> <p>15 underwriting of a much greater gap and an altogether</p> <p>16 more energetic or widespread formula for plugging it.</p> <p>17 MR FOXTON: My Lord, in terms of the quantification, I don't</p> <p>18 accept that the results will necessarily be that</p> <p>19 different, it will all depend upon what it would cost</p> <p>20 the party to borrow, if it can borrow, and what it will</p> <p>21 cost it to raise equity.</p> <p>22 We do submit that, at a conceptual level, there is</p> <p>23 no meaningful distinction between a party that goes</p> <p>24 along and says:</p> <p>25 "Lehmans has gone down in the market, there is now</p> <p style="text-align: center;">Page 117</p>	<p>1 In any event, as we have made clear in witness</p> <p>2 evidence -- which I can give your Lordship the reference</p> <p>3 for if necessary -- there was no expectation of</p> <p>4 a surplus at the early stage of this process and</p> <p>5 therefore it was not felt necessary or appropriate to</p> <p>6 have to investigate this issue at any great length, plus</p> <p>7 such filings as were made were made subject to express</p> <p>8 reservations of rights to change the position, including</p> <p>9 as to interest.</p> <p>10 My Lord, we would submit that that is a completely</p> <p>11 irrelevant diversion which is of no assistance to your</p> <p>12 Lordship at all.</p> <p>13 MR JUSTICE HILDYARD: It might be right, but the instinctive</p> <p>14 reaction of commercial men to a given instrument, which</p> <p>15 may be demonstrated by that and there probably is</p> <p>16 some factual basis for thinking it is, but it could be</p> <p>17 relevant. Couldn't it?</p> <p>18 MR FOXTON: My Lord, the difficulty with that argument is</p> <p>19 that the level of thought that any point may be given</p> <p>20 will naturally reflect the view of the parties as to</p> <p>21 whether this is frankly ever going to arise as a matter</p> <p>22 of reality or not. We would say the position a number</p> <p>23 of years ago now was one in which there was no reason to</p> <p>24 sort of reach any form of considered view on this point.</p> <p>25 I think that Mr Dicker is going to address this</p> <p style="text-align: center;">Page 119</p>
<p>1 some huge crisis of confidence, people don't want to</p> <p>2 lend money at all, there they are very worried about the</p> <p>3 banking industry and whether it will surprise and those</p> <p>4 that are prepared to lend will only lend at a very high</p> <p>5 rate of interest to reflect that risk. And I have had</p> <p>6 to raise the funds in those conditions and therefore</p> <p>7 that is the cost of funding I claim."</p> <p>8 And the party where the result of those market</p> <p>9 conditions is that it is either rational or required to</p> <p>10 raise that funding not by way of debt at all but by way</p> <p>11 of equity. We would submit that those are, to all</p> <p>12 material purposes, the same problem and the solution in</p> <p>13 one is equally as acceptable as the solution in the</p> <p>14 other.</p> <p>15 My Lord, Mr Zacaroli referred to the fact that</p> <p>16 various rates filed in administrations by other parties</p> <p>17 or by my clients at an earlier stage had involved</p> <p>18 borrowing rates.</p> <p>19 I think the matter was not pursued with huge</p> <p>20 enthusiasm and it was accepted it was not relevant to</p> <p>21 construction as such. I think one can delete the words</p> <p>22 "as such."</p> <p>23 Plainly this agreement has the meaning it has no</p> <p>24 later than when the parties contract by reference to it.</p> <p>25 Whatever happens afterwards cannot change that meaning</p> <p style="text-align: center;">Page 118</p>	<p>1 question to some extent, but I think there is not</p> <p>2 unanimity of how people went about responding to this.</p> <p>3 But to attach significance to the construction of the</p> <p>4 agreement to steps taken that took place in a context in</p> <p>5 which there was no commercial expectation any of this</p> <p>6 would matter, and even then were done recognising that</p> <p>7 what had been given was not in any sense a definitive</p> <p>8 response, we would say does not take the court, really,</p> <p>9 very far at all.</p> <p>10 MR JUSTICE HILDYARD: It is a bit like the progress one,</p> <p>11 I remember having, as it were, and still in interpreting</p> <p>12 a difficult set of words, which is you have your first</p> <p>13 and instinctive reaction as to what they mean. You then</p> <p>14 pore over them and get more and more detailed in your</p> <p>15 approach. It is worthwhile then going back to your</p> <p>16 instinctive approach. In a sense, this is just another</p> <p>17 example of that, isn't it, even if more ad hominem,</p> <p>18 possibly?</p> <p>19 MR FOXTON: It presupposes that they actually had the clause</p> <p>20 and its wording in mind when they --</p> <p>21 MR JUSTICE HILDYARD: Yes, it does. That they directed</p> <p>22 their mind to it, exactly. Yes.</p> <p>23 MR FOXTON: My Lord, I think the point was made on</p> <p>24 consequential loss and the fact that the distinction</p> <p>25 between consequential and non-consequential loss is more</p> <p style="text-align: center;">Page 120</p>

<p>1 difficult to draw, it is said, if the cost of funding is</p> <p>2 not confined to a pure borrowing rate.</p> <p>3 My Lord, I think I have anticipated that submission</p> <p>4 to some extent in advance, that the same issue of, does</p> <p>5 my having to fund this amount increase my cost of</p> <p>6 funding other amounts is a matter that is capable of</p> <p>7 arising both as to raising funds by way of debt and</p> <p>8 raising funds by way of equity. Your Lordship may have</p> <p>9 to resolve that, as it were, as a freestanding issue of</p> <p>10 significance, but it is not a matter that tells you that</p> <p>11 debt is in and equity is out.</p> <p>12 MR JUSTICE HILDYARD: No, but one complication of equity</p> <p>13 funding, which you have all acknowledged, is that unlike</p> <p>14 debt, which is usually just a minus on your balance</p> <p>15 sheet, as it were, equity may serve a plus point, in</p> <p>16 terms of your gearing or your satisfaction of regulatory</p> <p>17 requirement or a number of other measures of your</p> <p>18 strength, which is very difficult to measure. You say,</p> <p>19 I suppose, "Difficult to measure but not impossible and</p> <p>20 it comes out in the wash of the certificate"?</p> <p>21 MR FOXTON: My Lord, we are not suggesting that the cost of</p> <p>22 funding somehow seeks to measure those benefits.</p> <p>23 MR JUSTICE HILDYARD: It has to, hasn't it, otherwise it is</p> <p>24 a false figure. If, and you say that the draftsman</p> <p>25 perfectly satisfactorily intended that there might be</p> <p style="text-align: center;">Page 121</p>	<p>1 your clients say it didn't, but one could imagine that</p> <p>2 it would considerably prove the shape of the balance</p> <p>3 sheet for which value should be given, otherwise the</p> <p>4 charge of the equity funding is only charging the</p> <p>5 downside and not giving proper account or credit for the</p> <p>6 upside.</p> <p>7 MR FOXTON: My Lord, to the extent to which it is referable</p> <p>8 to the relevant amount and at the end of your</p> <p>9 calculation process, that is where you are going to be,</p> <p>10 it leaves you in the same position as you would have</p> <p>11 been in insofar as equity had been concerned if the</p> <p>12 relevant amount had been paid when it should have been</p> <p>13 paid. We would say that there is no sort of other</p> <p>14 benefit that falls to be brought into the mix.</p> <p>15 In terms of market sentiment, if that is the issue,</p> <p>16 one can see that obtaining a large borrowing facility</p> <p>17 may increase market confidence in an entity's ability to</p> <p>18 ride out the storm. The final point of the calculation</p> <p>19 on borrowing is to plug the gap of the relevant amount</p> <p>20 that otherwise would not have had to have been borrowed.</p> <p>21 Therefore the sort of sentiment benefits are simply</p> <p>22 irrelevant and extraneous to the exercise being</p> <p>23 undertaken.</p> <p>24 MR JUSTICE HILDYARD: I don't think it is only sentiment,</p> <p>25 but I understand your point. I don't think it is only</p> <p style="text-align: center;">Page 123</p>
<p>1 a huge great equity raising in order to plug the gap</p> <p>2 that has emerged in respect of this transaction and the</p> <p>3 gaps which have generally been exposed and then you</p> <p>4 allocate proper proportion and everything is fine. In</p> <p>5 the meantime, you will have, assuming the equity raising</p> <p>6 to be successful, put an enormous plus point on your</p> <p>7 balance sheet, which reduces the equity debt ratio and</p> <p>8 satisfies the regulator. That must be measured, mustn't</p> <p>9 it?</p> <p>10 MR FOXTON: My Lord, if you were paid the relevant amount</p> <p>11 that flows straight through to equity, you know, the</p> <p>12 situation that one looks at what the default has done,</p> <p>13 it has reduced your equity, you have a sum that would</p> <p>14 have been sitting there in an account which is no longer</p> <p>15 there. What the certified cost of equity is doing is in</p> <p>16 fact replacing that --</p> <p>17 MR JUSTICE HILDYARD: To that extent?</p> <p>18 MR FOXTON: To that extent.</p> <p>19 MR JUSTICE HILDYARD: Yes.</p> <p>20 MR FOXTON: And the process of certification of that cost is</p> <p>21 certifying the cost of replacing it to that extent.</p> <p>22 MR JUSTICE HILDYARD: You see, when your clients placed</p> <p>23 quite considerable numbers of shares and possibly in</p> <p>24 other transactions even more shares with someone like</p> <p>25 Berkshire Hathaway, that considerably improved -- maybe</p> <p style="text-align: center;">Page 122</p>	<p>1 sentiment.</p> <p>2 MR FOXTON: My Lord, I think we would say that if one is</p> <p>3 effectively replacing missing equity, which is what the</p> <p>4 failure to pay the relevant amount involves, that</p> <p>5 theoretical problem of are you somehow ending up in</p> <p>6 a better position falls away.</p> <p>7 My Lord, I have dealt with the issue of fees, I have</p> <p>8 dealt I think with the issue of knock on consequences.</p> <p>9 My Lord, enormous complexities I think was</p> <p>10 Mr Zacaroli's next point.</p> <p>11 My Lord, obviously debt instruments can themselves</p> <p>12 involve enormous complexities because there can be</p> <p>13 a whole series of factors that drive the rate payable.</p> <p>14 We saw that you can get rates which fall to be adjusted</p> <p>15 to achieve a specified internal rate of return for the</p> <p>16 lender. You may have interest rates linked to the</p> <p>17 leverage or profitability of the borrower, so complexity</p> <p>18 is there in most forms of corporate finance transaction</p> <p>19 in varying degrees.</p> <p>20 Compared with that, we would suggest the 10 per cent</p> <p>21 per annum fixed coupon cumulative dividend of the</p> <p>22 preference shares would come at the lower end of the</p> <p>23 scale, as far as degree of complexity is concerned.</p> <p>24 Obviously complexity in prospective certification is</p> <p>25 inherently greater than in certifying at the end of the</p> <p style="text-align: center;">Page 124</p>

<p>1 process. I think one point that Mr Zacaroli made when</p> <p>2 looking at the use of models in loss is the reason you</p> <p>3 need that is what loss is doing is compensating you for</p> <p>4 the loss of expected future benefits that would flow</p> <p>5 from a particular provision. Plainly, if you close out</p> <p>6 a 20-year swap, the process of prospectively determining</p> <p>7 what that benefit of that position would have been would</p> <p>8 be a complex one involving all sorts of assumptions as</p> <p>9 to yield and movement of rates and so forth.</p> <p>10 If on the other hand one is certifying at the end of</p> <p>11 the process, at the end of the period when the relevant</p> <p>12 amount has been paid, it is much easier to certify the</p> <p>13 cost of borrowing than it would be prospectively looking</p> <p>14 at a floating rate that might move day by day in</p> <p>15 advance, and similarly as far as cost of equity is</p> <p>16 concerned, you will know what you have had to pay during</p> <p>17 that period in respect of the equity funding and no</p> <p>18 complexity arises.</p> <p>19 My Lord, on the complexity point, we say first of</p> <p>20 all it arises in both and secondly the real driver of</p> <p>21 complexity of analysis is prospective versus</p> <p>22 retrospective certification, rather than anything</p> <p>23 inherent in the form of funding.</p> <p>24 My Lord, we do say this -- this the last point on</p> <p>25 this topic -- the real complexity that will be</p> <p style="text-align: center;">Page 125</p>	<p>1 MR JUSTICE HILDYARD: Let's break then.</p> <p>2 (3.17 pm)</p> <p>3 (A short adjournment)</p> <p>4 (3.24 pm)</p> <p>5 MR FOXTON: My Lord, I was going to move to the issue of the</p> <p>6 interrelationship of the default rate and the loss</p> <p>7 provision with the cost of funding language in each.</p> <p>8 My Lord will recall, we rely upon the same wording</p> <p>9 appearing in both, in part because of the approach which</p> <p>10 has been adopted by Judge Chapman and others to the</p> <p>11 architecture of the loss provision, if I may so term it,</p> <p>12 namely you are not looking to exclude things on</p> <p>13 an a priori construction basis and you are achieving</p> <p>14 certainty and predictability through the rationality</p> <p>15 good faith notification requirement.</p> <p>16 Your Lordship will recall that digging a little</p> <p>17 further into that, we made the point that on the 1992</p> <p>18 form and the loss measure, with unpaid amounts that are</p> <p>19 as it were already owing at the time of the closeout,</p> <p>20 your calculation of the costs of funding straddles the</p> <p>21 loss provision up to one point in time when you produce</p> <p>22 your figure and then will move into the default rate or</p> <p>23 provision thereafter.</p> <p>24 My Lord, the response to that has been varied, it is</p> <p>25 fair to say. I think for Wentworth, I think the</p> <p style="text-align: center;">Page 127</p>
<p>1 introduced into this exercise will be if the user of the</p> <p>2 form is required to apply, I don't know whether it is</p> <p>3 an eight-point test or depending on how many of the JA's</p> <p>4 questions one ends up having to answer, to determine</p> <p>5 what form of funding is in and what form of funding is</p> <p>6 out.</p> <p>7 That is susceptible to very real complexity,</p> <p>8 particularly given the constant development that one</p> <p>9 sees in the market in terms of financial instruments.</p> <p>10 I think Wentworth's answer to that is to say you are</p> <p>11 always going to get problems at the edges. My Lord,</p> <p>12 that is perhaps a necessary evil, if the concept that</p> <p>13 you are having to determine the edges of is one that has</p> <p>14 been forced on your attentions by the draftsman. We</p> <p>15 would say that it is not one that should be voluntarily</p> <p>16 undertaken by reading a limitation within the words</p> <p>17 "Cost of funding" that does not find express reference</p> <p>18 on the face of the phrase used.</p> <p>19 My Lord, I am conscious we started a little after</p> <p>20 2.00, I am entirely in your Lordship's hands as to</p> <p>21 whether this would be a convenient point to break or</p> <p>22 not.</p> <p>23 MR JUSTICE HILDYARD: Does it fit well with you? I think</p> <p>24 you said it was the last in this series of points.</p> <p>25 MR FOXTON: I am moving to a separate topic.</p> <p style="text-align: center;">Page 126</p>	<p>1 pre-lunch position on Wednesday was that the expression</p> <p>2 "Cost of funding" had a different meaning within the</p> <p>3 loss definition to that which very, very similar</p> <p>4 language had in the default rate provision.</p> <p>5 My Lord, we would say that that really cannot be</p> <p>6 right. The grounds upon which it is based, I think it</p> <p>7 is said, "Well, context is everything and, in the</p> <p>8 default rate, you are talking about the cost of funding</p> <p>9 the relevant amount".</p> <p>10 My Lord, with cost of funding, it is always the cost</p> <p>11 of funding something. There is always, implicitly at</p> <p>12 least, going to be the words "of X" added at the end of</p> <p>13 "cost of funding" because it is not an expression that</p> <p>14 has a meaning whereby you can arrive at it at large, but</p> <p>15 only by reference to the cost of funding a particular</p> <p>16 thing.</p> <p>17 My Lord, we say that that doesn't work.</p> <p>18 I think the refined version of the submission from</p> <p>19 Wentworth was this: insofar as "cost of funding" in the</p> <p>20 loss definition is doing the same job as "cost of</p> <p>21 funding" in the default rate, namely it is the cost of</p> <p>22 funding a sum of money, it has the same meaning but that</p> <p>23 it may be that it has other meanings as well within the</p> <p>24 loss definition when being used for other purposes.</p> <p>25 I hope I have not mis-summarised or garbled that</p> <p style="text-align: center;">Page 128</p>



<p>1 submission. If I have, apologies. That was my 2 understanding of the distinction.</p> <p>3 My Lord, we say that that is all a little unreal, 4 you have a phrase, it has a range of potential meanings 5 in the loss definition. If those meanings are a wide 6 range of potential meanings or a wider range of 7 potential meanings, the use of that very similar 8 language in the default rate provision cannot sensibly 9 have been intended to have a much narrower and more 10 restricted range of meaning.</p> <p>11 I think as far as the joint administrator is 12 concerned, I think Mr Trower's submission was that it 13 also must be read down as meaning "borrowing" in the 14 loss definition.</p> <p>15 My Lord, what one can say is this, the appearance of 16 those words in the loss definition, where they are 17 intended to illuminate without constraint, a wider hole, 18 they are something that is included, are a very 19 unpromising context in which to seek to read down that 20 language.</p> <p>21 We don't suggest, of course, that within the loss 22 definition the words "Cost of funding" are not capable 23 of covering borrowing, but we do say that they are not 24 limited to costs of funding by way of borrowing.</p> <p>25 Where they appear as part of a very broad provision,</p> <p style="text-align: center;">Page 129</p>	<p>1 the point in time at which you undertake the 2 notification or certification of loss or default rate 3 respectively.</p> <p>4 My Lord, the last point I think raised in relation 5 to loss and default rate as to why it was said that the 6 court could not be informed by the approach on one, when 7 interpreting the other, was it was said there may be 8 a different standard of legal review as far as loss is 9 concerned than as far as the certification under the 10 default rate is concerned.</p> <p>11 My Lord, my understanding of this point is it is 12 an argument run only by reference to the 2002 ISDA 13 master agreement and not the 1992 agreement, and it is 14 accepted that as far as the 1992 is agreement is 15 concerned, we are in straight Socimer whether under loss 16 or default rate.</p> <p>17 MR JUSTICE HILDYARD: I thought it was agreed that the 1992 18 and 2002 agreement, except where they depart on that 19 particular standard of loss, were to be interpreted 20 consistently?</p> <p>21 MR FOXTON: My Lord, personally I have a great deal of 22 difficulty with the idea that the 2002 agreement 23 introduced a different test, but given that I am not 24 party to a 2002 agreement for this purpose I have 25 decided to leave that particular battle to Mr Dicker,</p> <p style="text-align: center;">Page 131</p>
<p>1 as simply something else included within loss, the 2 argument that cost of funding falls to be read down as 3 meaning only borrowing is even more difficult as 4 an exercise in interpretative limitation than when 5 dealing with the essentially similar words in the 6 default rate provision.</p> <p>7 My Lord, the second argument I think made in 8 relation to loss is one I have anticipated already. It 9 was said that:</p> <p>10 "Well, of course you see models used in loss because 11 you are concerned with the present day determination of 12 the lost value of future performance. Therefore for 13 that you will need a model and that is somehow different 14 for the exercise which will go on in the default rate."</p> <p>15 My Lord, I have made my point that that really turns 16 on the prospective versus retrospective certification, 17 even with debt and a floating rate if you are looking in 18 advance to work out what it would cost you to fund 19 an amount by reference to that, you probably would have 20 to use a model, indeed almost certainly because you are 21 going to be trying to work out the day by day movements 22 over potentially a long period of a particular interest 23 rate.</p> <p>24 My Lord, the model issue once again is not in truth 25 a debt versus equity issue. It is simply a question of</p> <p style="text-align: center;">Page 130</p>	<p>1 whose clients are.</p> <p>2 As far as the 1992 agreement is concerned, we 3 have -- I think your Lordship was either taken to it or 4 it was mentioned, the judgment of 5 Mr Justice David Richards -- as I can now say -- as he 6 then was in the Fondazione case, where the Socimer test 7 is applied to certification of loss under the 1992 form. 8 At least as far as the 1992 form is concerned, there can 9 be no suggestion that you have a different test of legal 10 review as between the certificate and the default rate 11 and as between the loss such as to make it appropriate 12 to have a difference of approach in other respects as 13 well.</p> <p>14 MR JUSTICE HILDYARD: This may be a matter which I should 15 more properly address to Mr Dicker in consequence of 16 what you have said, but I should confess that I find the 17 definition of loss not by any means easy to be sure that 18 one has fully understood it.</p> <p>19 Just by way of warning to Mr Dicker and others, even 20 though ultimately it may not solve the riddle in the 21 particular case, I am not sure what the phrase is:</p> <p>22 "In connection with this agreement ... as the case 23 may be, including any loss of bargaining, cost of 24 funding or at the election of such party but without 25 duplication loss or cost incurred as a result of its</p> <p style="text-align: center;">Page 132</p>

<p>1 terminating."</p> <p>2 You can either, is this right -- defer to Mr Dicker</p> <p>3 if you think that more appropriate -- claim in respect</p> <p>4 of loss of bargain or cost of funding or on the on the</p> <p>5 other hand, but without duplication and at your</p> <p>6 election, loss or costs incurred as a result of</p> <p>7 terminating, liquidating et cetera, et cetera, any hedge</p> <p>8 or related trading position?</p> <p>9 You are put to your election as to different forms</p> <p>10 of recovery, or different measures of loss, either by</p> <p>11 reference to your loss of bargain or cost of funding, on</p> <p>12 the one hand, or, on the other hand, what it is going to</p> <p>13 take you either to buy, get out of or renegotiate some</p> <p>14 hedge or related trading position which you have used as</p> <p>15 a hedge or trading position, but you cannot double</p> <p>16 count?</p> <p>17 MR FOXTON: My Lord, certainly when one looks at it, it</p> <p>18 appears to contemplate you can either approach it facing</p> <p>19 the relevant payee or approach the question facing up</p> <p>20 the line, as it were, from where you are. It is not</p> <p>21 a point I have to say which I have had cause to consider</p> <p>22 up to now.</p> <p>23 MR JUSTICE HILDYARD: Others may have, but I am just trying</p> <p>24 to see whether it informs the meaning of cost of funding</p> <p>25 at all. I quite understand -- feel free now or</p> <p style="text-align: center;">Page 133</p>	<p>1 agreement had set about hedging that position.</p> <p>2 Equally, as far as cost of borrowing is concerned,</p> <p>3 it will have no knowledge of what particular facilities</p> <p>4 it has entered into. By contrast, the cost of equity,</p> <p>5 if one looks at the preference shares, certainly in the</p> <p>6 case of an entity like Goldman Sachs, one sees the</p> <p>7 regulatory filings that are produced to disclose all</p> <p>8 this information in the public domain. Cost of equity</p> <p>9 more generally, I am going to imagine that every analyst</p> <p>10 report ever produced on an entity of note tells you what</p> <p>11 its cost of equity is. Whilst your Lordship has only</p> <p>12 the benefit of unsupported assertions by either side,</p> <p>13 I think we would invite your Lordship to be very</p> <p>14 skeptical of the assertion that somehow evidence</p> <p>15 necessary to challenge loss would be more readily</p> <p>16 available to the counterparty than evidence necessary to</p> <p>17 challenge the certification of the cost of funding.</p> <p>18 I don't need to go further and say one is more, you</p> <p>19 know, that the default rate is more readily available,</p> <p>20 we simply say that is an entirely neutral point which</p> <p>21 takes your Lordship nowhere.</p> <p>22 My Lord, there is then the cost means the amount</p> <p>23 required to be paid. My Lord, it is fair to say that we</p> <p>24 have struggled to get to the bottom of what is meant by</p> <p>25 this point. When we received Wentworth's reply</p> <p style="text-align: center;">Page 135</p>
<p>1 hereafter to say, well, that is completely irrelevant</p> <p>2 but I am just trying to get a grip on what the phrase</p> <p>3 actually means.</p> <p>4 MR FOXTON: My Lord, can I consider that --</p> <p>5 MR JUSTICE HILDYARD: Yes.</p> <p>6 MR FOXTON: -- to the extent to which I have anything useful</p> <p>7 to add --</p> <p>8 MR JUSTICE HILDYARD: Mr Dicker may well have the answer up</p> <p>9 his sleeve already. He is smiling.</p> <p>10 MR FOXTON: Much more likely to have it than I would,</p> <p>11 my Lord.</p> <p>12 My Lord, there was also a suggestion that loss and</p> <p>13 default rate differ because the information that it</p> <p>14 would be necessary to have to conduct a meaningful</p> <p>15 challenge will be much more readily available to the</p> <p>16 paying party in respect of a loss amount than in respect</p> <p>17 of a certification of cost of funding based upon cost of</p> <p>18 equity.</p> <p>19 My Lord, that came before your Lordship without any</p> <p>20 evidence but by way of assertion. If one looks at the</p> <p>21 election your Lordship has just been drawing our</p> <p>22 attention to about costs of hedgings and establishing</p> <p>23 positions, it seems deeply improbable, I have to say,</p> <p>24 that the paying party would have any independent</p> <p>25 knowledge of how its counterparty under the ISDA master</p> <p style="text-align: center;">Page 134</p>	<p>1 skeleton, we had understood it was being said this is</p> <p>2 something that goes to good faith and rationality and</p> <p>3 that what has to be rational is your sort of calculation</p> <p>4 of what it cost or would have cost you to fund something</p> <p>5 and plainly if the figure you have come up with is one</p> <p>6 that can be shown to be greater than the amount that you</p> <p>7 would have had to pay, that will raise issues of</p> <p>8 rationality and good faith.</p> <p>9 However, it appears from oral submissions that it is</p> <p>10 being sort of reverted back to being a question of</p> <p>11 construction and that sort of implicit ingredient in the</p> <p>12 clause or in the definition itself.</p> <p>13 My Lord, it is very difficult to see how it can</p> <p>14 operate there without being completely destructive of</p> <p>15 the commercial certainty which certification is meant to</p> <p>16 bring. It is accepted now I think that you cannot</p> <p>17 simply look at a headline interest rate and therefore</p> <p>18 you have to look at all other things being equal.</p> <p>19 I have to say, it is extremely rare that they would be.</p> <p>20 There are a whole series of judgments one would imagine</p> <p>21 that fall to be exercised in weighing different features</p> <p>22 of different packages and their overall cost, it might</p> <p>23 include the cost of providing collateral if one is in</p> <p>24 the realm of secured lending, which would obviously</p> <p>25 lower the headline rate but might have impacts on other</p> <p style="text-align: center;">Page 136</p>

<p>1 aspects of a party's business. It is a very judgmental</p> <p>2 area and therefore one much more naturally arising in</p> <p>3 the context of a good faith rationality context than in</p> <p>4 the question of the threshold application of the clause.</p> <p>5 Even if one had what I suspect would be a rather</p> <p>6 rare case where you could say here we are, I have</p> <p>7 managed to find someone else offering exactly the</p> <p>8 funding that you have claimed, perhaps that you actually</p> <p>9 raised yourself, identical in all other respects, save</p> <p>10 this one, they are a couple of basis points lower on the</p> <p>11 cost. What happens if that was information not</p> <p>12 reasonably available to the certifying party at the time</p> <p>13 it took its decision?</p> <p>14 If this is an ingredient in construction, that would</p> <p>15 be no answer, it would be said, "Well, I am sorry you</p> <p>16 have certified the wrong rate, but that is absolutely</p> <p>17 counterintuitive when one looks at the application of</p> <p>18 the clause, which plainly is not intended to allow the</p> <p>19 second guessing of commercial judgments which are taken</p> <p>20 in good faith and choose from amongst the range of</p> <p>21 commercially reasonable outcomes.</p> <p>22 My Lord, we say this point either works at the</p> <p>23 certification stage or not at all and if brought into</p> <p>24 the threshold question of the application of the clause</p> <p>25 as a matter of construction would have very adverse and</p> <p style="text-align: center;">Page 137</p>	<p>1 construction exercise, we say is really tackling the</p> <p>2 issue at the wrong stage. The right stage is simply to</p> <p>3 say: looking at the information reasonably available to</p> <p>4 you, was this a rational and good faith certification of</p> <p>5 that cost?</p> <p>6 MR JUSTICE HILDYARD: I agree the mix between what goes as</p> <p>7 a matter of construction and what are the limits of</p> <p>8 rationality and is the latter the only test, I accept</p> <p>9 that is a difficult one for further thought, but</p> <p>10 supposing the funding gap, to take a wild example, were</p> <p>11 100. That is the relevant amount, and you are expecting</p> <p>12 that at least it will be repaid no later than three</p> <p>13 years' time. Your percentage costs, however broad the</p> <p>14 meaning of funding, is say 4 per cent for that, per</p> <p>15 year. But your broader business needs make it rational,</p> <p>16 in the broadest sense, for you to borrow 1,000, over say</p> <p>17 20 years, and the percentage rate for that enhanced</p> <p>18 amount over a longer period is, say, 8 per cent.</p> <p>19 Do you say that the certifiable amount is</p> <p>20 8 per cent?</p> <p>21 MR FOXTON: My Lord, if you build into the premise, as</p> <p>22 I think your Lordship does, that the business</p> <p>23 considerations that affect you at the date you are</p> <p>24 having to make that decision make the 8 per cent one of</p> <p>25 the commercially reasonable outcomes --</p> <p style="text-align: center;">Page 139</p>
<p>1 unintended consequences on the finality and</p> <p>2 predictability of that regime.</p> <p>3 I think it is said, well, look, the words "cost of"</p> <p>4 cannot operate in a vacuum. They don't, you know it is</p> <p>5 the cost of funding the relevant amount and therefore</p> <p>6 one has that criteria, "Here is the relevant amount,</p> <p>7 let's look at the cost of funding you have certified in</p> <p>8 relation to it", which will naturally provide</p> <p>9 appropriate reference points to test the certification.</p> <p>10 Plainly if you can show that the party has chosen to</p> <p>11 certify a rate when it was equally open to it on the</p> <p>12 position it was in with all other things being equal to</p> <p>13 go for a significantly cheaper rate, issues of</p> <p>14 rationality are inevitably going to be raised.</p> <p>15 My Lord, the attempt to introduce this as a matter</p> <p>16 of the threshold challenge does not fail.</p> <p>17 In terms of actual costs, there is this curiosity in</p> <p>18 the sense that you are only required to pay something</p> <p>19 once you have contracted to do it. Once you have</p> <p>20 contracted to do it, rather like Mr Dicker's coat, the</p> <p>21 terms on which you have contracted are those that you</p> <p>22 are required to pay.</p> <p>23 The clause does not require you to transact at all,</p> <p>24 hence the "If it were to fund" language, so the concept</p> <p>25 of introducing a test of requirement as part of the</p> <p style="text-align: center;">Page 138</p>	<p>1 MR JUSTICE HILDYARD: Commercially reasonable by reference</p> <p>2 to your ambition for the enterprise, not by reference to</p> <p>3 your need to plug the gap.</p> <p>4 As I understand it, that is really the point --</p> <p>5 I may have misunderstood Mr Zacaroli, but that seems to</p> <p>6 me to be the point made, that irrationality is</p> <p>7 a difficult one because you don't know whether it is</p> <p>8 irrational by the standards of your ambitions for the</p> <p>9 enterprise or irrational by reference to the much lesser</p> <p>10 sum of the relevant amount. The free choice that you</p> <p>11 suggest that the draftsman intended and the breadth of</p> <p>12 rational responses gives rise to this problem.</p> <p>13 MR FOXTON: My Lord, this may actually raise potentially</p> <p>14 a sort of separate issue --</p> <p>15 MR JUSTICE HILDYARD: Yes.</p> <p>16 MR FOXTON: -- which is reasonable as between who? One sees</p> <p>17 in the context of mitigation of damages, for example,</p> <p>18 that --</p> <p>19 MR JUSTICE HILDYARD: We are not on reasonable -- I am sorry</p> <p>20 to interrupt. We are on the sort of, as we have</p> <p>21 discussed before, not reasonable between the parties but</p> <p>22 simply totally unreasonable between any parties.</p> <p>23 MR FOXTON: My Lord, why it is possible that that sort of</p> <p>24 damages context may provide some assistance is generally</p> <p>25 you are told that there is admittedly a question of</p> <p style="text-align: center;">Page 140</p>

<p>1 objective reasonableness rather than rationality is one 2 that falls to be answered as between the two parties 3 rather than at large.</p> <p>4 What I would need to consider is how far, if at all, 5 that translates into the present context.</p> <p>6 Where your position is such that the reason that 7 plugging the gap by equity rather than debt is 8 commercially appropriate is because, filling this gap in 9 the situation in which you find yourself in at the time 10 makes taking on further debt potentially commercially 11 prejudicial, if one goes to a more extreme example, may 12 place you in breach of covenants or capital ratios, we 13 would submit plainly you must be allowed to certify the 14 8 per cent. That simply comes from the fact that you 15 certified the funding cost to it, to you, to the 16 recipient party.</p> <p>17 My Lord, provided that you have acted rationally in 18 that choice, we would say that you are entitled to 19 certify the 8 per cent on your Lordship's example.</p> <p>20 Whether there is then a separate test, and I would 21 need to think about this, where you say well it is 22 a question of reasonable as between A and B, you must 23 build into that the market conditions and all the 24 regulatory issues and so forth that affect party A, and 25 whether that leaves room for any other issues that may</p> <p style="text-align: center;">Page 141</p>	<p>1 regard to the position and propensities of the borrower, 2 undoubtedly. If there is a contemporaneous or 3 prospective default, that will weigh in the balance.</p> <p>4 You have to give rate, haven't you, to funding the 5 relevant amount?</p> <p>6 If the cost of funding some larger amount of which 7 the relevant amount is only part of your ambition and 8 that costs more, rationality speaks in favour of it but 9 instinct suggests that you are getting more by way of 10 recovery than truly is referable to the relevant amount.</p> <p>11 MR FOXTON: I suppose, my Lord, my difficulty with the point 12 is that that seems to lead to the outcome in which you 13 ignore the actual circumstances in which you are having 14 to raise this funding, which are going to reflect 15 everything else and would produce a sort of cost of 16 funding which could be significantly less than would 17 actually be incurred by the party in funding the gap.</p> <p>18 Equally, there is the issue that -- you know, look at 19 Lehmans raising funding once it had gone into insolvency 20 where one saw very high rates, the Sal Oppenheim case, 21 those no doubt reflect a whole series of situations 22 rather than being dictated by the size of the actual 23 22 million euros figure at issue in that case, but 24 because they are all the actual circumstance in which 25 this party, this receiving party, has had to or will</p> <p style="text-align: center;">Page 143</p>
<p>1 not be relevant to a consideration of what is reasonable 2 as between those two parties is something I would 3 probably need to give a bit of further thought to.</p> <p>4 Certainly there will be factors that impact upon the 5 party having to plug that hole that will make it 6 rational to go for the 8 per cent route that it must be 7 permitted to take into account when certifying, 8 otherwise it would be left in a sort of position in 9 which it is not being compensated for the actual cost to 10 it of plugging the gap.</p> <p>11 My Lord, Mr Morrison reminds me, if one has 12 a situation where there are two ISDA defaults under two 13 master agreements, there could be, with connected 14 parties in the same group, is each entitled to say, 15 "Ignore everything else, I want you to sort of approach 16 the issue of rationality of certification on the 17 assumption that this is all there is"? And each of them 18 is able to say that, even though the reality of a party 19 seeking to fund in those circumstances is it cannot set 20 about raising funding as if there were simply a single 21 default under a single master agreement. It is going to 22 have to have regard to the position it is actually in, 23 including the other exposures and their impacts.</p> <p>24 MR JUSTICE HILDYARD: That will inevitably be, for the 25 reasons we discussed earlier, that the lender will have</p> <p style="text-align: center;">Page 142</p>	<p>1 have to fund this amount will come into play.</p> <p>2 We say that would be equally true of a range of 3 considerations that make equity funding a rational 4 choice.</p> <p>5 MR JUSTICE HILDYARD: If you tweaked my example and reckoned 6 that underwriting to raise 100 would cost X and 7 underwriting to raise five times that much would cost 8 1.5 X, you are allowed to go for the 1.5 X are you?</p> <p>9 MR FOXTON: My Lord, it is all going to be ultimately 10 constrained by that test of rationality. I suppose one 11 would need to --</p> <p>12 MR JUSTICE HILDYARD: It is perfectly rational to want to 13 borrow money to meet a number of contingencies, the 14 question is how many contingencies are you allowed to 15 provide for? Including your own, you know, thoughts of 16 how you can get the shares away at this particular time 17 for a much larger amount. There are so many things to 18 build in. Anyway I leave it with you, possibly for 19 Mr Dicker.</p> <p>20 That is what I understand to be the burden of what 21 Mr Zacaroli, you say, reformulated view of the lowest 22 amount. I hope I have not done --</p> <p>23 MR ZACAROLI: That's correct, my Lord, yes.</p> <p>24 MR FOXTON: My Lord, I think this is implicit in your 25 Lordship's examples to me but of course it is a debt</p> <p style="text-align: center;">Page 144</p>

<p>1 issue as well, so exactly the same issue would arise if</p> <p>2 one is talking about raising a loan facility of 100 X.</p> <p>3 MR JUSTICE HILDYARD: Yes, I think you are right. I think</p> <p>4 that it applies whatever definition goes to funding,</p> <p>5 I don't think Mr Zacaroli said otherwise, I think it is</p> <p>6 across the board, you must not try and lay off your</p> <p>7 ambitions costs or your particular perception of the</p> <p>8 advantages of raising a lot more money in whatever form</p> <p>9 at that time, you must not lay off that to your</p> <p>10 counterparty. I don't think he distinguishes that.</p> <p>11 MR FOXTON: My Lord, I will think a bit further. One</p> <p>12 possible example of that is the issue of rationality as</p> <p>13 rationality between the parties, rather than: is this</p> <p>14 a rational business choice in your business generally?</p> <p>15 And that might address that question, but I will give it</p> <p>16 some further thought, my Lord.</p> <p>17 MR JUSTICE HILDYARD: Yes.</p> <p>18 MR FOXTON: My Lord, the next topic I think I have</p> <p>19 anticipated is Wentworth's specific reasons as to why</p> <p>20 equity falls to be excluded. I think this is</p> <p>21 essentially the debate I was having with your Lordship</p> <p>22 earlier on.</p> <p>23 I think Mr Zacaroli accepts that there are equity</p> <p>24 instruments -- using that phrase in the loosest possible</p> <p>25 sense -- that mimic, as he put it, the loan instrument.</p> <p style="text-align: center;">Page 145</p>	<p>1 some form of risk assessment and time value money</p> <p>2 analysis.</p> <p>3 If the issue of whether that is in or out falls to</p> <p>4 be approached as a matter of economic substance, which</p> <p>5 we would suggest would be the natural answer, and</p> <p>6 certainly the answer that the users of the form might</p> <p>7 expect, then if one applies the same concepts of</p> <p>8 economic substance to preference shares, we would say</p> <p>9 those equally ought to be in. If on the other hand what</p> <p>10 is said is:</p> <p>11 "No, legal form is everything and if your economic</p> <p>12 instrument, although debt in substance, is not debt in</p> <p>13 form, it doesn't count".</p> <p>14 That would once again be an outcome that involved</p> <p>15 drawing, we would say, illogical distinctions for the</p> <p>16 purposes of applying a limitation that finds no express</p> <p>17 reference in the wording of the clause.</p> <p>18 MR JUSTICE HILDYARD: I suppose in the old days, when</p> <p>19 shareholders were simply called contributories, that</p> <p>20 word rather illuminated, if you like, what the different</p> <p>21 status is. Even though the shares were paid up, you</p> <p>22 were still a contributory. Do you see what I mean?</p> <p>23 MR FOXTON: My Lord, yes. Obviously I think we would say</p> <p>24 that the reality now in terms of financial instruments</p> <p>25 is that there is a continuum without bright lines</p> <p style="text-align: center;">Page 147</p>
<p>1 I think he would say that it would fall to distinguish</p> <p>2 the two based upon English company law concepts,</p> <p>3 perhaps, as we have sought to show your Lordship,</p> <p>4 theories of participation provide no real basis for</p> <p>5 distinguishing between debt and equity, particularly</p> <p>6 when one builds in the fact that you may have</p> <p>7 conditionality in debt through limited recourse features</p> <p>8 and you may have equity where your right to return is</p> <p>9 one that accumulates, even if not paid until some future</p> <p>10 date.</p> <p>11 MR JUSTICE HILDYARD: Accountants might not agree with that.</p> <p>12 I don't know. They may say, actually, however close the</p> <p>13 mimicry, how it would be entered in on the balance sheet</p> <p>14 would be entirely different.</p> <p>15 MR FOXTON: My Lord, they would probably be applying</p> <p>16 substance over form IAS20, or whatever the relevant</p> <p>17 International Accounting Standard is.</p> <p>18 MR JUSTICE HILDYARD: It would just be sides of the balance</p> <p>19 sheet, wouldn't it?</p> <p>20 MR FOXTON: I mean one question we floated in opening, which</p> <p>21 I am not sure we have had a response to, we mentioned</p> <p>22 Repo transitions as one of the most common forms of</p> <p>23 secure lending which take the legal form of a sale of</p> <p>24 assets and an obligation to repurchase those assets at</p> <p>25 a slightly enhanced figure that will generally involve</p> <p style="text-align: center;">Page 146</p>	<p>1 available to sort of distinguish between a clear</p> <p>2 category of debt and a clear category of equity.</p> <p>3 I repeat my point, sometimes the court might be forced</p> <p>4 to engage in what we would submit would be a rather bold</p> <p>5 attempt to define for all purposes which are in and</p> <p>6 which are out, but to be forced into such an exercise to</p> <p>7 give effect for an implicit limitation is, we would say,</p> <p>8 a strong indication that that implicit limitation does</p> <p>9 not fall to be read into the wording.</p> <p>10 My Lord, the relevance of regulatory rules</p> <p>11 applicable to financial institutions and the</p> <p>12 Carlton Capital decision, I think we largely said most</p> <p>13 of what we wanted to say about that in our opening</p> <p>14 submissions. We did make the point that exactly the</p> <p>15 same issues can arise as far as non-financial</p> <p>16 institutions are concerned, by covenants, which mean</p> <p>17 that what is required to raise equity rather than incur</p> <p>18 further debt as a means of plugging a gap on its balance</p> <p>19 sheet.</p> <p>20 Reference was made to Mr Justice Briggs's judgment</p> <p>21 in Carlton Communications. Obviously that, your</p> <p>22 Lordship recalls, cited I think Lord Bingham in the</p> <p>23 Dairy Containers case as to what is legitimate factual</p> <p>24 matrix and what is not. We would say that providing the</p> <p>25 material is material reasonably available to both</p> <p style="text-align: center;">Page 148</p>

<p>1 parties, it is in. In answering that question, you</p> <p>2 probably have to look at the degree of detail with which</p> <p>3 you are having to rely on the regulatory capital</p> <p>4 position of financial institutions. The grainier you</p> <p>5 get, the less promising the submission that is</p> <p>6 reasonably available to both parties.</p> <p>7 We are at the absolute outer levels of abstraction</p> <p>8 there, namely that banks are required or can be required</p> <p>9 to have certain ratio of debt to equity. That is all we</p> <p>10 need, because once you have that, you have the fact that</p> <p>11 funding may have to take the form of equity in certain</p> <p>12 scenarios, which is all that is relevant for our</p> <p>13 purpose. We say that plainly falls within the</p> <p>14 reasonably available analysis, but even if we are wrong,</p> <p>15 the fact that the financial position or covenants</p> <p>16 applicable to a party may require it to raise equity</p> <p>17 rather than debt is of universal application to all</p> <p>18 commercial entities anyway and not limited to financial</p> <p>19 institutions.</p> <p>20 My Lord, there was also a suggestion that an answer</p> <p>21 to this point is, "Well, all the financial institution</p> <p>22 needs to do is take some of these steps that will enable</p> <p>23 it to borrow again. Therefore you cannot really say</p> <p>24 that you are prevented from taking on further borrowing</p> <p>25 by your regulatory capital requirements".</p> <p style="text-align: center;">Page 149</p>	<p>1 up with an eight-point plan for the identification of</p> <p>2 funding instruments that fall inside and outside the</p> <p>3 definition. My Lord, the questions appear in the Joint</p> <p>4 Administrators' skeleton at I think paragraph 65 in</p> <p>5 volume 3, tab 1, page 19.</p> <p>6 MR JUSTICE HILDYARD: Are these questions on which your</p> <p>7 answers will be different than Mr Dicker's?</p> <p>8 MR FOXTON: I would be astonished if they were different.</p> <p>9 MR JUSTICE HILDYARD: Who is best -- that is an invidious</p> <p>10 question, but who is most logically to deal with these.</p> <p>11 I don't want to interrupt unnecessarily, but it just</p> <p>12 seemed to me.</p> <p>13 MR DICKER: I am quite happy for my learned friend to,</p> <p>14 I would be surprised -- although I have not heard what</p> <p>15 he is going to say -- if our answers differed, but if</p> <p>16 they do --</p> <p>17 MR JUSTICE HILDYARD: If you are ready.</p> <p>18 MR FOXTON: I am and if I get them wrong there will be</p> <p>19 an opportunity for Mr Dicker to correct them.</p> <p>20 MR JUSTICE HILDYARD: There is that.</p> <p>21 MR FOXTON: Paragraph 65.1 is the first question, whether it</p> <p>22 must involve the incurring of an obligation to pay a sum</p> <p>23 of money. We say no, it is sufficient that there</p> <p>24 a financial detriment, whilst making the point that we</p> <p>25 did incur an obligation under the terms of the</p> <p style="text-align: center;">Page 151</p>
<p>1 My Lord, amongst those steps being raise more</p> <p>2 equity. My Lord, that really is, we would submit,</p> <p>3 an artificial submission that cost of borrowing can be</p> <p>4 appropriate, even for a financial institution that needs</p> <p>5 to deleverage because all it has to do is raise equity</p> <p>6 through incurring the costs of doing so to be back in</p> <p>7 a position where it can borrow again.</p> <p>8 One might equally make the same argument of debt</p> <p>9 I suppose, why do you need to borrow at 10 per cent, all</p> <p>10 we have to do is raise some more equity and improve your</p> <p>11 leverage and then you will be able to borrow at 5. It</p> <p>12 is a submission that basically says, ignore the words</p> <p>13 "Cost payable, costs of funding to it" by saying that</p> <p>14 "it" being a shorthand for the recipient in the position</p> <p>15 that it is in can change its surrounding circumstances</p> <p>16 and therefore become a different "it" with a lower cost</p> <p>17 of funding. My Lord, that is plainly not what the</p> <p>18 clause contemplates.</p> <p>19 (Pause)</p> <p>20 My Lord, I am conscious that Mr Trower pointed out</p> <p>21 we had not given our answers to the Joint</p> <p>22 Administrators' eight questions and it struck me that</p> <p>23 that is something we ought to do. In advance, my Lord,</p> <p>24 I do repeat my submission that this is asking the court</p> <p>25 to undertake a very bold and ambitious exercise, coming</p> <p style="text-align: center;">Page 150</p>	<p>1 preference shares to pay a sum of money.</p> <p>2 My Lord, whether any such obligation must be</p> <p>3 incurred when obtaining the funding and as part of the</p> <p>4 bargain entered into to obtain such funding.</p> <p>5 I think on explanation, it was said that that was to</p> <p>6 address the situation where you have dividend on</p> <p>7 ordinary stock, to which there is, as it were, no</p> <p>8 accrued entitlement to payment until such time as the</p> <p>9 dividend is declared. At which point there becomes</p> <p>10 an entitlement to payment.</p> <p>11 My Lord, as we don't accept that the relevant costs</p> <p>12 must be incurred through an obligation, we equally say</p> <p>13 that there does not have to be an obligation incurred at</p> <p>14 the time of funding. Once again, we would say that in</p> <p>15 any event the preference share obligations were incurred</p> <p>16 at the time of funding. The fact that you may have</p> <p>17 conditionality such that it crystallises later on is no</p> <p>18 different from many forms of debt funding where the</p> <p>19 precise amount payable may depend for example on changes</p> <p>20 in a tracker rate or changes in the leverage of the</p> <p>21 borrower or any other matters by which conditional</p> <p>22 obligations in the package produce a particular</p> <p>23 consequence further down the line.</p> <p>24 Whether cost incurred if a payment obligation is</p> <p>25 itself discretionary. Yes, we say that a cost can be</p> <p style="text-align: center;">Page 152</p>

<p>1 incurred. If one asks that question after the event,  2 when the discretion has been exercised and the amount  3 has been paid, we would submit that the argument that  4 that is not a cost that has been incurred can be seen to  5 be, with respect, an absolutely hopeless argument. Even  6 if one asks it prospectively, particularly when looking  7 at cumulative dividends, coupon under preference shares,  8 the fact that the time for payment may depend upon  9 a discretion which otherwise will accumulate into the  10 future does not prevent it being a cost incurred in any  11 event. Simply as a matter of principle, the fact that  12 there is a discretion cannot retrospectively mean that  13 a cost paid is not a cost or an amount paid is not  14 a cost and therefore equally, if you are looking at the  15 position prospectively, the meaning cannot be different.</p> <p>16 My Lord, I think 4 is a subset of 3 and we would  17 give exactly the same answer, there is no difference in  18 principle there as to the fact of payment or the amount  19 of payment.</p> <p>20 My Lord, as far as 5 is concerned, your Lordship  21 will know we say that the funding exercise need not be,  22 and indeed almost invariably will not be one undertaken  23 for the specific purpose of funding the relevant amount,  24 albeit that what you certify will involve at the end of  25 your calculation a process of allocation that relates</p> <p style="text-align: center;">Page 153</p>	<p>1 recovery. It may be there is a sort of chronological  2 limitations in that the loss definition takes you up to  3 a point in time at which the loss amount is calculated  4 and your default rate provision kicks in thereafter. It  5 may be that in practice that avoids any question of  6 double recovery because you are going to be looking at  7 separate periods of time.</p> <p>8 If you have an arrangement fee, for example, that  9 has been amortised and prorated over the length of the  10 period, part of it may fall within the loss definition  11 because there is a period of time on an unpaid amount  12 that has become wrapped up in the loss definition that  13 you are calculating then. Part of it may fall  14 thereafter within a separate period of time.</p> <p>15 MR JUSTICE HILDYARD: You say one should invest the same  16 phrase with the same meaning in both contexts, if in  17 both contexts there is a very expansive meaning,  18 sufficiently expansive that in calculating your costs of  19 funding you can charge the costs of funding of entirely  20 making good the enterprise for the past and future, is  21 there not a major danger of double recovery?</p> <p>22 MR FOXTON: My Lord, just on the premise of that question,  23 the issue about whether you can charge some prorated  24 element of entirely making good the enterprise for past  25 and future is not a characterisation of our case that --</p> <p style="text-align: center;">Page 155</p>
<p>1 that cost to the relevant amount in question and the  2 period of time in question.</p> <p>3 My Lord, number 6, whether it includes loss of  4 profits or consequential losses resulting from  5 non-payment of the relevant amount. We don't allege  6 that truly consequential losses are covered, so a party  7 who says, "If you had paid me this amount I would have  8 been enable to invest it in this transaction and secured  9 this very lucrative gain that I want to recover".</p> <p>10 As always, lurking within broad phrases such as  11 "consequential loss" there are difficulties in the  12 detail. We say that if the cost of funding the relevant  13 amount has knock-on effects of the cost of funding  14 generally, that is properly part of the cost of funding  15 and not consequential.</p> <p>16 We also say, as your Lordship knows, that is  17 an issue that arises on both debt and equity and if we  18 are wrong about that, it doesn't answer the wider and  19 more significant questions with which the court is  20 concerned.</p> <p>21 MR JUSTICE HILDYARD: This does throw up the loss definition  22 and the question of double recovery, doesn't it?</p> <p>23 MR FOXTON: My Lord, it does. At the moment I fail to see  24 how you could ever have a rational good faith  25 certification that involved affect effecting a double</p> <p style="text-align: center;">Page 154</p>	<p>1 MR JUSTICE HILDYARD: I know you have to allocate to the  2 relevant amount.</p> <p>3 MR FOXTON: Yes. My Lord, it would all be -- I will not go  4 back and repeat the submissions, but in terms of the  5 issue of double recovery, at the moment I have to say  6 I am finding it -- given that one is concerned with  7 separate time periods and amortisation, I find it  8 difficult to see how there is any more of an issue of  9 double recovery there than on arrangement fees or the  10 knock on consequences of borrowing on overall costs of  11 borrowing, if the court holds that to be a permissible  12 part of cost of funding.</p> <p>13 My Lord, issue 7, we say, yes, the cost of funding  14 includes professional or arrangement fees where those  15 have been incurred for the purpose of obtaining the  16 funding. I think it is accepted that insofar as fees  17 are paid to the party providing the funding, that is so.  18 The line is drawn when the fees are paid to the third  19 party and we make the point that that arises on both the  20 debt and equity side of the divide.</p> <p>21 My Lord, issue 8 is the point we have been through  22 with your Lordship, we say that is a matter of  23 certification and rationality and if built into the  24 threshold question of construction, is going to allow  25 widespread second guessing of commercial decisions which</p> <p style="text-align: center;">Page 156</p>

<p>1 the certification process was intended to avoid.</p> <p>2 My Lord, the position where a party cannot borrow.</p> <p>3 I think that was one of the Joint Administrators'</p> <p>4 questions. Mr Zacaroli I think said well look the court</p> <p>5 need not enter into this dangerous territory, it is not</p> <p>6 an issue that in fact arises. As I understood from the</p> <p>7 Joint Administrators, it is not simply a theoretical</p> <p>8 point but, my Lord, in any event, we would say it is</p> <p>9 an important question to test the viability of the</p> <p>10 competing constructions before your Lordship.</p> <p>11 If the correct answer is, if you can't borrow you</p> <p>12 get 0 plus 1 per cent, the result of that is that</p> <p>13 a party that was able to and did raise equity funding</p> <p>14 and incurred the costs in doing so is assumed by this</p> <p>15 clause to have no cost of funding at all. We say that</p> <p>16 is an uncommercial outcome.</p> <p>17 I think it is suggested, well, look, a party who can</p> <p>18 raise equity can always borrow and therefore that the</p> <p>19 problem would not arise. My Lord, that is not going to</p> <p>20 be the case. One can well see a scenario in which</p> <p>21 existing equity providers, rather than see the loss of</p> <p>22 the funding they have already provided, are prepared to</p> <p>23 provide further equity funding in return for the returns</p> <p>24 that that gives, in circumstances in which someone may</p> <p>25 not be prepared to lend to the company.</p> <p style="text-align: center;">Page 157</p>	<p>1 MR FOXTON: My Lord, the only point we wanted to make or</p> <p>2 that is this. Plainly the "if it were to fund" language</p> <p>3 looks at a world in which a party does not go out and</p> <p>4 contract but is certifying what it would have done. If</p> <p>5 what it would have done is enter into a termed period</p> <p>6 funding at a particular rate at a particular point in</p> <p>7 time, we say it is able to certify on that basis. It is</p> <p>8 not required to say, "Well, although that is what we</p> <p>9 would have done, in fact we can now see that that would</p> <p>10 have been an unwise approach, because with the benefit</p> <p>11 of hindsight we can see that things are moved</p> <p>12 differently".</p> <p>13 Anymore than if what it would have done was go out</p> <p>14 and borrow at a, you know, a particularly low rate or</p> <p>15 obtain equity funding on a particular basis, it can then</p> <p>16 be seen with the benefit of hindsight, there could have</p> <p>17 been higher costs of funding incurred. The if it were</p> <p>18 to fund case may involve a party being treated as though</p> <p>19 it had raised the funding, because this is what it</p> <p>20 certifies, at a particular rate at a particular point in</p> <p>21 time without thereafter being able to revisit that</p> <p>22 decision.</p> <p>23 My Lord, issue 14, we have moved from a submission</p> <p>24 that only manifest errors fall to be reviewed to one in</p> <p>25 which it is said the clause allows any error of fact,</p> <p style="text-align: center;">Page 159</p>
<p>1 My Lord, if the boot were on the other foot, and</p> <p>2 a party which had managed to raise equity funding within</p> <p>3 the range of 6.8 to 11 per cent compound -- where</p> <p>4 Goldman Sachs will be -- would have had to pay a higher</p> <p>5 rate in order to borrow, one can see that the argument,</p> <p>6 that nonetheless it could require that higher rate even</p> <p>7 though it had incurred a lower rate raising equity</p> <p>8 funding would receive very little sympathy from either</p> <p>9 the paying party or, we suggest, the court.</p> <p>10 This perhaps illustrates the more general danger of</p> <p>11 a construction which prevents parties which have raised</p> <p>12 their funding via equity funding and on the assumption</p> <p>13 for present purposes they have acted in good faith and</p> <p>14 rationally in doing so, being shut out by</p> <p>15 an interpretation of the clause from recovering those</p> <p>16 actual costs.</p> <p>17 My Lord, that is what we say on the party unable to</p> <p>18 borrow case.</p> <p>19 My Lord, I probably have no more than five minutes</p> <p>20 of submissions, so with your Lordship's permission</p> <p>21 I will finish it.</p> <p>22 MR JUSTICE HILDYARD: Yes, please.</p> <p>23 MR FOXTON: My Lord, issue 13, your Lordship may recall that</p> <p>24 is the stage at which one does the certification.</p> <p>25 MR JUSTICE HILDYARD: Yes.</p> <p style="text-align: center;">Page 158</p>	<p>1 manifest or not, to be subject to challenge. My Lord,</p> <p>2 this is a very significant argument and a very</p> <p>3 significant development of Wentworth's position in</p> <p>4 relation to the circumstances in which the certification</p> <p>5 is binding. We do say that the attempt to distinguish</p> <p>6 between issues of fact and issues of judgment is itself</p> <p>7 pregnant with scope for disapproval. The person</p> <p>8 undertaking the certification is both determining the</p> <p>9 facts and reaching the judgment in relation to them.</p> <p>10 If one looks at the area of Wednesbury</p> <p>11 unreasonableness in public law, from which the</p> <p>12 contractual discretion cases have drawn a test, there is</p> <p>13 no similar distinction between issues of alleged errors</p> <p>14 of fact and alleged errors of judgment. It is ripe, we</p> <p>15 submit, for a whole series of unnecessary challenges and</p> <p>16 disputes. The short answer to all of these is that the</p> <p>17 same commercial reasonable test applies to both and</p> <p>18 unless the court is persuaded, and we have not seen</p> <p>19 an example thus far, that there is, in is sense, obvious</p> <p>20 and immediately identifiable errors of fact which might</p> <p>21 nonetheless fail the commercial rationality test. We</p> <p>22 say that this is not a point that needs to be addressed</p> <p>23 by some separate implication over and above those</p> <p>24 recognised by cases such as Socimer and other cases on</p> <p>25 contractual discretions.</p> <p style="text-align: center;">Page 160</p>



<p>1 On any view, an attempt to take issues of fact  2 entirely outside the scope of the presumptive effect  3 given to the certificate, we say would effectively  4 destroy the finality that that process is intended to  5 give, and involve a recognition of a very significant  6 exception under the ISDA form, which certainly, as far  7 as we have been able to consider it since we heard this  8 point developed today, does not find recognition in  9 allied areas of the law which consider issues of  10 contractual discretion or certification. The idea you  11 get an untrammelled ability to investigate errors of  12 fact is, we say, a heterodox submission for provisions  13 of this kind.</p> <p>14 My Lord, where we do agree I think with  15 Mr Zacaroli -- to finish on a rare note of consensus --  16 is, if one looks at the form of the certificate, plainly  17 one is concerned with something that does not involve  18 the service of supporting evidence on any sort of  19 significant scale because it is inherent in the idea of  20 certification that one is dealing with something in  21 a relative summary form. We do see the force of the  22 argument that, at least through a process of  23 interrogation of the certifying party, there is likely  24 to be a requirement for reasonable detail, just as one  25 saw that in the loss provision.</p> <p style="text-align: center;">Page 161</p>	<p>1 or further to the interrogation, would have to be what,  2 sufficient in your perception, your client's perception  3 to demonstrate rationality of approach in good faith?  4 MR FOXTON: My Lord, yes, the ambit of what has to be  5 provided must be coloured by the court's conclusion as  6 to what exercise can properly be performed by the --  7 MR JUSTICE HILDYARD: The way you put it, as I understand  8 it, is certain things will be beyond the pale if the  9 other side are right. Within the pale, all you have to  10 do is demonstrate rationality and good faith and you can  11 do that by a sufficient statement to justify the  12 conclusion of rationality.  13 MR FOXTON: My Lord, yes. I mean the reason why that must  14 be right, we submit, is that the any information  15 requirement cannot go further than that which is  16 necessary for the other party to have, given the very  17 limited scope for challenge that the certification  18 process gives them. Plus, we do say that it is clear  19 from the use of "as certified by" language that one is  20 concerned with something relatively limited. Even  21 within the loss calculation, there has always been --  22 reasonable detail has been a very different thing from  23 the type of material one gets served in a court when  24 seeking to demonstrate a loss.  25 MR JUSTICE HILDYARD: Yes. Thank you very much.</p> <p style="text-align: center;">Page 163</p>
<p>1 We ourselves have relied upon the fact that there  2 will be cases in which the consequences of late payment  3 fall to be considered both within the context of the  4 loss definition and the default rate. We accept it  5 would be very odd if there was a reasonable detail  6 requirement in relation to the former and an ability to  7 stand or fall on a single number in the latter.</p> <p>8 We do agree that this is not a case in which you  9 simply can produce a single number and nothing else.  10 Whether the reasonable detail is something that arises  11 at the stage of the certification or is something that  12 follows from the questions being put by the other party  13 is a different question. We say that the latter is  14 appropriate because there may be circumstances in which  15 the party does not need to go beyond the figure, doesn't  16 feel the need to challenge it, but we accept as a matter  17 of practicality, if the reasonableness is put in issue,  18 there is going to have to be the giving of reasonable  19 detail as to how that calculation was arrived at, which  20 would then provide the basis for a rationality or good  21 faith challenge if one was felt to be appropriate.</p> <p>22 My Lord, I think that is everything that I wanted to  23 say in reply.</p> <p>24 MR JUSTICE HILDYARD: Your certificate for the accompanying  25 explanation by whatever process, ie with a certificate</p> <p style="text-align: center;">Page 162</p>	<p>1 MR FOXTON: Thank you, my Lord.  2 MR JUSTICE HILDYARD: Right, Mr Dicker, you would like to  3 start at 10.30 tomorrow?  4 MR DICKER: My Lord I am entirely in your Lordship's hands.  5 MR JUSTICE HILDYARD: I think we have done today justice.  6 How are we doing on time, still well up to speed?  7 MR DICKER: I think we are well up to speed for two reasons,  8 (1), I think we were not due to have started our reply  9 submissions until tomorrow.  10 MR JUSTICE HILDYARD: Until tomorrow, yes.  11 MR DICKER: Secondly, I think it is likely, as I understand  12 from my learned friend, Mr Zacaroli, that we will both  13 be very short on US law. We are well ahead of schedule.  14 MR JUSTICE HILDYARD: Good. 10.30 tomorrow.  15 (4.25 pm)  16 (The hearing adjourned until 10.30 am the following day)  17  18  19  20  21  22  23  24  25</p> <p style="text-align: center;">Page 164</p>

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