

<p>1 Monday, 18 November 2013</p> <p>2 (10.30 am)</p> <p>3 Submissions by MR TRACE</p> <p>4 MR JUSTICE DAVID RICHARDS: Yes, Mr Trace?</p> <p>5 MR TRACE: May it please your Lordship, as teacher's pet we</p> <p>6 can tell your Lordship we have done our homework this</p> <p>7 weekend, and I do not know about the others. But I am</p> <p>8 going to do, just tease you at the moment by saying we</p> <p>9 have done our homework but I will come back to that</p> <p>10 point, if I may, in a little while because we had got on</p> <p>11 to the fascinating subject of the equitable rule.</p> <p>12 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>13 MR TRACE: The particular question, as your Lordships knows,</p> <p>14 that we had reached was the question of how in this case</p> <p>15 the equitable rule should apply in administrations. We</p> <p>16 submit along with both LBL and LBHI that both my learned</p> <p>17 friend Mr Trower and Mr Zacaroli's attempts to extend</p> <p>18 the equitable rule in the way they are, stretching it,</p> <p>19 turns it into a rule that effectively prohibits</p> <p>20 a contributory from receiving any dividends in respect</p> <p>21 of what we might call ordinary debts owed to it ie other</p> <p>22 than sums owed as a shareholder unless and until it is</p> <p>23 no longer under a potential liability to pay a call,</p> <p>24 even where a company is not in liquidation and no calls</p> <p>25 have been made. For your Lordship's note, that is in</p> <p style="text-align: center;">Page 1</p>	<p>1 recall.</p> <p>2 MR JUSTICE DAVID RICHARDS: I do.</p> <p>3 MR TRACE: The shares had a nominal value of £50 and £15</p> <p>4 paid up and the liquidator made a call of £10. Again</p> <p>5 for the transcript and your Lordship's note, that is</p> <p>6 Day~3 at pages 99 to 100. We, with respect, say that</p> <p>7 Mr Wolfson is absolutely right in his submissions on</p> <p>8 this part of the case by reference to the authorities to</p> <p>9 show that the rule has only been applied where a call</p> <p>10 has been made or where there is a present liability on</p> <p>11 the person contributing to the sum paid and the payment</p> <p>12 of that call is not fully paid. We respectfully submit</p> <p>13 that those cases and that principle, as adumbrated just</p> <p>14 now, are a complete answer on this point. We would add</p> <p>15 this though, my Lord, all the cases referred to by</p> <p>16 Lord~Walker in Canwell(?) were cases where a call had</p> <p>17 already been made on the contributory; your Lordship</p> <p>18 will recall the Grazelles case; Ariferis(?) No 1, which</p> <p>19 for present purposes we do not need to say,</p> <p>20 your Lordship has to in some way say it is wrong and</p> <p>21 decide it. We say it is not relevant for the purposes</p> <p>22 of this case; your Lordship does not have to decide</p> <p>23 that. Obviously if your Lordship does decide it we take</p> <p>24 the benefit of it. That is where I said or mentioned to</p> <p>25 your Lordship on Friday that we take a slightly</p> <p style="text-align: center;">Page 3</p>
<p>1 our supplemental submissions at paragraph 5. My Lord,</p> <p>2 we say that, and we respectfully submit it in the first</p> <p>3 place that the principle does not fall to be applied at</p> <p>4 all in administrations because it applies, and</p> <p>5 I mentioned this at the beginning, only once a call has</p> <p>6 been made by a liquidator. Your Lordship will recall,</p> <p>7 Mr Wolfson took your Lordship to the cases, and we also</p> <p>8 rely on those cases in making that submission, and I do</p> <p>9 not propose to take you to them again, and indeed</p> <p>10 your Lordship will have noted that Mr Trower accepts,</p> <p>11 and for your Lordship's note that is paragraph 20 of his</p> <p>12 supplemental submissions, that all the cases to date</p> <p>13 involve situations where calls had already been made.</p> <p>14 Your Lordship might like to note the transcript</p> <p>15 reference is Day 3, at the very top of page 97.</p> <p>16 However, my Lord, although we are not going to go to the</p> <p>17 cases, we do urge on your Lordship the principle that</p> <p>18 Mr Wolfson was making, that it is very clear from those</p> <p>19 cases that the rule only applied once a call had been</p> <p>20 made and then, and this is critical, only in respect of</p> <p>21 the sum called. Your Lordship will recall the Grisells</p> <p>22 case. There the potential exposure of the member was to</p> <p>23 greater calls as not all the unpaid up share capital had</p> <p>24 yet been called. Your Lordship himself pointed that out</p> <p>25 from the facts in the headnote, your Lordship will</p> <p style="text-align: center;">Page 2</p>	<p>1 different view in the round. And Re West Coast</p> <p>2 Goldfield, as your Lordship will recall as well. As a</p> <p>3 result of that, as no call has been made here, and of</p> <p>4 course no call can we submit be made while LIBE is in</p> <p>5 administration then there is no question of the</p> <p>6 equitable rule being engaged at all. Also, my Lord, as</p> <p>7 Mr Wolfson submitted, this is supported by the citation</p> <p>8 that Lord Walker made when he approved the statement of</p> <p>9 the equitable rule in Re Abrahams; your Lordship will</p> <p>10 recall that.</p> <p>11 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>12 MR TRACE: There, where the debt was due to the testator, is</p> <p>13 one that was not immediately payable whereas the right</p> <p>14 of the debtor to receive the residuary share was an</p> <p>15 immediate right. We deal with this, for your Lordship's</p> <p>16 note, in our submissions at paragraphs 60 to 61. My</p> <p>17 learned friend Mr Wolfson also made submissions to your</p> <p>18 Lordship about the nature of the rule. He submitted</p> <p>19 that it could not properly apply unless until a call is</p> <p>20 made. My Lord, as to that we make a number of</p> <p>21 submissions: obviously we support the submission. But</p> <p>22 the way we put it is that there is no justification for</p> <p>23 the rule applying where there is no debt currently</p> <p>24 payable, a debt at least, currently payable by my</p> <p>25 clients at all. That is the point we make in our</p> <p style="text-align: center;">Page 4</p>

<p>1 submissions at paragraph 62 to 65. In the first place, 2 unless the debt is immediately payable, which of course 3 it is not, because even on LIBE's own case it is 4 contingent -- I made that point before -- the rule is 5 not applicable because there can be no question of my 6 clients "doing equity" or "completing the estate". 7 Secondly, my Lord, if the equitable rule does apply it 8 should of course only be where the creditor is in the 9 position of my clients who can decide whether it should 10 make the necessary payment to complete the estate and 11 receive dividends or not. Of course my clients cannot 12 make that decision in respect of general potential 13 liability. Your Lordship observed, your Lordship will 14 recall to Mr Wolfson during his submissions on Thursday 15 afternoon, that there was an issue as to whether the 16 fact that the administrators could not and had not made 17 a call should potentially enable the members to escape 18 the application of the rule. The potential detriment of 19 the non-member, a creditor; your Lordship will recall 20 that. Your Lordship pointed out that the difficulty 21 was, in effectively a distributed administration is 22 something entirely new, an entirely new procedure, and 23 therefore one that has not been considered in any of the 24 cases. Of course we accept that. However, as it is 25 established that where a company is in administration</p> <p style="text-align: center;">Page 5</p>	<p>1 also make it in their opening submissions at 2 paragraph 115. So, my Lord, what is clear is that LIBE 3 accepts that two of the contingencies that need to be 4 looked at in valuing the members' potential liability as 5 contributors are first of all LIBE going into 6 liquidation and secondary, LIBE's liquidators making 7 a call. We say that is all of a piece, in our 8 submission. The administrators of course knew this when 9 they chose to go into a distributive administration. We 10 respectfully submit it is to be inferred that they made 11 that choice because they intended to distribute the LIBE 12 estate fully. The answer "creditors(?) in 13 administration". Effectively my Lord, and this is an 14 important point that underlines our submissions on this 15 part of the case, we respectfully submit that the 16 distributive administration is effectively an 17 alternative to liquidation. I will come back to this in 18 relation to the lacuna but we say that gives the hint as 19 to what one would say to the minister. Now of course, 20 my Lord, and your Lordship will appreciate, we do not 21 know what evidence was filed and what submissions were 22 made when it applied to the court. Your Lordship will 23 know one has applied to the court for permission to make 24 distributions and we say that is all telling because we 25 say that is part and parcel of why it is an alternative</p> <p style="text-align: center;">Page 7</p>
<p>1 the relevant rule applies in respect of calls that have 2 been made rather than calls or further calls to which 3 the contributory might be liable in the future. We 4 submit that the position is, a fortiori, administration. 5 So, to adopt the approach and to persuade your Lordship 6 generally, if your Lordship wants to find a principle, 7 we accept there has been no authority in relation to 8 that particular problem your Lordship has identified but 9 nevertheless as a matter of principle we say the 10 position is a fortiori here. Here where no call can be 11 made at all unless and until A the company passes into 12 liquidation, as we submit, and B there is a shortfall 13 requiring the liquidators (Inaudible). My Lord, it is 14 important to note that the LIBE administrators accept 15 they cannot make a call while LIBE is in administration. 16 They do not contend that the failure to give them this 17 power is another lacuna. I will come back to that in 18 relation to the homework point which the court should 19 fill. They accept that if a call needs to be made they 20 will have to go into liquidation to make it. The 21 administrators have said that one of the facts in 22 deciding whether or not to go into liquidation will be 23 the outcome of this application. For your Lordship's 24 note, that is Mr Down's fourth witness statement, which 25 is 3/6/22, paragraph 65. That is the reference. They</p> <p style="text-align: center;">Page 6</p>	<p>1 to liquidation. The court has to be persuaded as to the 2 right thing to do. I will come back to this in relation 3 to the lacuna but we say what then happens is one has to 4 take the rough with the smooth, such as it be. I say 5 we: they, the LIBE administrators. Your Lordship will 6 also know that know the relevant provision provides that 7 no distribution can be made to unsecured 8 non-preferential creditors without the permission of the 9 court. The reason why we do not know any of that and we 10 do not know what was actually said is that application 11 is C. That is Mr Howell's witness statement at 3/4/5, 12 paragraph 20 for your Lordship's note. 13 MR JUSTICE DAVID RICHARDS: 3... 14 MR TRACE: 3/4/5; paragraph 20. Forgive me giving the 15 references like that. Now part of the homework we have 16 done over the weekend is to dig out the decision of 17 Mr Justice Rimer, a very wise judgment, re GHE 18 Realisations Ltd. (Handed) I do not know when 19 your Lordship last looked at this. There were joint 20 administrations which had entered administration ration 21 pursuant to an administration order. They applied to 22 the court for permission under the relevant paragraph. 23 That is the paragraph here that I have been talking 24 about: made distributions to non-pref unsecured 25 creditors and:</p> <p style="text-align: center;">Page 8</p>

<p>1 "They also sought directions as to the proper manner</p> <p>2 ...(Reading to the words)... following the intended</p> <p>3 distribution. In particular as whether it would be open</p> <p>4 to ...(Reading to the words)... paragraph 84(1)."</p> <p>5 "On the application it was held, granting</p> <p>6 permission, that the consideration which would</p> <p>7 ultimately govern ...(Reading to the words)... under the</p> <p>8 relevant paragraph, make distribution [et cetera] was</p> <p>9 whether the making of the proposed distributions</p> <p>10 ...(Reading to the words)... in the best interests of</p> <p>11 ...(Reading to the words)... the relevant court in that</p> <p>12 case was so satisfied."</p> <p>13 Then the learned judge gave directions that the</p> <p>14 administrator was under a duty to serve notice, et</p> <p>15 cetera. Your Lordship can see that.</p> <p>16 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>17 MR TRACE: Now, my Lord, as your Lordship will have seen,</p> <p>18 that case established that the principal consideration</p> <p>19 on such an application was in the interest of the</p> <p>20 company's creditors(?) as a whole. If your Lordship</p> <p>21 turns to paragraph 10, if your Lordship looks just below</p> <p>22 F, does your Lordship have page 290?</p> <p>23 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>24 MR TRACE: It is the sentence that begins:</p> <p>25 "Mr Windat's second statement." Does your Lordship</p> <p style="text-align: center;">Page 9</p>	<p>1 at page 355. If your Lordship picks it up. It is about</p> <p>2 14 lines down, the sentence that begins:</p> <p>3 "There will be circumstances",</p> <p>4 On page 351. The numbering is at the top.</p> <p>5 MR JUSTICE DAVID RICHARDS: Sorry, just help me again where</p> <p>6 it is.</p> <p>7 MR TRACE: It is 14 lines down from the top.</p> <p>8 MR JUSTICE DAVID RICHARDS: "There will be". Yes, I have</p> <p>9 it.</p> <p>10 MR TRACE: "There will be circumstances in which particular</p> <p>11 categories of creditors may be adversely or beneficially</p> <p>12 affected by a distribution in administration as opposed</p> <p>13 to a liquidation."</p> <p>14 Your Lordship notes the contrast. It is</p> <p>15 administration as opposed to liquidation. But we say</p> <p>16 effectively there is a choice and it is an alternative;</p> <p>17 in fact a real alternative. What one has to do is</p> <p>18 persuade the court that the relevant approach is the</p> <p>19 right one, is a distributive administration and that is</p> <p>20 why there is the sanction of the court:</p> <p>21 "In such cases ...(Reading to the words)... the test</p> <p>22 which we suggest should be applied ...(Reading to the</p> <p>23 words)... may alter the amount of provable debt</p> <p>24 ...(Reading to the words)... it may also be the case</p> <p>25 that ...(Reading to the words)... paragraph 68(2)."</p> <p style="text-align: center;">Page 11</p>
<p>1 see that?</p> <p>2 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>3 MR TRACE: "Mr Windat's second statement [it gives the date]</p> <p>4 confirms that the joint administrators [these are the</p> <p>5 critical words] had expressly considered ...(Reading to</p> <p>6 the words)... in liquidation and have concluded that</p> <p>7 there were no other creditors ...(Reading to the</p> <p>8 words)... who would be so affected."</p> <p>9 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>10 MR TRACE: I cannot help tweaking my learned friend's tail</p> <p>11 by noting at paragraph 10 in the report that the learned</p> <p>12 judge relied upon Mr Trower's own book, I say his own</p> <p>13 book but the book to which he is no doubt contributing</p> <p>14 in which the authors point out that:</p> <p>15 "The case may be one in which particular categories</p> <p>16 of creditors ... the administration or in the subsequent</p> <p>17 liquidation",</p> <p>18 And they give illustration as to how this might</p> <p>19 arise. What we have done, if I may, is if I can just</p> <p>20 hand up. (Handed)</p> <p>21 MR JUSTICE DAVID RICHARDS: Thank you very much.</p> <p>22 MR TRACE: I am sure Mr Trower is no doubt hard at work on</p> <p>23 the next edition.</p> <p>24 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>25 MR TRACE: The relevant passage for your Lordship's note is</p> <p style="text-align: center;">Page 10</p>	<p>1 Then, my Lord, Miss Hutton then asks me to read on</p> <p>2 and I do:</p> <p>3 "It is thought however that the jurisdiction in</p> <p>4 England and Wales ...(Reading to the words)... is</p> <p>5 different in concept from a general direction in</p> <p>6 connection with any aspect of the management of the</p> <p>7 company's affairs, business or property."</p> <p>8 In our respectful submission, if that is right, and</p> <p>9 we respectfully urge upon your Lordship that it is, that</p> <p>10 there is this choice, there is this clear alternative.</p> <p>11 What has happened here is that by choosing to move to</p> <p>12 distribution without making calls, the administrators</p> <p>13 have made clear their view that a call is highly</p> <p>14 unlikely, so unlikely that distributions will be made</p> <p>15 without going into liquidation. Rather than there being</p> <p>16 any difficulty in such a case with the rule not being</p> <p>17 applied. We respectfully submit that it would be</p> <p>18 contrary to the principles established by the</p> <p>19 authorities for the rule to be applied in such a case.</p> <p>20 The situation we respectfully submit is at least as</p> <p>21 strong and very similar to the situation of</p> <p>22 a liquidation where no call has yet been made.</p> <p>23 Consistently with this, and we say for the same reasons,</p> <p>24 it is also our position and our submission that our</p> <p>25 clients are to be treated as under no section 74</p> <p style="text-align: center;">Page 12</p>

<p>1 liability, including no contingent liability at all. We 2 make that in our supplemental submissions, for 3 your Lordship's note at paragraph 6F. My Lord, that is 4 our primary case. Our alternative case, as I mentioned 5 at the very beginning, is if we are wrong and the court 6 is concerned that the liability should be recognised now 7 then we respectfully submit it is obvious that it is an 8 existing contingent liability Of LIBE, LBHI2, and 9 available for set-off in the ordinary way after 10 valuation to reflect the contingency in accordance with 11 the rules and principles in Danko(?) which has already 12 been mentioned by Mr Trower and Mr Wolfson. For your 13 Lordship's note, it is in our opening submissions at 14 paragraph 69 and the relevant rules, as your Lordship no 15 doubts knows by now, are Insolvency Rules, 285(3) and 16 (4) in particular. For all these reasons we 17 respectfully submit that there is no reason why the 18 approach we propose does not give full reflection to the 19 principle behind the contributory rule. Despite the 20 fact that calls cannot be made other than by 21 a liquidator when the company is in liquidation the 22 administrators started distributing the state to 23 unsecured non-preferential creditors in the admin. They 24 therefore chose, we respectfully submit, to take 25 a snapshot of the company's financial position now</p> <p style="text-align: center;">Page 13</p>	<p>1 reason they are being kept out of sums due to them in 2 respect of debts owed to them. My Lord, these are debts 3 which it is common ground are debts owed to them other 4 than in their capacity as members. That is the first 5 prejudice. Secondly, my Lord, there is nothing they can 6 do, nothing that my clients can do or the other member 7 to improve their position as no call has been made. 8 They are not able to make a commercial decision about 9 whether they should meet the call in order to "complete 10 the estate". Thirdly, my Lord, and this follows on from 11 the point we were making earlier, given that the 12 administrators have chosen to embark on a distributive 13 administration rather than a liquidation, as opposed to 14 a liquidation, as an alternative to liquidation, and in 15 making that decision the administrators have formed 16 a particular view and acted on the basis of a particular 17 view as to whether a call is necessary, at least in the 18 near future. They must have done. In our respectful 19 submission there is absolutely no reason whatever why 20 that decision should not just follow through into the 21 way in which the members are dealt with in the 22 meanwhile, in particular in relation to distributions. 23 So that is the first way we put it. 24 We have alternative submission. Even if the 25 section 74 liability is to be recognised as a contingent</p> <p style="text-align: center;">Page 15</p>
<p>1 rather than in liquidation and they decided to 2 distribute on that basis. Having made that choice, 3 my Lord, whether one calls it the rough or the smooth or 4 whatever, having elected that alternative, however one 5 describes it, we say then everything flows from there. 6 Part of that choice we respectfully submit must have 7 included an informed decision about the likelihood or 8 otherwise of a call being made because of course we do 9 not know the actual position as the file is sealed. 10 That likelihood of course will have reflected the 11 potential contingent liability of my clients for a call 12 which must have been valued, in some way there is 13 a liability, rather not as a liability of the 14 administration at all or as a potential liability, all 15 of which is consistent, we respectfully submit, with the 16 principle. Now, my Lord, in answer to what we said LIBE 17 in its supplemental submissions for, and your Lordship's 18 note that is paragraph 29(iv), argue and submit there is 19 no real prejudice to members by applying the 20 contributory rule and that there will be no real 21 prejudice to creditors if the rule were not applied. 22 With respect we fundamentally disagree for the following 23 three reasons: first, there is real prejudice to the 24 members and of course their creditors given that both 25 members are in admin in the meanwhile for the simple</p> <p style="text-align: center;">Page 14</p>	<p>1 liability of LBHI2 while LIBE is in administration then 2 we respectfully submit that the appropriate treatment is 3 for the administrators to value it and we set that our 4 in our submissions, for your Lordship's note at 5 paragraph 73-87. Having done that valuation, that value 6 is then set off against my client's proof in the 7 administration, again as set out in our submissions at 8 paragraph 68-72, rather than apply the contributory or 9 equitable(?) rule. So our alternative submission is it 10 is one of valuation, we say in the ordinary way, as 11 I said in opening. If that valuation does not 12 adequately reflect the fact that a call is very unlikely 13 then we challenge the valuation and the relevant rule is 14 in the liquidation rule, 483(?) and in the admin it is 15 rule 270. Further, my Lord, if and when it becomes 16 clear or clearer that no call is going to be made then 17 the value of the section 74 liability will fall to be 18 revalued which again is expressly contemplated by the 19 rules, for example, rule 486(i). So, my Lord, that is 20 what we say under how the equitable rule should apply 21 Now, my Lord, we have a further alternative. If that is 22 wrong, of course we do not accept for a minute it is, 23 but if any of the above is wrong and the equitable rule 24 rather than insolvency set-off does fall to be applied 25 in the administration of LIBE or if the equitable rule</p> <p style="text-align: center;">Page 16</p>

<p>1 fails to be applied in due course if a call is made in</p> <p>2 LIBE's liquidation then we respectfully submit the way</p> <p>3 it should be applied is as LBL and Mr Wolfson's client</p> <p>4 submit ie the calculation is carried out in the maths</p> <p>5 notation by Lord Justice Chadwick in SSSL and described</p> <p>6 in words by Lord (Inaudible) My Lord, that is all we</p> <p>7 wish to say in relation to that.</p> <p>8 I trailed at the beginning the homework that we have</p> <p>9 done.</p> <p>10 MR JUSTICE DAVID RICHARDS: Your primary submission in this</p> <p>11 area is that the members are not under any section 74</p> <p>12 liability, contingent or otherwise.</p> <p>13 MR TRACE: Correct.</p> <p>14 MR JUSTICE DAVID RICHARDS: And therefore there is no</p> <p>15 liability either for the administrators to prove in your</p> <p>16 administration, distributive administration, or to be</p> <p>17 the subject of set-off. I understand that you really</p> <p>18 rely on Mr Issacs' submissions in that respect; is that</p> <p>19 right?</p> <p>20 MR TRACE: That is right, particularly in relation to</p> <p>21 regulatory --</p> <p>22 MR JUSTICE DAVID RICHARDS: Yes. That is really the</p> <p>23 regulatory background to the subordinated debt.</p> <p>24 MR TRACE: But also we rely on that, but also we rely on the</p> <p>25 submission --</p> <p style="text-align: center;">Page 17</p>	<p>1 I mentioned, it requires permission under paragraph 65</p> <p>2 of schedule B1. secondly, my Lord, in GHE -- and I have</p> <p>3 shown your Lordship the case -- Mr Justice Rimer (as he</p> <p>4 then was) held that the question was whether it was in</p> <p>5 the best interest of the creditors as a whole.</p> <p>6 Your Lordship will recall that.</p> <p>7 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>8 MR TRACE: Thirdly, he also held, following citation from</p> <p>9 Mr Trower's learned tome, that that involved</p> <p>10 consideration of whether distributions would affect</p> <p>11 creditors unequally. Your Lordship will recall that</p> <p>12 passage, I showed your Lordship that. Fourthly, it is</p> <p>13 perhaps -- (Pause) your Lordship will have noted from</p> <p>14 page 355 that Mr Trower and his fellow writers, and if</p> <p>15 I can just go back to page 355. Of course, my Lord,</p> <p>16 this book was written I think, the last edition, in</p> <p>17 2002.</p> <p>18 MR TROWER: 4.</p> <p>19 MR TRACE: 2004 I am told. But it is instructive, and again</p> <p>20 I cannot resist tweaking my learned friend's tail, to</p> <p>21 note that on page 355 -- I pick it up at line 4:</p> <p>22 "Schedule B1 of the Act gives no further guidance as</p> <p>23 to the circumstance in which the grant of permission</p> <p>24 ...(Reading to the words)... might be appropriate but</p> <p>25 the most obvious situation [say the learned editors] is</p> <p style="text-align: center;">Page 19</p>
<p>1 MR JUSTICE DAVID RICHARDS: Oh, you do. Thank you very</p> <p>2 much.</p> <p>3 MR TRACE: But there are two further alternatives.</p> <p>4 MR JUSTICE DAVID RICHARDS: Yes, I follow that but just on</p> <p>5 that, as it were, your main point, you are content to</p> <p>6 rely on Mr Isaacs.</p> <p>7 MR TRACE: Yes.</p> <p>8 MR JUSTICE DAVID RICHARDS: Thank you.</p> <p>9 MR TRACE: I then trailed as I --</p> <p>10 MR JUSTICE DAVID RICHARDS: Your homework.</p> <p>11 MR TRACE: My homework.</p> <p>12 NEW SPEAKER: Yes, yes.</p> <p>13 MR TRACE: Goody two shoes. Now, my Lord, can I remind</p> <p>14 your Lordship what we submitted on Friday afternoon. We</p> <p>15 submitted that it was possible to think of principled</p> <p>16 reasons and I gave your Lordship a couple of examples</p> <p>17 why Parliament may have decided to treat accrued</p> <p>18 interest differently on the move from admin to</p> <p>19 liquidation than on the move from liquidation to admin.</p> <p>20 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>21 MR TRACE: In our respectful submission, what we said was</p> <p>22 correct and there is a principled reasons for</p> <p>23 a different treatment of interest in these two</p> <p>24 circumstances. We make four short points. First of</p> <p>25 all, distribution in administration is not assumed. As</p> <p style="text-align: center;">Page 18</p>	<p>1 the case in which liquidation is unnecessary because the</p> <p>2 effect of the admin has also been to wind up the</p> <p>3 company's affairs ...(Reading to the words)... to the</p> <p>4 company's unsecured creditors."</p> <p>5 We say that is all of a piece with how we say the</p> <p>6 principle is. My Lord, if those four perhaps</p> <p>7 propositions are correct, and we respectfully submit</p> <p>8 they are unanswerable, then in those circumstances the</p> <p>9 principle situation is that distribution in</p> <p>10 administration is an alternative rather than</p> <p>11 a pre-cursor to liquidation. It is therefore, in our</p> <p>12 respectful submission, entirely possible that the</p> <p>13 current difference in the rules is the result of the</p> <p>14 legislature considering that there is no need for</p> <p>15 a provision for accrued interest rights in the</p> <p>16 administration to continue if the company goes into</p> <p>17 liquidation. The situation might arise in this case on</p> <p>18 LIBE's case if the court were to find that a call can be</p> <p>19 made for statutory interest, for example. However, the</p> <p>20 fact it might arise here in the very peculiar</p> <p>21 circumstances of this case of unlimited companies does</p> <p>22 not demonstrate that the current rules involve any error</p> <p>23 or should be construed other than as all parties suggest</p> <p>24 of their natural reading as the judge, as your Lordship</p> <p>25 has already commented the situation here is a very much</p> <p style="text-align: center;">Page 20</p>

<p>1 a one off. Miss Hutton reminds me that in the second</p> <p>2 report, which is in volume 6A, at page 165, it might be</p> <p>3 worth getting that out, my Lord. Does your Lordship</p> <p>4 have page 165?</p> <p>5 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>6 MR TRACE: The passage I would like to draw your attention</p> <p>7 to is section 4.5 on that page. It is headed:</p> <p>8 "Proposed mechanism for future creditor</p> <p>9 distribution."</p> <p>10 Does your Lordship see that?</p> <p>11 MR JUSTICE DAVID RICHARDS: I do.</p> <p>12 MR TRACE: If your Lordship sees the left-hand column, and</p> <p>13 drop down to the last paragraph:</p> <p>14 "The administrator's current view."</p> <p>15 Does your Lordship see that?</p> <p>16 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>17 MR TRACE: We are just checking the date.</p> <p>18 MR JUSTICE DAVID RICHARDS: I think it is on the bottom of</p> <p>19 page 164. It is for the period to 14 September 2009.</p> <p>20 MR TRACE: Your Lordship is quite right. What is notable,</p> <p>21 the fifth paragraph:</p> <p>22 "The administrator's current view [that is at that</p> <p>23 stage] is that scheme of arrangement is likely to be</p> <p>24 most sufficient ...(Reading to the words)... unsecured</p> <p>25 creditors."</p> <p style="text-align: center;">Page 21</p>	<p>1 mentioned this on Friday -- before proposed proceedings</p> <p>2 to be brought by the liquidator. I mentioned this.</p> <p>3 But, my Lord, in such a case, the administrators will</p> <p>4 either not have gone into a distributive administration</p> <p>5 at all, so that no question arises, or, alternatively,</p> <p>6 the relevant administrators will not have a surplus</p> <p>7 because they will be about to bear the costs of those</p> <p>8 investigations in subsequent proceedings. So it is very</p> <p>9 difficult to see this sort of contingency, if I can call</p> <p>10 it that. It follows, my Lord, and we say it</p> <p>11 inextricable follows that where a company moves from</p> <p>12 admin into liquidation there will not be any creditors</p> <p>13 who have an accrued right to statutory interest in the</p> <p>14 admin and the assets in the hand of the relevant</p> <p>15 administrators which might otherwise constitute the</p> <p>16 necessary surplus will be liable to be spent in the</p> <p>17 subsequent and following liquidation. By contrast, of</p> <p>18 course, moving from liquidation into administration</p> <p>19 might occur in a case where a the liquidator realised he</p> <p>20 was going to realise more assets than expected and pay</p> <p>21 all unsecured creditors in full, so leaving him with</p> <p>22 a surplus for the purposes of section 189(2) and</p> <p>23 therefore wanting to go into admin as a pre-cursor to</p> <p>24 some sort of rescue of the company; one can see that.</p> <p>25 However, it might well be thought that a transition to</p> <p style="text-align: center;">Page 23</p>
<p>1 No suggestion of liquidation. This is all of</p> <p>2 a piece, we respectfully submit, for the principal</p> <p>3 approach we urge upon your Lordship. It is an</p> <p>4 alternative. The court has to be gone(?) to for</p> <p>5 permission. A decision has to be made. Points have to</p> <p>6 be put to the court.</p> <p>7 MR JUSTICE DAVID RICHARDS: It is not a once and for all</p> <p>8 decision. A court may give permission for a limited</p> <p>9 distribution and the company may subsequently go into</p> <p>10 liquidation.</p> <p>11 MR TRACE: That is possible. But, my Lord, I do not want to</p> <p>12 sound cheeky but anything is possible. We respectfully</p> <p>13 submit when one is looking to see what was the real</p> <p>14 underlying principle, your Lordship was clearly troubled</p> <p>15 on Friday to find some sort of principle. In our</p> <p>16 respectful submission, that is the answer.</p> <p>17 Your Lordship will also recall that we submitted in</p> <p>18 summary that it is very difficult to think of</p> <p>19 circumstances where a company in administration with</p> <p>20 a surplus for the purposes of rule 288(7) would go into</p> <p>21 liquidation. In that situation the administrators are</p> <p>22 most likely either to pay statutory interest and bring</p> <p>23 the administration to an end, option 1, or, the cases</p> <p>24 illustrate that one reason why a company might move from</p> <p>25 admin into liquidation is to make investigations -- I</p> <p style="text-align: center;">Page 22</p>	<p>1 admin to the possibility of any such rescue should not</p> <p>2 prejudice the creditors who were paid or were to be paid</p> <p>3 from the funds available in the liquidation, including</p> <p>4 interest from an expected surplus. Your Lordship, as we</p> <p>5 have seen, and gave us homework to do as to the possible</p> <p>6 policy rationale, it flows from what we have said that</p> <p>7 there is a clear policy, we respectfully submit. We</p> <p>8 submit that with possible exception of this case,</p> <p>9 because it is so unusual, and in particular it involves</p> <p>10 the unlimited company position, in our respectful</p> <p>11 submission it is difficult to imagine a situation where</p> <p>12 a company would make partial distribution to creditors</p> <p>13 in a distributive administration and then go into</p> <p>14 liquidation with money left over from the administration</p> <p>15 and pay the remaining distributions to unsecured</p> <p>16 creditors in liquidation. If the unsecured creditors</p> <p>17 were capable of being paid in full then there would be</p> <p>18 unlikely to be a good reason as the why the</p> <p>19 administrators had simply made the distributions</p> <p>20 (Inaudible) in the admin, so they could then ascertain</p> <p>21 whether or not they had a surplus to apply in the</p> <p>22 disjoint of interest under the rule. If there were</p> <p>23 little or no chance of the unsecured creditors being</p> <p>24 paid 100p in the pound and some other good reason eg, as</p> <p>25 I have suggested, the investigation of and bringing</p> <p style="text-align: center;">Page 24</p>

6 (Pages 21 to 24)

<p>1 proceedings against former directors, so there is some</p> <p>2 good reason to go into liquidation, then there will be</p> <p>3 no need to protect the interest of unsecured creditors</p> <p>4 in obtaining payment of statutory interest under</p> <p>5 rule 288(7) because there is little of no chance, we</p> <p>6 stress that, of the existence of a surplus which is the</p> <p>7 trigger for the payment of that statutory interest and</p> <p>8 certainly no accrued right to interest at the date at</p> <p>9 which the company went into administration. So we</p> <p>10 respectfully submit the short brief to the minister in</p> <p>11 very headline points would be that distributing admin is</p> <p>12 an alternative and was always perceived to be an</p> <p>13 alternative to liquidation. Mr Trower in his book</p> <p>14 effectively points that out. A choice has to be made.</p> <p>15 An application has to be made to the court. It is only</p> <p>16 in the very, very exceptional circumstances of this case</p> <p>17 that any possible problem might arise which is not one</p> <p>18 that one would ever have thought of. So it is not some</p> <p>19 gaping lacuna we respectfully submit that your Lordship</p> <p>20 should somehow strain to try and fill. We respectfully</p> <p>21 submit there is a very strong policy reason for why the</p> <p>22 situation has not been dealt with at all.</p> <p>23 MR JUSTICE DAVID RICHARDS: Can you just remind me of the</p> <p>24 rule that applies to liquidations on interest? I know</p> <p>25 we have got section 189 and there is rule 288, but there</p> <p style="text-align: center;">Page 25</p>	<p>1 the minister.</p> <p>2 MR TRACE: Well, my Lord, yes and no. Yes, because it is</p> <p>3 a fact. But no, in respect of whether that is an answer</p> <p>4 to the principle of which we have been submitting</p> <p>5 to your Lordship.</p> <p>6 MR JUSTICE DAVID RICHARDS: Your answer I think proceeds the</p> <p>7 on basis that a distributed administration is seen is an</p> <p>8 alternative rather than a precursor.</p> <p>9 MR TRACE: That is the headline point.</p> <p>10 MR JUSTICE DAVID RICHARDS: That will take care of interest.</p> <p>11 That is true so far as it goes. But it does not, does</p> <p>12 it, provide an answer for the case of the</p> <p>13 non-distributed administration of a company which then</p> <p>14 goes into liquidation.</p> <p>15 MR TRACE: My Lord, it does not provide an answer for the</p> <p>16 non-distributed administration. That is certainly true.</p> <p>17 But in relation to the headline to the minister,</p> <p>18 certainly it is not enough for the minister to go on and</p> <p>19 make a speech on. Joking apart --</p> <p>20 MR JUSTICE DAVID RICHARDS: Yes, I am not joking. It seems</p> <p>21 to me that it is still be difficult to see, to find the</p> <p>22 justification in the case of an administration followed</p> <p>23 by a liquidation except I understand your argument in</p> <p>24 respect of distributed administration.</p> <p>25 MR TRACE: But, my Lord, we also make the point, obviously</p> <p style="text-align: center;">Page 27</p>
<p>1 is one in Harkencore(?) as well, is there not?</p> <p>2 MR TRACE: Yes, if I can find it.</p> <p>3 MR JUSTICE DAVID RICHARDS: It is 493.</p> <p>4 MR TRACE: 493 I think it is. Miss Hutton leaps ahead of</p> <p>5 me.</p> <p>6 MR JUSTICE DAVID RICHARDS: You see under 493(1):</p> <p>7 "Where a debt approved in the liquidation bears</p> <p>8 interest and that interest is proveable as part of the</p> <p>9 debt except insofar as it is payable in respect of any</p> <p>10 period after the relevant date."</p> <p>11 The relevant date is --</p> <p>12 MR TRACE: Is defined in A1.</p> <p>13 MR JUSTICE DAVID RICHARDS: -- in A1. But if the</p> <p>14 liquidation has been preceded by an administration it is</p> <p>15 the date of administration. So if a company goes into</p> <p>16 administration on January 1, June 1st it goes into</p> <p>17 liquidation and then debts are proved. There is no</p> <p>18 interest proveable after, accruing after 1 January.</p> <p>19 MR TRACE: That is right.</p> <p>20 MR JUSTICE DAVID RICHARDS: That does not depend upon the</p> <p>21 administration being a distributive administration. It</p> <p>22 could apply to any.</p> <p>23 MR TRACE: No. It could apply to any.</p> <p>24 MR JUSTICE DAVID RICHARDS: So, I mean, one has to take</p> <p>25 account of that in trying to put together the policy for</p> <p style="text-align: center;">Page 26</p>	<p>1 trying to define the principle, and I think I've said</p> <p>2 it, and I will repeat it, if I may, that an accrued</p> <p>3 right includes the idea of some sort of surplus after</p> <p>4 payment of proved debts and in a non-distributing</p> <p>5 administration there never is such a surplus.</p> <p>6 MR JUSTICE DAVID RICHARDS: It might be in the liquidation.</p> <p>7 MR TRACE: Possibly in the liquidation, but then we make the</p> <p>8 point that we say that, if that's right, there well may</p> <p>9 well be reasons to go back to an admin, as we've said.</p> <p>10 MR JUSTICE DAVID RICHARDS: I'm not sure that would help.</p> <p>11 You would still lose on out on that period of interest,</p> <p>12 wouldn't you?</p> <p>13 MR TRACE: My Lord, yes. But my Lord --</p> <p>14 MR JUSTICE DAVID RICHARDS: Well, it may be that that is the</p> <p>15 effect of the legislation.</p> <p>16 MR TRACE: But, my Lord, it may also be, with respect, that</p> <p>17 that's something your Lordship doesn't have to grapple</p> <p>18 with, because we're not in that situation. We're in</p> <p>19 a distributive administration.</p> <p>20 MR JUSTICE DAVID RICHARDS: Well, I've been asked to grapple</p> <p>21 with it. I hadn't, I don't think, appreciated when</p> <p>22 I started the hearing last Tuesday that I was being</p> <p>23 asked to decide that, but I was told by Mr Trower -- and</p> <p>24 I think everyone agreed, certainly no-one dissented --</p> <p>25 that I am being asked to and there must be some</p> <p style="text-align: center;">Page 28</p>

<p>1 practical reason that I'm being asked it, I hope.</p> <p>2 MR TROWER: My Lord, indeed your Lordship is and one only</p> <p>3 has to listen to Mr Trace's submissions to see why,</p> <p>4 because it is an important factor, for everybody</p> <p>5 concerned, on what should happen next.</p> <p>6 MR JUSTICE DAVID RICHARDS: Right. Very well. There we</p> <p>7 are. Yes, Mr Trace?</p> <p>8 MR TRACE: Well, those are our submissions in relation to</p> <p>9 those.</p> <p>10 MR JUSTICE DAVID RICHARDS: Thank you.</p> <p>11 MR TRACE: Currency conversion claims.</p> <p>12 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>13 MR TRACE: My Lord, I'm conscious of the time. I don't know</p> <p>14 whether the shorthand writer would like a break. Are you</p> <p>15 happy to continue, or would you like one a bit later?</p> <p>16 MR JUSTICE DAVID RICHARDS: Well, I think --</p> <p>17 MR TRACE: When we reach quarter past eleven.</p> <p>18 My Lord, currency conversion claims. Your Lordship</p> <p>19 will recall the way Mr Zacaroli put it, and for</p> <p>20 your Lordship's note it's paragraph 6 of his opening</p> <p>21 submissions, and the way it's put by Mr Zacaroli is that</p> <p>22 a claim, or so-called currency conversion claim, he says</p> <p>23 is premised on:</p> <p>24 "(a) the contractual right of a creditor to be paid</p> <p>25 a debt in a currency other than Sterling; and</p> <p style="text-align: center;">Page 29</p>	<p>1 submission is flawed. We respectfully submit that to</p> <p>2 start with there's no binding authority for the</p> <p>3 proposition that an unsecured creditor is entitled to</p> <p>4 payment of any sort of currency conversion claim before</p> <p>5 any surplus is returned to the members of a company.</p> <p>6 Nor is there any such authority that any claim of this</p> <p>7 sort exists or should even be recognised, and we make</p> <p>8 that point in our opening submissions at paragraph 88,</p> <p>9 for your Lord's note.</p> <p>10 Now, my Lord, what Lydian have come up with is</p> <p>11 they've said that they've got a very specific claim,</p> <p>12 they say, the value of which can be calculated in</p> <p>13 a specific way, and which Mr Zacaroli says should always</p> <p>14 be available -- always, he says -- in circumstances</p> <p>15 where the movement in the exchange rate means that the</p> <p>16 foreign currency can receive the payment in Sterling</p> <p>17 et cetera, which amount to less than 100 per cent of</p> <p>18 debt.</p> <p>19 Now, my Lord, the problem is twofold. First of all,</p> <p>20 my Lord, as Mr Wolfson identified in his submissions,</p> <p>21 which we support on this aspect of the case -- it was</p> <p>22 Friday morning, my Lord -- the claim proposed by</p> <p>23 Mr Zacaroli would permit a creditor which had in fact</p> <p>24 suffered no loss at all by reason of currency movements,</p> <p>25 to recover a further payment on the basis of an apparent</p> <p style="text-align: center;">Page 31</p>
<p>1 (b) an entitlement to enforce that debt by action</p> <p>2 and obtain judgment expressed in a foreign currency,</p> <p>3 execute against assets in England in a sum of pounds,</p> <p>4 representing the judgment debt, converted from the</p> <p>5 foreign currency in the rate of the date of execution."</p> <p>6 My Lord, Mr Trower makes the same point. For</p> <p>7 your Lordship's note, that's paragraphs 51 and 52(1) of</p> <p>8 his openings.</p> <p>9 Now, my Lord, what they both say, both Mr Trower</p> <p>10 and Mr Zacaroli, this purported claim exists wherever</p> <p>11 the amount paid to the creditor in Sterling on its proof</p> <p>12 in LIBE's insolvency, although equal to 100 per cent of</p> <p>13 the creditor's proof is, when converted into relevant</p> <p>14 contractual currency upon the date its paid, less than</p> <p>15 100 per cent of the full amount of the debt expressed in</p> <p>16 the contractual currency, and so they say that Lydian,</p> <p>17 for example, was entitled to be paid in a foreign</p> <p>18 currency under its contract with LIBE. This carried with</p> <p>19 it a particular entitlement, namely if the debt was</p> <p>20 enforced by action to obtain a judgment expressed in the</p> <p>21 foreign currency and to obtain execution against assets</p> <p>22 et cetera. So they say any payment in Sterling which</p> <p>23 amounted to less than 100 per cent would leave</p> <p>24 a shortfall.</p> <p>25 Now, my that sounds good, but in our respectful</p> <p style="text-align: center;">Page 30</p>	<p>1 currency loss. Now, my Lord, we respectfully agree with</p> <p>2 Mr Wolfson and urge upon your Lordship that, as that</p> <p>3 possibility demonstrates, there are real difficulties</p> <p>4 with the approach postulated by Mr Zacaroli, which mean</p> <p>5 that recognising any such claim would be very far from</p> <p>6 the simple exercise which Mr Zacaroli would suggest in</p> <p>7 making his submission. Secondly, my Lord --</p> <p>8 MR JUSTICE DAVID RICHARDS: Well, just to spell out, how</p> <p>9 would he, the creditor, recover a further payment</p> <p>10 without suffering any loss? Can you just spell that out</p> <p>11 for me? I mean, he's got to demonstrate a currency</p> <p>12 loss.</p> <p>13 MR TRACE: My Lord yes.</p> <p>14 MR JUSTICE DAVID RICHARDS: Is this the point about the</p> <p>15 discount for future payments, so different interest --</p> <p>16 all right.</p> <p>17 MR TRACE: My Lord, yes. We've got example, which I can</p> <p>18 give your Lordship.</p> <p>19 MR JUSTICE DAVID RICHARDS: Okay, just give me a moment.</p> <p>20 MR TRACE: And three simple factual steps, my Lord. Now,</p> <p>21 one imagines a debt of a million dollars due on</p> <p>22 1 January, which the company doesn't pay. Secondly, my</p> <p>23 Lord, the company subsequently goes into administration</p> <p>24 on 1 March. We've tried to model this on what Mr Lawson</p> <p>25 said. The company subsequently goes into administration</p> <p style="text-align: center;">Page 32</p>

<p>1 on 1 March, permission is given to distribute and, 2 pursuant to the relevant rule, which is 286(i), a 3 million dollar claim is converted into Sterling at the 4 rate prevailing on 1 March. Then thirdly, 3, payment is 5 made in the distributive administration on 1 July. So 6 it's a debt on 1 January which is not paid, 7 administration on 1 March and the claim is converted at 8 that date and payment's made on 1 July.</p> <p>9 Now, what Mr Zacaroli is asking the court to 10 recognise is a claim by a foreign currency creditor, 11 where the amount of Sterling the creditor receives on 12 1 July, when converted at the exchange rate on 1 July, 13 is less than \$1 million, the claim being said to be the 14 difference between the million dollars and the dollar 15 equivalent on 1 July of whatever Sterling he'd then 16 receive.</p> <p>17 MR JUSTICE DAVID RICHARDS: Just to flesh this out, so are 18 we saying -- can we just give some notional Sterling 19 equivalents to the million dollars at each of the three 20 dates you've given: 1 January, 1 March and 1 July?</p> <p>21 MR TRACE: Yes, we can, my Lord.</p> <p>22 MR JUSTICE DAVID RICHARDS: Thank you.</p> <p>23 MR TRACE: If the Sterling equivalent on 1 January was 24 800,000, and on 1 March it was 900,000, pounds this is, 25 Sterling, and on 1 July it was 950,000, now, my Lord,</p> <p style="text-align: center;">Page 33</p>	<p>1 pre-administration.</p> <p>2 I'm so sorry, it's 100,000, £100,000 better off than 3 he would have been if the company had paid its debt when 4 due pre-administration. So let's go through that again, 5 my Lord, because it's dense stuff.</p> <p>6 MR JUSTICE DAVID RICHARDS: I mean, I understand it in 7 Sterling terms, but I don't understand it in US dollars 8 terms. If he had been paid on 1 January, £800,000, in 9 Sterling, he would have received \$1 million, which is 10 his contractual right.</p> <p>11 MR TRACE: Yes.</p> <p>12 MR JUSTICE DAVID RICHARDS: On 1 July, he receives £900,000, 13 which is less than \$1 million. So he's not received his 14 contractual right. I mean, it doesn't matter what 15 Sterling difference is. What matters is the dollar 16 difference, because he's entitled to payment in dollars.</p> <p>17 MR TRACE: Well, he was entitled to payment in dollars, yes, 18 but, in terms of how this works, because of the dates 19 that are then chosen for the relevant payments, he's 20 actually in fact better off.</p> <p>21 MR JUSTICE DAVID RICHARDS: Well, in dollar terms he's not.</p> <p>22 MR TRACE: But in pound terms he is.</p> <p>23 MR JUSTICE DAVID RICHARDS: But his contractual claim is in 24 dollars.</p> <p>25 MR TRACE: I appreciate that, my Lord, but that's the</p> <p style="text-align: center;">Page 35</p>
<p>1 taking those three possibilities, which is perfectly 2 possible, if the creditor had been paid on 1 January 3 that's fact number 1, when the debt was paid, was 4 payable, he would have received £800,000 Sterling.</p> <p>5 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>6 MR TRACE: In fact, on my hypothesis, or our hypothesis, ie 7 the company going into administration on the 1st, 8 permission given to distribute and the million dollar 9 claim is converted into Sterling at the rate prevailing 10 on 1 March, in that secondary scenario his proof, the 11 relevant creditor's proof, was converted on 1 March as 12 being for £900,000 Sterling. Thirdly, he received, 13 assuming payment in full, as this is a case where 14 there's a surplus, £900,000 on 1 July.</p> <p>15 MR JUSTICE DAVID RICHARDS: Which gave him less than 16 \$1 million.</p> <p>17 MR TRACE: That's right.</p> <p>18 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>19 MR TRACE: So we respectfully urge upon your Lordship that, 20 even on Mr Zacaroli's analysis, this gives the creditor 21 a claim of £50,000, which is the difference between the 22 Sterling equivalent of the debt on the date of 23 conversion and the date of payment, when in fact the 24 creditor is £150,000 better off than he would have been 25 if the company had paid its debt when due</p> <p style="text-align: center;">Page 34</p>	<p>1 artificiality, we respectfully submit, of this claim, 2 this purported claim.</p> <p>3 MR JUSTICE DAVID RICHARDS: I see. Right.</p> <p>4 MR TRACE: Of course I completely accept your Lordship's 5 point, but what your Lordship is asked to do by 6 Mr Zacaroli, he says, oh well, of course this is 7 a claim. But, as Mr Wolfson rightly points out, and we 8 accept, and we urge upon your Lordship, it can lead to 9 very difficult results.</p> <p>10 My Lord, I was giving two flaws with the argument. 11 That's first one, we respectfully submit.</p> <p>12 MR JUSTICE DAVID RICHARDS: That's the first one, yes.</p> <p>13 MR TRACE: My Lord, I do respectfully urge upon 14 your Lordship it is no answer to say "oh well, if you'd 15 been paid in dollars". If we had paid in dollars, we 16 wouldn't be here at all.</p> <p>17 MR JUSTICE DAVID RICHARDS: Right.</p> <p>18 MR TRACE: My Lord, the second flaw is that the foreign 19 currency creditors, on Mr Zacaroli's analysis, would 20 have an upside only option. Mr Zacaroli doesn't suggest 21 that any adjustment process should work both ways, ie 22 adjusting payments if a foreign currency creditor 23 received more than 100 per cent of the debt expressed in 24 the foreign currency at the relevant exchange rate on 25 the date it was paid. In those circumstances, my Lord,</p> <p style="text-align: center;">Page 36</p>

<p>1 this purported currency conversion claim involved, we 2 respectfully submit, an uneven treatment of foreign 3 currency creditors which undermines the existing 4 statutory scheme in respect of foreign currency claims. 5 Your Lordship will know rule 286(7) makes it clear that 6 a line is drawn as to the relevant date, so there's a 7 certain figure for which a foreign currency claimant can 8 proved. That's the rationale behind that rule, to 9 provide certainty and have a fixed date, and on that 10 date a relevant line is drawn in the sand. 11 Now, the trouble with lines in the sand is sometimes 12 more sand goes, but there it is. It's a line in the 13 sand. 14 Not only are there these, we respectfully submit, 15 difficult factual questions, but there are also legal 16 problems, my Lord, with the greatest of respect to my 17 learned friend Mr Zacaroli and indeed Mr Trower. The 18 purported claim is based solely and simply on the dictum 19 of Lord Justice Brightman in In Re Lines Brothers -- 20 your Lordship has seen it -- and we respectfully 21 submit -- and we will go back to it -- that that dictum 22 is of relatively little weight, not only because it's a 23 dictum, but first of all Lord Justice Brightman 24 expressly stated the issue didn't arise for decision in 25 the case before them, and your Lordship will recall Page 37</p>	<p>1 Brothers approach. Its a statutory scheme enacted after 2 that decision which did not adopt the suggestions made 3 in Lines Brothers. My Lord, moreover, in this 4 particular case there is no suggestion, as far as we're 5 aware, that it's going to be possible for LIBE to pay 6 all unsecured creditors and statutory interest in full 7 thus leaving anything available to discharge the 8 purported currency conversion claims, if they exist. 9 Now, my Lord, the relevant evidence is given by the 10 administrators, and I'm going to give your Lordship the 11 reference, of LIBE and is to the effect that the assets 12 available will run out either during payment of 13 statutory interest or during payment of my clients, 14 whichever the court decides is to be paid first, and the 15 references are first of all Mr Down's first witness 16 statement, that's paragraph 58. 17 MR JUSTICE DAVID RICHARDS: Downs -- 18 MR TRACE: Downs 1, paragraphs 58. 19 MR JUSTICE DAVID RICHARDS: So that's in -- can you give me 20 just the volume reference. 21 MR TRACE: The volume is -- I think it's 3, tab 6. 22 MR JUSTICE DAVID RICHARDS: 3, tab, 6. 23 MR TRACE: 21. 24 MR JUSTICE DAVID RICHARDS: Right. Thank you. 25 MR TRACE: There are two paragraphs, my Lord, for your Page 39</p>
<p>1 that. Secondly, he specifically recognised, this is 2 21C, that he wished "to guard against expressing any 3 concluded view upon it", and lastly he acknowledged 4 that: 5 "I do not say this is necessarily the solution to 6 the problem but I have not heard any convincing 7 objection to that solution." 8 My Lord, we don't get from the case anything like 9 the sort of analysis that has now been, we hope 10 helpfully, given to your Lordship. 11 My Lord, we would add this, that not only is it just 12 a dictum, with the problems that often dicta don't have, 13 but it's expressly sort of put tentatively even as 14 dictum by Lord Justice Brightman in the case, it's been 15 superseded by the legislative scheme now in force post 16 1986, which now, in our respectful submission, clearly 17 provides a statutory scheme for the payment of post 18 liquidation and post administration interest from any 19 surplus remaining in the hands of the relevant office 20 holder following payment of approved debts. 21 Now, my Lord, this point has very considerable 22 force, we respectfully submit, not only in itself, but 23 it also gives weight to our submission that the interest 24 provisions don't leave room, that's the interest 25 provisions in the statutory scheme, for the Re Lines Page 38</p>	<p>1 Lordship's note. It's paragraphs 58 and 59 what he says 2 there, for the transcript, is: 3 "If unsecured creditors are paid in full and it's 4 held that statutory interest ranks ahead of the 5 sub-debt, there will be no monies available to meet 6 LBHI2's sub-debt claim. But if the sub-debt ranks ahead 7 of statutory interest, then LBHI2's sub-debt claim will 8 be paid in full and the amount of funds available to pay 9 statutory interest will be reduced by corresponding 10 liability." 11 That's what he says. 12 MR JUSTICE DAVID RICHARDS: Is that fleshed out with some 13 figures somewhere? 14 MR TRACE: Let me just have a look at it. 15 It is volume 3, my Lord, tab 6, and its page 21, 16 my Lord, and the answer is there's a little bit of 17 figures. It is page 21, my Lord. It's paragraph 58 and 18 509 I was paraphrasing, and it actually says: 19 "If it's held ... [etcetera] statutory interest 20 ranks ahead in the some of 1.3 billion." 21 There's nothing else -- 22 MR JUSTICE DAVID RICHARDS: There will be no monies 23 available to meet subordinate -- 24 MR TRACE: So that's the only thing there. 25 MR JUSTICE DAVID RICHARDS: If it's decided that LBHI2's Page 40</p>

<p>1 subordinated claim ranks ahead of the payment of</p> <p>2 interest, then the subordinated debt would in the high</p> <p>3 estimated outcome be paid in full, so there would be --</p> <p>4 yes, I see.</p> <p>5 MR TRACE: And, my Lord, to see the high estimate outcome,</p> <p>6 if you go back --</p> <p>7 MR JUSTICE DAVID RICHARDS: We're talking about quite a lot</p> <p>8 money here on any footing, aren't we?</p> <p>9 MR TRACE: That's right, my Lord.</p> <p>10 MR JUSTICE DAVID RICHARDS: On the high estimate, it's a</p> <p>11 figure in excess of 1.3 billion.</p> <p>12 MR TRACE: That's right, and, if your Lordship looks back to</p> <p>13 paragraph 56, there's a reference to the 9th progress</p> <p>14 report and in the second sentence -- does your Lordship</p> <p>15 have paragraph 56, second sentence?</p> <p>16 MR JUSTICE DAVID RICHARDS: I do, yes.</p> <p>17 MR TRACE: "The estimated outcome, that is dividend payment</p> <p>18 for unsecureds, ranged from 61p in the pound to 116p in</p> <p>19 the pound, subject to important assumptions."</p> <p>20 MR TROWER: My Lord, we've now got the 10th progress report,</p> <p>21 I think, in the miscellaneous document bundle. So the</p> <p>22 most up to date one is tab 12, miscellaneous documents,</p> <p>23 because that came in obviously after the evidence.</p> <p>24 MR JUSTICE DAVID RICHARDS: Thank you. Sorry, miscellaneous</p> <p>25 documents bundle?</p> <p style="text-align: center;">Page 41</p>	<p>1 MR TRACE: Deficiency or surplus.</p> <p>2 MR JUSTICE DAVID RICHARDS: Yes, I see.</p> <p>3 MR TRACE: I think the deficiency or surplus line for</p> <p>4 present purposes is the most interesting.</p> <p>5 MR JUSTICE DAVID RICHARDS: Sorry?</p> <p>6 MR TRACE: I think for present purposes, my Lord, it's the</p> <p>7 deficiencies/surplus line that is the most important.</p> <p>8 MR JUSTICE DAVID RICHARDS: Yes, indeed. Yes, well, thank</p> <p>9 you very much more that.</p> <p>10 MR TRACE: Thank you Mr Trower. Very helpful.</p> <p>11 MR JUSTICE DAVID RICHARDS: Thank you. Yes.</p> <p>12 MR TRACE: My Lord, I'm sorry to ask you to take it back,</p> <p>13 but in my notes I've also drawn attention to a couple of</p> <p>14 other passages in that same report. I do apologise for</p> <p>15 going back. It is the 10th report, my Lord.</p> <p>16 My Lord, I think those figures are still important,</p> <p>17 but I'd made a note of just a couple of passages. On</p> <p>18 page 5, the second paragraph in the first column I'd</p> <p>19 noted the sentence that begins there is an increasing</p> <p>20 likelihood. Does your Lordship see that?</p> <p>21 MR JUSTICE DAVID RICHARDS: Yes, I do.</p> <p>22 MR TRACE: "There's an increasing likelihood that there</p> <p>23 would be a significant surplus."</p> <p>24 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>25 MR TRACE: "... after the payment of all unsecureds and</p> <p style="text-align: center;">Page 43</p>
<p>1 MR TROWER: Yes. I've got it as --</p> <p>2 MR TRACE: It's just headed miscellaneous documents bundle.</p> <p>3 MR JUSTICE DAVID RICHARDS: Yes, I have it.</p> <p>4 MR TRACE: It's tab 12 in there, my Lord. I'm very</p> <p>5 grateful.</p> <p>6 MR TROWER: And page 9 is the one.</p> <p>7 MR TRACE: If your Lordship has page 9.</p> <p>8 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>9 MR TRACE: Indicative financial outcome:</p> <p>10 "We set out in the table below a high level analysis</p> <p>11 showing our current view of the low and high case</p> <p>12 financial outcome scenarios for unsecured creditors."</p> <p>13 And they says:</p> <p>14 "We've moved from reporting values in hundreds of</p> <p>15 millions to tens of millions."</p> <p>16 And it says:</p> <p>17 "... important to note that this is an indicative</p> <p>18 financial outcome range, subject to change, and excludes</p> <p>19 post admin interest which might become payable on claims</p> <p>20 so that it should be read in conjunction with the</p> <p>21 notes."</p> <p>22 And your Lordship then sees under "creditors".</p> <p>23 MR JUSTICE DAVID RICHARDS: Yes, total creditors. Low is</p> <p>24 17, high is 13.59, and then we have a deficiency or</p> <p>25 a surplus.</p> <p style="text-align: center;">Page 42</p>	<p>1 trust claims, it should be available to fund the payment</p> <p>2 of post administration interests and/or the claims of</p> <p>3 shareholders."</p> <p>4 At page 6, in the second column, my Lord, under</p> <p>5 some words in bold in the middle, so it is the third</p> <p>6 full paragraph that begins "the recent strengthening".</p> <p>7 Does your Lordship see that?</p> <p>8 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>9 MR TRACE: "The recent strengthening In the financial</p> <p>10 position of the administration now suggests that an</p> <p>11 outcome close to 100 per cent recovery is likely in the</p> <p>12 low case scenario, whilst in the high case scenario</p> <p>13 there will be sufficient funds to settle in full all</p> <p>14 ordinary ranking (unsubordinated) claims with the</p> <p>15 significant surplus available to fund claims by</p> <p>16 shareholders and/or other unsecured creditors claims for</p> <p>17 post administration interest."</p> <p>18 MR JUSTICE DAVID RICHARDS: Yes. Thank you.</p> <p>19 MR TRACE: And, my Lord, the conclusion that we ask</p> <p>20 your Lordship to draw from that material evidence is</p> <p>21 that this is simply a hypothetical question. So what</p> <p>22 your Lordship could do -- of course, its entirely</p> <p>23 a matter for your Lordship -- although asked to decide</p> <p>24 this point, your Lordship could express no concluded</p> <p>25 view on it in this application in the same way as Lord</p> <p style="text-align: center;">Page 44</p>

<p>1 Justice Brightman expressed no concluded view in Lines</p> <p>2 Brothers.</p> <p>3 MR JUSTICE DAVID RICHARDS: Sorry, I'm not quite clear. If</p> <p>4 statutory interest ranks ahead of your client's</p> <p>5 subordinated debt, on the best case scenario as it</p> <p>6 exists at the moment, will interest be paid in full, and</p> <p>7 there may be a surplus after the payment of interest?</p> <p>8 Mr Trower may be able to assist on that.</p> <p>9 MR TROWER: My Lord, our understanding is that there is</p> <p>10 a possibility that, if interest comes out first, that</p> <p>11 there will then be a surplus after the payment of</p> <p>12 interest and the question will then become who comes</p> <p>13 next.</p> <p>14 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>15 MR TRACE: I'm grateful for that answer. My Lord, I think</p> <p>16 that's what I said before. I think that's right.</p> <p>17 MR JUSTICE DAVID RICHARDS: Well, I think -- okay.</p> <p>18 MR TRACE: My Lord, it's not quite what the report says, but</p> <p>19 I'm grateful to Mr Trower. The report at page 5 says:</p> <p>20 "There's an increasing likelihood there will be a</p> <p>21 significant surplus after payment of all unsecured and</p> <p>22 trust claims."</p> <p>23 But there it is. That's page 5, my Lord, the</p> <p>24 passage I read your Lordship.</p> <p>25 MR JUSTICE DAVID RICHARDS: Well, I think the trouble is</p> <p style="text-align: center;">Page 45</p>	<p>1 your Lordship will recall that three examples were</p> <p>2 given. First of all there was the Humber Ironworks</p> <p>3 decision where the Court of Appeal considered whether</p> <p>4 interest accruing after the commencement of the</p> <p>5 liquidation, ie non-proveable interest, under</p> <p>6 a pre-liquidation contract need not be discharged before</p> <p>7 any surplus to determine shareholders, that example.</p> <p>8 The second one was your Lordship's T@N decision, and</p> <p>9 your Lordship knows what that decided, that this led to</p> <p>10 revision of rule 13.12(2). The third case that was</p> <p>11 referred to was the recent Nortel decision.</p> <p>12 Now, my Lord, Mr Wolfson has already addressed</p> <p>13 your Lordship on these points, and we adopt those</p> <p>14 submissions and support them. But very briefly,</p> <p>15 my Lord, and by way of emphasis, we make two</p> <p>16 submissions. First of all, the Humber Ironworks</p> <p>17 concerned post liquidation interest, which is now</p> <p>18 expressly provided for in section 192.</p> <p>19 As far as the T@N is concerned, that concerned tort</p> <p>20 claimants who didn't suffer actionable damage until</p> <p>21 after the commencement of the winding up, which is again</p> <p>22 now expressly provided for in rule 13.12(2).</p> <p>23 Lastly, my Lord, whilst of course in Nortel the</p> <p>24 Supreme Court did recognise a category of non-proveable</p> <p>25 liabilities to be discharged after the statutory</p> <p style="text-align: center;">Page 47</p>
<p>1 that obviously these things are subject to all sort of</p> <p>2 sensitivities of outcome, but what Mr Trower is</p> <p>3 suggesting is that this may not be a wholly hypothetical</p> <p>4 question.</p> <p>5 MR TROWER: My Lord, I'm slightly concerned to hear what my</p> <p>6 learned friend said just now, because it is in the</p> <p>7 application. It's something that all parties before</p> <p>8 your Lordship wanted your Lordship to decide. But there</p> <p>9 we are.</p> <p>10 MR JUSTICE DAVID RICHARDS: Yes, thank you.</p> <p>11 MR TRACE: I nevertheless like to give judges ways out if</p> <p>12 they wish to have them. (Laughter).</p> <p>13 But, my Lord, it's in the application and we don't</p> <p>14 shrink from that.</p> <p>15 My Lord, in addition to the currently alleged</p> <p>16 purported currency conversion claim, Lydian points at</p> <p>17 paragraph 19 to other types of liabilities which are</p> <p>18 non-provable -- your Lordship will recall this</p> <p>19 submission -- and which they say rank for payment</p> <p>20 following the discharge of proveable debts and statutory</p> <p>21 interest, but prior to any sums being returnable to</p> <p>22 members."</p> <p>23 And what Lydian argues, through Mr Zacaroli, is that</p> <p>24 the existence of these claims supports his submissions</p> <p>25 about the existence of currency conversion claims and</p> <p style="text-align: center;">Page 46</p>	<p>1 interest, they didn't say what was included within that</p> <p>2 category, and in particular, as your Lordship knows, the</p> <p>3 Supreme Court didn't recognise anything that was partly</p> <p>4 admitted for proof in accordance with the rules as</p> <p>5 leaving a rump, non-proveable claim.</p> <p>6 So we respectfully submit, with the greatest of</p> <p>7 respect to my learned friend, that those authorities</p> <p>8 don't support the proposition that my learned friend</p> <p>9 Mr Zacaroli would have your Lordship accept.</p> <p>10 My Lord, the last area that I can deal with, I think</p> <p>11 briefly, before the shorthand writer's break is the</p> <p>12 question of priority of the currency conversion claims.</p> <p>13 Your Lordship will know, and that's the last point</p> <p>14 I want to make at all, Lydian, through Mr Zacaroli,</p> <p>15 says -- and, for your Lordship's note it's</p> <p>16 paragraph 21 -- that:</p> <p>17 "The currency conversion claims rank for payment</p> <p>18 ahead of any amounts due by way of debt from LIBE to</p> <p>19 LBHI2 and LBL, notwithstanding the basic rule that</p> <p>20 a currency conversion claim cannot complete with the</p> <p>21 claims of other creditors."</p> <p>22 Now, my Lord, it says that, through Mr Zacaroli, for</p> <p>23 two reasons: first, it's said, because LBHI2 has</p> <p>24 contractually subordinated it's debt to all other</p> <p>25 liabilities at LIBE, including currency conversion</p> <p style="text-align: center;">Page 48</p>

<p>1 claims; and secondly, so it's said, because of the</p> <p>2 operation of the contributory rule.</p> <p>3 Now, my Lord, this is where there's a bit of a link,</p> <p>4 as your Lordship will appreciate. In relation to the</p> <p>5 first point, the contractual subordination, obviously we</p> <p>6 repeat the submissions that we've made and our</p> <p>7 submission on this point mirrors the submissions on the</p> <p>8 interrelationship between statutory interest and the</p> <p>9 sub-debt claim of our clients.</p> <p>10 Now, my Lord, it's important to bear in mind here</p> <p>11 that it's not suggested, so far as we're aware, by</p> <p>12 anyone that the currency conversion claims is anything</p> <p>13 other than a non-proveable debt. Therefore, as accepted</p> <p>14 by Lydian in its position paper, and the note for that</p> <p>15 is 12.1 in the files, the currency conversion claim</p> <p>16 should rank in the list of priority of payments below</p> <p>17 the payment of two things: (a) all proved debts and (b)</p> <p>18 statutory interest, which is entirely in accordance with</p> <p>19 the waterfall list that Lord Neuberger set out in</p> <p>20 Nortel.</p> <p>21 So, my Lord, in conclusion on this point, and in</p> <p>22 summary, our client's position is the sub-debt is</p> <p>23 a probable debt and that the true effect of</p> <p>24 subordination provisions in the sub-debt agreements is</p> <p>25 that our clients rank below other unsubordinated</p> <p style="text-align: center;">Page 49</p>	<p>1 MR ISAACS: As a matter of a construction of the sub-debt</p> <p>2 agreements. The second is whether LBHI2's potential</p> <p>3 section 74 liability falls to be taken into account for</p> <p>4 the purposes of contributory rule in LBIE's</p> <p>5 administration. The third is whether LBHI2's potential</p> <p>6 74 liability extends to statutory interest. The fourth</p> <p>7 is whether that liability extends to currency conversion</p> <p>8 claims and the fifth is whether that liability extends</p> <p>9 to post-administration contractual claims interest.</p> <p>10 MR JUSTICE DAVID RICHARDS: The fourth is?</p> <p>11 MR ISAACS: Whether the potential section 74 liability of</p> <p>12 LBHI2 extends to currency conversion claims.</p> <p>13 MR JUSTICE DAVID RICHARDS: Oh yes.</p> <p>14 MR ISAACS: And the fifth is post-administration contractual</p> <p>15 claims of interest.</p> <p>16 I will turn to the first, my Lord, contractual</p> <p>17 subordination. I will address this in three stages.</p> <p>18 The first is I will highlight certain features of the</p> <p>19 agreements. The second is I will address the factual</p> <p>20 matrix. The third is I will develop seven reasons why,</p> <p>21 having regard to the contractual provisions of the</p> <p>22 factual matrix the subordinated debt is not subordinated</p> <p>23 to statutory interest.</p> <p>24 MR JUSTICE DAVID RICHARDS: Right.</p> <p>25 MR ISAACS: I will obviously seek to avoid repeating what</p> <p style="text-align: center;">Page 51</p>
<p>1 unsecured creditors for dividend purposes on the subject</p> <p>2 claims in LIBE's administration, but that the sub-debt</p> <p>3 is still a probable unsecured debt which must be</p> <p>4 discharged in full both before statutory interest and</p> <p>5 before any non-proveable claims such as the purported</p> <p>6 currency conversion claim.</p> <p>7 My Lord, as I put it in opening, whatever the</p> <p>8 position of the currency conversion claim, our ultimate</p> <p>9 position is it comes behind us.</p> <p>10 My Lord, those are our submissions.</p> <p>11 MR JUSTICE DAVID RICHARDS: Thank you very much. Well, it</p> <p>12 would probably be convenient if I took the break now.</p> <p>13 Mr Issacs, I would invite you to take Mr Trace's -- your</p> <p>14 team to move into poll position and I will rise for 10</p> <p>15 minutes. Thank you very much.</p> <p>16 (11.40 pm)</p> <p>17 (A short break)</p> <p>18 (11.51 am)</p> <p>19 Submissions by MR ISAACS</p> <p>20</p> <p>21 MR JUSTICE DAVID RICHARDS: Mr Isaacs.</p> <p>22 MR ISAACS: My Lord, I propose to address five issues. They</p> <p>23 are as follows. The first is whether the subordinated</p> <p>24 debt is payable in priority to statutory interest.</p> <p>25 MR JUSTICE DAVID RICHARDS: Right.</p> <p style="text-align: center;">Page 50</p>	<p>1 has been said by my learned friends Mr Wolfson and</p> <p>2 Mr Trace. On occasion that is will be difficult.</p> <p>3 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>4 MR ISAACS: Starting with the provisions of the contract and</p> <p>5 I will focus on two aspects of the contracts. The first</p> <p>6 is the purpose of the subordinated agreements and the</p> <p>7 purpose of the subordinated lender. The second is the</p> <p>8 subordinating provision.</p> <p>9 MR JUSTICE DAVID RICHARDS: Right.</p> <p>10 MR ISAACS: Turning first to the purpose of the agreement</p> <p>11 and the subordinated lending. There are three points</p> <p>12 here. The first is not disputed; the sub-debt</p> <p>13 agreements are based on FSA templates. There are no</p> <p>14 material difference between the terms of the</p> <p>15 subordinating provision in the agreements and that in</p> <p>16 the FSA's standard form agreement. That is agreed fact</p> <p>17 paragraph 41-page 7.</p> <p>18 MR JUSTICE DAVID RICHARDS: Agreed fact paragraph?</p> <p>19 MR ISAACS: Paragraph 41.</p> <p>20 MR JUSTICE DAVID RICHARDS: Thank you, yes.</p> <p>21 MR ISAACS: The second point is that the recital states that</p> <p>22 the borrower wishes to use the loan or each advance in</p> <p>23 accordance with FSA rule IPRU-INS rule 1063. That is</p> <p>24 page 226.</p> <p>25 MR JUSTICE DAVID RICHARDS: You are looking at?</p> <p style="text-align: center;">Page 52</p>

<p>1 MR ISAACS: I am looking at that one, my Lord, because this</p> <p>2 has numbers in it. The other one hasn't.</p> <p>3 MR JUSTICE DAVID RICHARDS: Okay.</p> <p>4 MR ISAACS: Your Lordship sees it says "front page" at the</p> <p>5 top and there is a single recital "whereas".</p> <p>6 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>7 MR ISAACS: It is that "whereas" paragraph that refers to</p> <p>8 the rule.</p> <p>9 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>10 MR ISAACS: The third point is that numerous provisions in</p> <p>11 the contract refer to the FSA and the rule IPRU-INS</p> <p>12 1063.</p> <p>13 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>14 MR ISAACS: Now, in the main they require either the FSA to</p> <p>15 be notified of matters or they provide that the</p> <p>16 provision of the loan is subject to the grant of</p> <p>17 permission by the FSA. Briefly, if I may, I would like</p> <p>18 to just take you through those starting off at page 229.</p> <p>19 These are examples of the former category, in other</p> <p>20 words where there is a notification requirement. Your</p> <p>21 Lordship sees at the bottom of page 229 in the box</p> <p>22 "notes to paragraph 9", "the repayment date for the loan</p> <p>23 must be one of..." and then there is a reference to</p> <p>24 giving notice to the FSA.</p> <p>25 MR JUSTICE DAVID RICHARDS: Yes.</p> <p style="text-align: center;">Page 53</p>	<p>1 consent of the FSA. Similarly paragraph 7, also not</p> <p>2 without the prior consent of the FSA.</p> <p>3 The third aspect of this, a point your Lordship has</p> <p>4 drawn attention to already, is the reference to the</p> <p>5 financial resources requirement. There are a number of</p> <p>6 these. One sees that in paragraph 4.3(b) page 234</p> <p>7 towards the end of that sentence in the context of</p> <p>8 repayment.</p> <p>9 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>10 MR ISAACS: One also sees it in 4.3(c)(1), also in the</p> <p>11 context of repayment.</p> <p>12 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>13 MR ISAACS: And one sees it device in the subordinating</p> <p>14 provision, which is paragraph 5.1(a) at the bottom of</p> <p>15 page 235, where it appears in the main paragraph and</p> <p>16 also on the last line of that page. The financial</p> <p>17 resources requirement is defined at page 232 as having</p> <p>18 the meaning given to it in the financial rules. The</p> <p>19 financial rules are defined as IPRU-INS 10 in the FSA</p> <p>20 handbook. This contract is for a specific statutory</p> <p>21 purpose and gives the FSA extensive powers of overview</p> <p>22 and control. My submission is that there can be no</p> <p>23 proper analysis of this contract without an analysis of</p> <p>24 the factual matrix and IPRU 1063 in particular. Your</p> <p>25 Lordship has not had the benefit of any explanation of</p> <p style="text-align: center;">Page 55</p>
<p>1 MR ISAACS: The next one in relation to repayment is at</p> <p>2 page 234 and that is paragraph 2.3 at the top the page:</p> <p>3 "The lender and the borrower undertake to provide</p> <p>4 the FSA with details in writing."</p> <p>5 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>6 MR ISAACS: Also in paragraph 4.4 just over the page, 235 on</p> <p>7 the right-hand side at the end of the third line:</p> <p>8 "Notice of institution of proceedings."</p> <p>9 4.6(c), again, notice of intention to institute</p> <p>10 proceedings to the FSA.</p> <p>11 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>12 MR ISAACS: Examples of the second category, that is to say</p> <p>13 control, are to be found in paragraph 4.3, which is on</p> <p>14 page 234. One sees reference to:</p> <p>15 "Except where the FSA otherwise permits."</p> <p>16 4.3(c), one sees the consent of the FSA referred to.</p> <p>17 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>18 MR ISAACS: Over the page at 236-paragraph 5.4 is reference</p> <p>19 to the form and substance of the reports being</p> <p>20 acceptable to the FSA.</p> <p>21 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>22 MR ISAACS: And in paragraph 6, bottom of the page,</p> <p>23 "representations", the borrower taking steps such as</p> <p>24 securing the subordinated liabilities and the other</p> <p>25 steps in paragraph 6 not to be done without the prior</p> <p style="text-align: center;">Page 54</p>	<p>1 the factual matrix until this point, therefore I need go</p> <p>2 through it in some detail.</p> <p>3 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>4 MR ISAACS: The second provision of the contract I refer to</p> <p>5 is the subordinating provision itself.</p> <p>6 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>7 MR ISAACS: And in relation to that I make four points. The</p> <p>8 first relates to the nature of the subordinating. There</p> <p>9 are two measures used to subordinate in this contract,</p> <p>10 the first is paragraph 5 at 236, which we have seen many</p> <p>11 times. What is important about that provision is that</p> <p>12 it makes payment conditional on LBIE being solvent as</p> <p>13 defined.</p> <p>14 The second mechanism is at paragraph 5.5 and 5.6.</p> <p>15 I don't think we have looked at this in any detail.</p> <p>16 This is the subordinating trust. If any sums are</p> <p>17 received when the terms are not satisfied they have to</p> <p>18 be held on trust and returned and this also refers to</p> <p>19 payment.</p> <p>20 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>21 MR ISAACS: There is no reference in paragraph 5 or anywhere</p> <p>22 in the contract to postponement of proof. The second</p> <p>23 point is that the definition of solvent in the</p> <p>24 subordination provision at paragraph 5.2 provides, as</p> <p>25 far as relevant, that LBIE is able to pay its debts, its</p> <p style="text-align: center;">Page 56</p>

<p>1 liabilities, in full. I emphasise there the use of the</p> <p>2 present tense.</p> <p>3 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>4 MR ISAACS: The third point is, as your Lordship has pointed</p> <p>5 out more than once, paragraph 5.1(b) is applicable</p> <p>6 whether or not LBIE is in insolvency.</p> <p>7 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>8 MR ISAACS: And 5.2 (a) provides:</p> <p>9 "Certain obligations are to be disregarded, in</p> <p>10 particular those which are not capable of being</p> <p>11 established or determined in the insolvency of the</p> <p>12 borrower."</p> <p>13 My submission is the reference to "capable of being</p> <p>14 established or determined in the insolvency of the</p> <p>15 borrower" expressly contemplates the rules which govern</p> <p>16 which obligations are payable or capable of being</p> <p>17 established or determined in the administration.</p> <p>18 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>19 MR ISAACS: The fourth point on the page refers to this</p> <p>20 definition of insolvency on page 232. The important</p> <p>21 point about this is that it contemplates that the</p> <p>22 borrower may be in an insolvency regime in any</p> <p>23 jurisdiction. In other words it is not just in English</p> <p>24 administration or insolvency, it could be in another</p> <p>25 country. I will come back to that point.</p> <p style="text-align: center;">Page 57</p>	<p>1 Basel 1.</p> <p>2 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>3 MR ISAACS: The second is the directive 89/229.</p> <p>4 MR JUSTICE DAVID RICHARDS: 89?</p> <p>5 MR ISAACS: /229.</p> <p>6 MR JUSTICE DAVID RICHARDS: 229?</p> <p>7 MR ISAACS: 229, which gave effect to Basel 1. The third is</p> <p>8 directive 93/6. That is the capital adequacy directive</p> <p>9 of 1993. It extended the definition of "own funds" in</p> <p>10 the 89/229 directive to investment firms.</p> <p>11 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>12 MR ISAACS: The fourth document is Basel 2.</p> <p>13 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>14 MR ISAACS: The fifth document is directive 2006 at 48,</p> <p>15 which implemented Basel 2. The final document is</p> <p>16 directive 2006/49, which is the 2006 capital adequacy</p> <p>17 directive and that replaced the 1993 capital adequacy</p> <p>18 directive.</p> <p>19 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>20 MR ISAACS: I will take them in turn, starting with Basel 1,</p> <p>21 which one finds in bundle 3 (a) tab 1.</p> <p>22 MR JUSTICE DAVID RICHARDS: 3?</p> <p>23 MR ISAACS: 3A.</p> <p>24 MR JUSTICE DAVID RICHARDS: Oh yes.</p> <p>25 MR ISAACS: So the front page of that tab you see:</p> <p style="text-align: center;">Page 59</p>
<p>1 The second part of our submission on subordination,</p> <p>2 then, is factual matrix. There are two key aspects of</p> <p>3 the factual matrix, the first is the rule 1063 referred</p> <p>4 to in the recital. The second is the rules governing</p> <p>5 obligations which are payable or capable of being</p> <p>6 established or determined administration.</p> <p>7 So I turn first to IPRU-INS 1063 and as a helpful</p> <p>8 summary at the supplemental authorities bundle-tab 3 it</p> <p>9 is paragraph 1.1.1(g). This is taken from the rule</p> <p>10 IPRU-INS, but it is a helpful summary because it tells</p> <p>11 you where we are going:</p> <p>12 "Before 1 January 2007 [and I am reading the first</p> <p>13 sentence] the interim prudential source book for</p> <p>14 investment businesses (IPRU-INS) was the part of the</p> <p>15 handbook that dealt with capital requirements for</p> <p>16 investment firms subject to the position risk</p> <p>17 requirements of the previous version of the capital</p> <p>18 adequacy directive."</p> <p>19 That is what we are interested in, my Lord, because</p> <p>20 the agreements were before that date.</p> <p>21 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>22 MR ISAACS: I will focus on that. The capital adequacy</p> <p>23 requirements were set out in European directives. There</p> <p>24 are six documents which need to be looked at. They are</p> <p>25 as follows: the first is the Basel Accord, known as</p> <p style="text-align: center;">Page 58</p>	<p>1 "International convergence of capital measurement</p> <p>2 and capital standards, July 1998 from the Basel</p> <p>3 committee on banking supervision."</p> <p>4 If I can pick it up at paragraph 3 where it talks</p> <p>5 about the objectives of this. It says:</p> <p>6 "Two fundamental objectives lie at the heart of the</p> <p>7 committee's work on regulatory convergence. They are</p> <p>8 firstly that the new framework should serve to</p> <p>9 strengthen the soundness and stability of the</p> <p>10 international banking system and secondly that the</p> <p>11 framework should be fair and have a high degree of</p> <p>12 consistency in its application to banks in different</p> <p>13 countries with a view to diminishing an existing source</p> <p>14 of competitive inequality amongst international banks."</p> <p>15 Paragraph 8, my Lord.</p> <p>16 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>17 MR ISAACS: "It should also be emphasised that capital</p> <p>18 adequacy as measured by the present framework, although</p> <p>19 important, is one of a number of factors to be taken</p> <p>20 into account when assessing the strength of banks. The</p> <p>21 framework in this document is mainly directed towards</p> <p>22 assessing capital in relation to credit risk, the risk</p> <p>23 of counter-party failure, but other risks, notably</p> <p>24 interest rate risk and the investment risk on securities</p> <p>25 need to be taken into account by supervisors in</p> <p style="text-align: center;">Page 60</p>

<p>1 assessing overall capital adequacy."</p> <p>2 Next paragraph 44-page 14. Picking it up at the end</p> <p>3 of the first line:</p> <p>4 "The committee agreed a minimum standard should now</p> <p>5 be set which international banks generally will be</p> <p>6 expected to achieve by the end of the transitional</p> <p>7 period. It is also agreed that the standard should be</p> <p>8 set at a level consistent with the objective of securing</p> <p>9 overtime (inaudible) based on consistent capital ratios</p> <p>10 for all international banks. Accordingly, the committee</p> <p>11 confirms that the target standard ratio of capital to</p> <p>12 weighted risk assets should be set at 8 per cent. This</p> <p>13 is expressed as a common minimum standard which</p> <p>14 international banks will be expected to observe by the</p> <p>15 end of 1992."</p> <p>16 The committee referred to subordinated term debt at</p> <p>17 page 6-paragraph 23.</p> <p>18 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>19 MR ISAACS: "The committee have agreed that subordinated</p> <p>20 term debt instruments have significant deficiencies as</p> <p>21 constituents of capital in view of their fixed maturity</p> <p>22 and their inability to absorb losses except in</p> <p>23 a liquidation. These deficiencies justify an additional</p> <p>24 restriction on the amount of such debt capital which is</p> <p>25 eligible for inclusion in the capital base.</p> <p style="text-align: center;">Page 61</p>	<p>1 an internal market in the banking sector, since own</p> <p>2 funds serve to ensure the continuity of credit</p> <p>3 institutions and to protect savings whereas such</p> <p>4 harmonisation will strengthen the supervision of credit</p> <p>5 institutions and contribute to further coordination in</p> <p>6 the banking sector, in particular the supervision of</p> <p>7 major risks and solvency ratios."</p> <p>8 The third recital:</p> <p>9 "Whereas own funds can serve to absorb losses which</p> <p>10 were not matched by a sufficient volume of profits,</p> <p>11 whereas own funds also serve as an important yardstick</p> <p>12 for the competent author authorities, in particular for</p> <p>13 the assessment of solvency of credit institutions and</p> <p>14 for other prudential purposes."</p> <p>15 The fourth recital:</p> <p>16 "The criteria for determining the composition of own</p> <p>17 funds must not be left solely to member states."</p> <p>18 MR JUSTICE DAVID RICHARDS: Where is that?</p> <p>19 MR ISAACS: I picked that up half way down:</p> <p>20 "Whereas credit institutions in a common banking</p> <p>21 market..."</p> <p>22 MR JUSTICE DAVID RICHARDS: Oh I see, yes.</p> <p>23 MR ISAACS: The key article is article 2.1 over the page</p> <p>24 your Lordship sees there:</p> <p>25 "Subject to the limits imposed in article 6,</p> <p style="text-align: center;">Page 63</p>
<p>1 Consequentially it has been concluded that subordinated</p> <p>2 term debt instruments with a minimum original term for</p> <p>3 maturity of over five years may be included within the</p> <p>4 supplementary elements of capital but only to a maximum</p> <p>5 of 50 per cent of the core capital elements and subject</p> <p>6 to adequate amortisation arrangements."</p> <p>7 Finally paragraph 30 which described the categories</p> <p>8 of risk captured in the framework. I beg your pardon,</p> <p>9 31:</p> <p>10 "There are many different kinds of risks against</p> <p>11 which bank's managements need to guard. For most part</p> <p>12 the main risk is credit risk, that is to say the risk of</p> <p>13 counter-party failure, but there are many other kinds of</p> <p>14 risk, for example investment risk, interest rate risk,</p> <p>15 exchange rate risk, concentration risk. The central</p> <p>16 focus of this framework is credit risk and as a further</p> <p>17 aspect of credit risk, country transfer risk."</p> <p>18 That is all I propose to say about Basel 1.</p> <p>19 MR JUSTICE DAVID RICHARDS: Mmm-hmm.</p> <p>20 MR ISAACS: The next document is in the next tab and it is</p> <p>21 the 1989 directive on own funds and credit institutions.</p> <p>22 Picking it up at the first recital, once again one is</p> <p>23 looking for the purpose of this:</p> <p>24 "Whereas common basic standards for the own funds of</p> <p>25 credit institutions are a key factor in the creation of</p> <p style="text-align: center;">Page 62</p>	<p>1 unconsolidated own funds shall consist of the following</p> <p>2 items..."</p> <p>3 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>4 MR ISAACS: And the first is capital -- picking it up at 8,</p> <p>5 fixed term cumulative preference shares and subordinated</p> <p>6 loan capital as referred to in article 4.3.</p> <p>7 MR JUSTICE DAVID RICHARDS: The expression "own funds".</p> <p>8 MR ISAACS: Yes, that is capital.</p> <p>9 MR JUSTICE DAVID RICHARDS: Is that defined anywhere?</p> <p>10 MR ISAACS: It is defined as capital.</p> <p>11 MR JUSTICE DAVID RICHARDS: Can you show me where that is.</p> <p>12 MR ISAACS: I will do, my Lord. I wonder if I might come</p> <p>13 back to that rather than stopping now.</p> <p>14 MR JUSTICE DAVID RICHARDS: Certainly.</p> <p>15 MR ISAACS: We will proceed on that basis for now.</p> <p>16 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>17 MR ISAACS: Article 4.3 is over the page and it says:</p> <p>18 "Members, member states or the competent authorities</p> <p>19 may include subordinated loan capital referred to in</p> <p>20 that provision if binding agreements exist under which</p> <p>21 in the event of the bankruptcy or liquidation of the</p> <p>22 credit institution they rank after the claims of all</p> <p>23 other creditors and are not to be repaid until all other</p> <p>24 debts outstanding at the time are settled."</p> <p>25 And then there are various conditions in relation to</p> <p style="text-align: center;">Page 64</p>

16 (Pages 61 to 64)

<p>1 subordinated loan capital and I wonder if I could invite</p> <p>2 your Lordship to read those.</p> <p>3 MR JUSTICE DAVID RICHARDS: Give me a moment. Sorry, you</p> <p>4 wanted me to look at the conditions.</p> <p>5 MR ISAACS: Yes. Your Lordship sees they refer to criteria</p> <p>6 dates.</p> <p>7 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>8 MR ISAACS: That is all I was proposing to say about that</p> <p>9 directive.</p> <p>10 MR JUSTICE DAVID RICHARDS: Right, thank you.</p> <p>11 MR ISAACS: The third one, the 93/6 directive, which like</p> <p>12 I said is the 93 capital adequacy directive, is at the</p> <p>13 next tab. Again, one looks for the objective and the</p> <p>14 purpose of these directives. Picking it up at the</p> <p>15 recital, which is the first big paragraph in the</p> <p>16 right-hand column.</p> <p>17 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>18 MR ISAACS: "Whereas the approach that has been adopted is</p> <p>19 to effect only the essential harmonisation that is</p> <p>20 necessary and sufficient to secure mutual recognition of</p> <p>21 authorisation and of prudential supervision systems,</p> <p>22 whereas the adoption of measures to coordinate the</p> <p>23 definition of the own funds of investment funds, the</p> <p>24 establishment of the amounts of their initial capital</p> <p>25 and the establishment of a common framework for</p> <p style="text-align: center;">Page 65</p>	<p>1 own funds in the earlier directive means capital?</p> <p>2 MR ISAACS: 23, thank you Mr Trower. Own means own funds as</p> <p>3 defined in the earlier directive. This definition may,</p> <p>4 however --</p> <p>5 MR JUSTICE DAVID RICHARDS: Where are we reading? Oh yes.</p> <p>6 MR ISAACS: 23. I will look at that definition and come</p> <p>7 back to you on that point.</p> <p>8 MR JUSTICE DAVID RICHARDS: Yes, okay.</p> <p>9 MR ISAACS: If we can go to article 4.</p> <p>10 MR JUSTICE DAVID RICHARDS: Yes, article 4.</p> <p>11 MR ISAACS: And annex five, my Lord. I beg your pardon,</p> <p>12 over the page.</p> <p>13 MR JUSTICE DAVID RICHARDS: Annex five?</p> <p>14 MR ISAACS: Yes. That says:</p> <p>15 "The own funds of investment firms and credit</p> <p>16 institutions shall be defined in accordance with</p> <p>17 directive 89/229."</p> <p>18 And there is a reference to subordinated loan</p> <p>19 capital at paragraph 2.3. At paragraph 371 there is the</p> <p>20 conditions for subordinated loans.</p> <p>21 MR JUSTICE DAVID RICHARDS: That's right. Paragraph 2?</p> <p>22 MR ISAACS: 2(c) referred to the subordinated loan capital</p> <p>23 "subject to the conditions set out below", and your</p> <p>24 Lordship sees the conditions set out below, including</p> <p>25 paragraph 3.</p> <p style="text-align: center;">Page 67</p>
<p>1 monitoring the risks incurred by investment firms are</p> <p>2 essential aspects of the harmonisation necessary for the</p> <p>3 achievement of mutual recognition within the framework</p> <p>4 of the internal financial market."</p> <p>5 And towards the bottom, the penultimate recital:</p> <p>6 "Whereas this directive forms part of the wider</p> <p>7 international effort to bring about approximation of the</p> <p>8 rules in force regarding the supervision firms and</p> <p>9 credit institutions. Whereas common basic standards for</p> <p>10 own funds are a key feature in the internal market since</p> <p>11 own funds serve to ensure the continuity of institutions</p> <p>12 and to protect investors."</p> <p>13 Four down:</p> <p>14 "Whereas it is necessary to develop common standards</p> <p>15 for market risks incurred by credit institutions and</p> <p>16 provide a complementary framework for the supervision of</p> <p>17 the risks incurred, in particular market risks and more</p> <p>18 especially position risks counter-party settlement risks</p> <p>19 and foreign exchange risks."</p> <p>20 If your Lordship could turn over a couple of pages</p> <p>21 to paragraph 26.</p> <p>22 MR JUSTICE DAVID RICHARDS: Oh yes.</p> <p>23 MR ISAACS: Your Lordship has the answer to the question;</p> <p>24 capital means own funds.</p> <p>25 MR JUSTICE DAVID RICHARDS: Well, yes. Does that mean that</p> <p style="text-align: center;">Page 66</p>	<p>1 MR JUSTICE DAVID RICHARDS: Just let me look at these. That</p> <p>2 is 2(c). Then did you say?</p> <p>3 MR ISAACS: There are others, my Lord, that is the only one</p> <p>4 that --</p> <p>5 MR JUSTICE DAVID RICHARDS: Yes, okay.</p> <p>6 MR ISAACS: My Lord it might be helpful if I say at this</p> <p>7 stage and give your Lordship an indication of where I am</p> <p>8 going.</p> <p>9 MR JUSTICE DAVID RICHARDS: Okay.</p> <p>10 MR ISAACS: Your Lordship may have seen on the evidence that</p> <p>11 there was an issue as to whether the subordinated debt</p> <p>12 is lower tier two or tier three. There is some evidence</p> <p>13 that goes to that. As it turns out I don't believe it</p> <p>14 is important, the difference in this case. It has not</p> <p>15 been raised by my learned friend Mr Trower and I am not</p> <p>16 proposing to make a point about it either. When I refer</p> <p>17 to the conditions in relation to subordinated debt that</p> <p>18 is by way of background more than an attempt to seek to</p> <p>19 argue that it is upper tier two as opposed to tier</p> <p>20 three. We do say it is upper tier two but that is not</p> <p>21 a part of the argument on which I need rely. What I am</p> <p>22 doing at the moment principally is establishing the</p> <p>23 objective of the directive so I can establish the</p> <p>24 purpose behind the contrary.</p> <p>25 MR JUSTICE DAVID RICHARDS: I follow.</p> <p style="text-align: center;">Page 68</p>

<p>1 MR ISAACS: I beg your pardon, my Lord. I mis-spoke. If</p> <p>2 I said upper tier two I meant lower tier two. We say it</p> <p>3 is tier three and it could be argued it is possibly</p> <p>4 upper tier two.</p> <p>5 Picking it up at the fourth document, which is Basel</p> <p>6 2. Your Lordship sees this document is from the Basel</p> <p>7 Committee on Banking Supervision again:</p> <p>8 "International convergence of capital measurement</p> <p>9 and capital standards, a revised framework, June 2006."</p> <p>10 That is the front page. Picking it up in</p> <p>11 paragraph 1 your Lordship sees the sentence that starts</p> <p>12 "it sets out the details" which is about three quarters</p> <p>13 of the way down in the middle of the line.</p> <p>14 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>15 MR ISAACS: "It sets out the details of the agreed framework</p> <p>16 for measuring capital adequacy and the minimum standards</p> <p>17 to be achieved which the national supervisory</p> <p>18 authorities represented on the committee would propose</p> <p>19 for adoption in their respective countries."</p> <p>20 The objective of the committee's work is described</p> <p>21 in paragraph 4 at the top of the next page:</p> <p>22 "The fundamental objective of the committee's work</p> <p>23 is to revise the 1988 accord [that was Basel 1]. To</p> <p>24 develop a framework that would further strengthen the</p> <p>25 soundness and stability of the international banking</p> <p style="text-align: center;">Page 69</p>	<p>1 "The committee considers the key element of capital</p> <p>2 on which the main emphasis should be placed is equity</p> <p>3 capital and disclosed reserves."</p> <p>4 Then paragraph 49.2:</p> <p>5 "Notwithstanding this emphasis, the member countries</p> <p>6 of the committee also consider there are a number of</p> <p>7 other important and legitimate constituents of a bank's</p> <p>8 capital base which may be included within the system of</p> <p>9 measurement, subject to conditions set out below."</p> <p>10 And they form tier 2. Your Lordship sees that</p> <p>11 starting at 49.46. Over the page again at page 16,</p> <p>12 subordinated term debt.</p> <p>13 MR JUSTICE DAVID RICHARDS: Sorry, where is that?</p> <p>14 MR ISAACS: That is paragraph 49.12.</p> <p>15 MR JUSTICE DAVID RICHARDS: Oh yes, I see. Yes.</p> <p>16 MR ISAACS: Again, that is permitted but only if it has</p> <p>17 a maturity of over five years. Then in the following</p> <p>18 paragraph, 49.13, is the reference to tier 3</p> <p>19 subordinated debt and the statement:</p> <p>20 "Banks may also at the discretion of their national</p> <p>21 authority employ a third tier of capital, tier 3,</p> <p>22 consisting of short term subordinated debt as defined in</p> <p>23 paragraph 49.14 below for the sole purpose for meeting a</p> <p>24 proportion of the capital requirements for market</p> <p>25 risks."</p> <p style="text-align: center;">Page 71</p>
<p>1 system while maintaining sufficient consistency that</p> <p>2 capital adequacy regulation will not be a significant</p> <p>3 source of competitive inequality among internationally</p> <p>4 active banks."</p> <p>5 Paragraph 5, half way down:</p> <p>6 "The committee is also retaining key elements of the</p> <p>7 1988 capital adequacy framework, including the general</p> <p>8 requirement for banks to hold total capital equivalent</p> <p>9 of at least 8 per cent of their risk weighted assets."</p> <p>10 And so on. Paragraph 40, which is page 12, and this</p> <p>11 relates to the calculation of minimum capital</p> <p>12 requirements and it is set out in this section.</p> <p>13 Paragraph 41:</p> <p>14 "The definition of eligible regulatory capital as</p> <p>15 outlined in the 1988 accord and clarified in the press</p> <p>16 release remains in place, except for the modifications</p> <p>17 in paragraphs 37 to 39 and 43."</p> <p>18 The definition is outlined in paragraph 49 and in</p> <p>19 the annex.</p> <p>20 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>21 MR ISAACS: If one then goes to paragraph 49, which is on</p> <p>22 page 14. This is the introduction of the distinction</p> <p>23 I referred to earlier between tier 1, tier 2 and tier 3</p> <p>24 capital. 49.1 is core capital, also described as basic</p> <p>25 equity or tier 1.</p> <p style="text-align: center;">Page 70</p>	<p>1 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>2 MR ISAACS: Other over the page at 49.14:</p> <p>3 "For short term subordinated debt to be eligible as</p> <p>4 tier 3 capital it needs to be capable of becoming a part</p> <p>5 of a bank's permanent capital and thus be available to</p> <p>6 absorb losses in the event of insolvency. It must</p> <p>7 therefore at a minimum..."</p> <p>8 And the conditions are set out. Would your Lordship</p> <p>9 please read those?</p> <p>10 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>11 MR ISAACS: We say if it were necessary to consider it, the</p> <p>12 sub-debt in this case does meet tier 3 capital but</p> <p>13 nothing I am going to say will require that as a</p> <p>14 premise.</p> <p>15 The fifth document, my Lord, is the directive</p> <p>16 2006/48.</p> <p>17 MR JUSTICE DAVID RICHARDS: Just a moment.</p> <p>18 MR ISAACS: This is the document used to implement Basel 2</p> <p>19 in relation to credit institutions. Lots of recitals to</p> <p>20 this one. If I can draw your Lordship's attention to</p> <p>21 recital 28.</p> <p>22 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>23 MR ISAACS: If your Lordship can read these.</p> <p>24 MR JUSTICE DAVID RICHARDS: I will.</p> <p>25 MR ISAACS: 28 is the first one.</p> <p style="text-align: center;">Page 72</p>

<p>1 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>2 MR ISAACS: 32.</p> <p>3 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>4 MR ISAACS: The reference to supervision and minimum capital</p> <p>5 in 34.</p> <p>6 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>7 MR ISAACS: The prevention of distortions in 35, distortions</p> <p>8 of competition and the strengthening of the banking</p> <p>9 system.</p> <p>10 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>11 MR ISAACS: Ensuring adequate solvency in 36.</p> <p>12 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>13 MR ISAACS: And 37, adopting Basel 2.</p> <p>14 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>15 MR ISAACS: 43 refers to:</p> <p>16 "Increased recognition being given to techniques of</p> <p>17 credit risk mitigation within the framework of rules</p> <p>18 designed to ensure solvency is not undermined by undue</p> <p>19 recognition."</p> <p>20 And 46:</p> <p>21 "In order to ensure adequate solvency of credit</p> <p>22 institutions within the group it is essential that the</p> <p>23 minimum capital requirements apply on the basis of the</p> <p>24 consolidated financial situation of the group."</p> <p>25 MR JUSTICE DAVID RICHARDS: Yes.</p> <p style="text-align: center;">Page 73</p>	<p>1 directive. Its formal name is "the directive on the</p> <p>2 capital adequacy of investment firms and credit</p> <p>3 institutions (recast)." For the purpose one looks at</p> <p>4 the recitals, which are now numbered. It is recital</p> <p>5 number 4 and recital number 5. If your Lordship could</p> <p>6 please read them.</p> <p>7 MR JUSTICE DAVID RICHARDS: I will. (Pause).</p> <p>8 MR ISAACS: Again, mutual recognition of organisation and</p> <p>9 supervision and establishment of capital adequacy.</p> <p>10 Recital 11 at the bottom.</p> <p>11 MR JUSTICE DAVID RICHARDS: 11, did you say?</p> <p>12 MR ISAACS: Yes, please. This is explaining why this is</p> <p>13 being extended.</p> <p>14 "Investment firms face in respect of their trading</p> <p>15 book business the same risk as credit institutions. It</p> <p>16 is appropriate that the pertinent provisions of 2006/48</p> <p>17 apply equally to investment firms."</p> <p>18 Again important for purpose, the next recital:</p> <p>19 "Own funds can serve to absorb losses which are not</p> <p>20 matched by a sufficient volume of profits to ensure the</p> <p>21 continuity of institutions and to protect investors.</p> <p>22 The own funds also serve as an important yardstick for</p> <p>23 the competent authorities, in particular for the</p> <p>24 assessment of the solvency of institutions and for other</p> <p>25 prudential purposes. Therefore in order to strengthen</p> <p style="text-align: center;">Page 75</p>
<p>1 MR ISAACS: Own funds is dealt with in chapter 2, which is</p> <p>2 two pages into the document.</p> <p>3 MR JUSTICE DAVID RICHARDS: Sorry, where is that?</p> <p>4 MR ISAACS: It is chapter 2. We don't have page numbers.</p> <p>5 MR JUSTICE DAVID RICHARDS: Oh yes, that is fine.</p> <p>6 MR ISAACS: Article 56, own funds.</p> <p>7 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>8 MR ISAACS: It says:</p> <p>9 "Wherever a member state lays down a provision and</p> <p>10 an implementation of the community legislation</p> <p>11 concerning the prudential supervision of the credit</p> <p>12 institution which uses the term 'own funds', it shall</p> <p>13 bring the term or concept in with the definition given</p> <p>14 in articles 57 to 61 and 63 to 66."</p> <p>15 Under article 57(h) we have the reference to</p> <p>16 subordinated loan capital as referred to in article</p> <p>17 64.3.</p> <p>18 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>19 MR ISAACS: 64.3 is over the page. That is in material</p> <p>20 terms identical to that found in the earlier directive</p> <p>21 and if your Lordship could read that paragraph and the</p> <p>22 conditions, please. (Pause).</p> <p>23 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>24 MR ISAACS: The sixth and final document is over the page in</p> <p>25 the next tab, tab 6. It is the 2006 capital adequacy</p> <p style="text-align: center;">Page 74</p>	<p>1 the community financial system and to prevent</p> <p>2 distortions of the competition, it is appropriate to lay</p> <p>3 down common basic standards of own funds."</p> <p>4 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>5 MR ISAACS: I was not proposed to say anything more about</p> <p>6 that directive, that was the sixth document. I will now</p> <p>7 make a few remarks about implementation in the UK. For</p> <p>8 this we need bundle 3B. Tab 9 is IPRU-INS.</p> <p>9 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>10 MR ISAACS: Which is the prudential source book in which to</p> <p>11 find the rule referred to in the subordinated debt</p> <p>12 agreement. One gets the purpose from the very first</p> <p>13 guidance, 1.1.1 over the page, page 1 of 4:</p> <p>14 "The interim prudential source book for investment</p> <p>15 business [that is IPRU-INS] sets out the detailed</p> <p>16 financial resources and prudential standards which the</p> <p>17 FSA applies to certain firms on an interim basis pending</p> <p>18 the introduction of a single prudential source book."</p> <p>19 At page 9, IPRU-INS 10 -- page 13, sorry my Lord.</p> <p>20 10.62 financial resources and 10.62(1)R. R is a rule,</p> <p>21 and the rule is that the firm must at all times maintain</p> <p>22 financial resources in excess of its financial resource</p> <p>23 requirement as detailed in rule 10.70. Your Lordship</p> <p>24 will recall that is the term that is used in the</p> <p>25 agreements.</p> <p style="text-align: center;">Page 76</p>

<p>1 MR JUSTICE DAVID RICHARDS: I do, yes.</p> <p>2 MR ISAACS: "A firm must calculate its financial resources</p> <p>3 in accordance with table 10.62(2)(a) below, unless it</p> <p>4 has been granted a waiver or notified its intention to</p> <p>5 use 10.62(2)(c)."</p> <p>6 At page 17 we see that subordinated loans are</p> <p>7 permitted, subject to the rules set out there. If your</p> <p>8 Lordship sees, 10.32R(a) has to be drawn up in</p> <p>9 accordance in accordance with the standard form obtained</p> <p>10 from the FSA.</p> <p>11 MR JUSTICE DAVID RICHARDS: Yes, 10?</p> <p>12 MR ISAACS: 10.63(2)R(a).</p> <p>13 MR JUSTICE DAVID RICHARDS: Yes, thank you.</p> <p>14 MR ISAACS: At 10.70, which is at page 28, is the dreaded</p> <p>15 financial resources requirement. I may be doing my</p> <p>16 learned friend Mr Trower a favour in the next 10</p> <p>17 minutes. It is extremely complicated and I will deal</p> <p>18 with it very briefly if I may. It is defined in 10.70R</p> <p>19 as the sum of two elements, the primary requirement and</p> <p>20 the secondary requirement. The primary requirement is</p> <p>21 defined as the higher of two elements as well, the first</p> <p>22 of which composes four elements, the PRR, the CRR the</p> <p>23 LER and the base requirement. The second is the firm's</p> <p>24 initial capital. The reason it is possible to get some</p> <p>25 clarity on this is that those initials are defined as</p> <p style="text-align: center;">Page 77</p>	<p>1 MR JUSTICE DAVID RICHARDS: Yes, right.</p> <p>2 MR ISAACS: So it is measuring risk and large exposures.</p> <p>3 Below one sees "the expenditure requirement must be..."</p> <p>4 and it is defined which reference to another defined</p> <p>5 term, which is relevant annual expenditure. That is</p> <p>6 defined over the page at 10.73(2). Your Lordship sees</p> <p>7 that all of the items that form the relevant annual</p> <p>8 expenditure, and there are a lot of them, are</p> <p>9 effectively profit and loss items.</p> <p>10 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>11 MR ISAACS: That is all I am proposing to say about that at</p> <p>12 this stage, my Lord, but I will come back to it.</p> <p>13 MR JUSTICE DAVID RICHARDS: Just give me a moment. (Pause).</p> <p>14 MR ISAACS: Thank you. I can now turn to the second aspect</p> <p>15 of the factual matrix.</p> <p>16 MR JUSTICE DAVID RICHARDS: What I can't quite make out at</p> <p>17 the moment, looking at the clause 5.1(a) of the</p> <p>18 subordination agreement, is quite how this ties in.</p> <p>19 This is entirely my fault, obviously, but it says that</p> <p>20 the requirement is that the borrower should be in</p> <p>21 compliance with not less than 120 per cent of its</p> <p>22 financial resources requirement immediately after</p> <p>23 payment by the borrower. Now, the financial resources</p> <p>24 requirement is a sum of the primary and secondary</p> <p>25 requirement.</p> <p style="text-align: center;">Page 79</p>
<p>1 position risk requirement, counter-party risk</p> <p>2 requirement and large exposures requirement. One sees</p> <p>3 that at page 32, 10.80, the position risk requirement.</p> <p>4 That is in respect of all trading book and physical</p> <p>5 commodities and physical commodities derivative items.</p> <p>6 That is rule 10.81.</p> <p>7 At page 37 is the counter-party risk requirement,</p> <p>8 which must be calculated on counter-party exposures and</p> <p>9 if your Lordship could read that 10.170R.</p> <p>10 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>11 MR ISAACS: And then page 57 is the large exposures</p> <p>12 requirement.</p> <p>13 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>14 MR ISAACS: And that has to be calculated on all exposures</p> <p>15 to all third parties and groups and so on. Now if we</p> <p>16 can go back to page 28, which is the final resources</p> <p>17 requirement, and look at what the base requirement is,</p> <p>18 which is at 10.72. It is page 28.</p> <p>19 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>20 MR ISAACS: One sees the base requirement must be calculated</p> <p>21 in accordance with a formula. Although the formula is</p> <p>22 rather complicated, the elements in it are the three</p> <p>23 risk requirements we have just looked at in the</p> <p>24 denominator and the expenditure requirement which is</p> <p>25 defined below.</p> <p style="text-align: center;">Page 78</p>	<p>1 MR ISAACS: Yes.</p> <p>2 MR JUSTICE DAVID RICHARDS: That seems to suggest some -- I</p> <p>3 am not quite sure what the financial resources</p> <p>4 requirement is an amalgam of. Looking at PRRs and CRRs</p> <p>5 and so on it looks like exposures, so effectively</p> <p>6 liabilities.</p> <p>7 MR ISAACS: I would submit it is a element of risk and</p> <p>8 exposure.</p> <p>9 MR JUSTICE DAVID RICHARDS: What does it mean to be in</p> <p>10 compliance with not less than 125 per cent of</p> <p>11 a requirement which is measured by risk? What does it</p> <p>12 have to do or have to be in compliance with the</p> <p>13 requirement?</p> <p>14 MR ISAACS: My understanding my Lord, is these are all</p> <p>15 numbers.</p> <p>16 MR JUSTICE DAVID RICHARDS: Indeed. What does it have to</p> <p>17 have in order to comply?</p> <p>18 MR ISAACS: It has to have a sufficient amount of capital,</p> <p>19 for example, or risk, or risk capital.</p> <p>20 MR JUSTICE DAVID RICHARDS: I see. I am trying to find that</p> <p>21 link.</p> <p>22 MR ISAACS: One way of looking at it, I suppose, is in</p> <p>23 relation to annual expenditure, which is revenue plus</p> <p>24 losses minus a lot of expense items.</p> <p>25 MR JUSTICE DAVID RICHARDS: Right. The drafting of 5.1(a)</p> <p style="text-align: center;">Page 80</p>

20 (Pages 77 to 80)

<p>1 presupposes that the financial resources requirement 2 imposes a minimum requirement on the borrower. 3 MR ISAACS: Yes. 4 MR JUSTICE DAVID RICHARDS: And actually that is to say 5 comply to the extent of 120 per cent. How does a firm 6 comply with this requirement? What does it have to have 7 in order to comply with the requirement? I think maybe 8 I am not really understanding the requirement. 9 MR ISAACS: May I reflect on that, my Lord, rather than 10 trying to deal with it now? 11 MR JUSTICE DAVID RICHARDS: Yes. 12 MR ISAACS: It may be I will reflect and get (inaudible) 13 because I am not an expert. The basis of my submission 14 was going to be that this is a requirement which 15 requires a certain amount of initial capital and risk 16 protection. 17 MR JUSTICE DAVID RICHARDS: That I follow, that I do follow. 18 One tends to think of risk as being the opposite of 19 an asset; risk is something which puts the asset at 20 risk. It may be that this is where I am not really 21 understanding the point. 22 MR ISAACS: With respect, my Lord, that might be expert 23 evidence. But if I may my understanding is that one 24 measures risk, for example, by relevance to the size of 25 the asset or so-called value of risk.</p> <p style="text-align: center;">Page 81</p>	<p>1 requirement", that means that the borrower must maintain 2 financial resources of not less than 120 per cent of its 3 financial resources requirement? 4 MR ISAACS: That is my understanding of the position. 5 MR JUSTICE DAVID RICHARDS: I see, right. Thank you. That 6 makes sense, I can see how that makes sense. It is just 7 a slightly odd way of putting it. Well, it probably 8 isn't, but it strikes me, as an uninitiated, as 9 a slightly odd way. 10 MR ISAACS: I was now going to go on to the second aspect of 11 the financial matrix. It is more familiar ground, I am 12 pleased to say my Lord, it is the rules which govern the 13 obligations which are payable or capable of being 14 established or determined in LBIE's administration. 15 MR JUSTICE DAVID RICHARDS: Yes. 16 MR ISAACS: There are three aspects of these provision that 17 I focus on. The first is that they are mandatory. 18 MR JUSTICE DAVID RICHARDS: Yes. 19 MR ISAACS: The second is they do not provide that all 20 liabilities of the company are to be paid in full. In 21 general, presently payable debts and liabilities 22 denominated in sterling are to be paid in full but other 23 categories of debts and liabilities are to be paid in 24 amounts governed by the rules, which may well be not in 25 full. The third point is payment of the amount provided</p> <p style="text-align: center;">Page 83</p>
<p>1 MR JUSTICE DAVID RICHARDS: I don't think it is expert 2 evidence because this is a legal framework with which 3 the firm must comply. Complex it may be, but it is 4 a matter of law because these requirements, I think, at 5 least I assume, have legal effect. 6 MR ISAACS: What I meant, my Lord, is that the way one 7 measures risk might be. 8 MR JUSTICE DAVID RICHARDS: Well, it is defined. It is 9 a rather basic point I am asking as to how you comply 10 with risk, if you like, if it is risk. I am just having 11 difficulty in grappling with the concept at the moment. 12 By all means come back to it. Don't try -- move on 13 quickly and then comes back. 14 MR ISAACS: Your Lordship has in mind that at all times 15 a firm must maintain financial resources in excess of 16 that financial requirement. 17 MR JUSTICE DAVID RICHARDS: That is where I am trying to 18 find it. 19 MR ISAACS: That is 10.62(1)R. Page 17. 20 MR JUSTICE DAVID RICHARDS: "A firm must at all times 21 maintain financial resources in excess of its financial 22 resources requirement." 23 So when we look at clause 5.1(a), does that mean 24 where it says "the borrower being in compliance with not 25 less than 120 per cent of its financial resources</p> <p style="text-align: center;">Page 82</p>	<p>1 for by the rules will discharge the debt in full even if 2 the amount paid is less than the payment in full. 3 MR JUSTICE DAVID RICHARDS: Yes. 4 MR ISAACS: These points may be illustrated by reference to 5 contingent and future liabilities. Payment in full of 6 a contingent sum would be inconsistent with rule 2.81 7 because that rule requires the value of contingent debts 8 to be estimated so that a value is attributed for the 9 purposes of proof and distribution. By definition that 10 process of estimation will reduce the amount. 11 Similarly, future liabilities not payable in full. The 12 treatment of those is slightly different, because they 13 are discounted for the purposes of dividend but not 14 proof on the basis of an assumption that they are 15 treated as paid at the date the company enters 16 administration and that the appropriate discount rate is 17 5 per cent per annum compound. The reference there is 18 to rules 2.89 and 2.105. 19 MR JUSTICE DAVID RICHARDS: Yes. 20 MR ISAACS: It might be worth looking at that quickly, my 21 Lord. 22 MR JUSTICE DAVID RICHARDS: Yes. 23 MR ISAACS: 2.105(1). Insofar as the distinction between 24 future and contingent debts is concerned, you will see 25 that at 2.105(1) it says that:</p> <p style="text-align: center;">Page 84</p>

<p>1 "The creditor who has proof (?) of a debt of which 2 payment is not due at the date of the declaration of 3 dividend is entitled to dividend equally with others, 4 but then it has to be discounted at 5 per cent per 5 annum." 6 The amount of the proof is reduced. 7 MR JUSTICE DAVID RICHARDS: Yes. 8 MR ISAACS: So the amount he gets is actually less than the 9 proof. That is not the case with contingent debts, 10 because he gets the amount he proofs for, albeit that is 11 discounted against the nominal value of the debt. 12 MR JUSTICE DAVID RICHARDS: An estimated amount, yes. 13 MR ISAACS: There is a difference in treatment. 14 MR JUSTICE DAVID RICHARDS: Indeed. 15 MR ISAACS: That is significant in this case. I will come 16 on to that. I will make point by reference to two 17 authorities. I will deal briefly with one, if I may, in 18 the last minutes. 19 MR JUSTICE DAVID RICHARDS: Yes. 20 MR ISAACS: It is Lines Brothers. There are a number of 21 Lines Brothers decisions. This is the decision of 22 Mr Justice Slade which is at bundle 1C. 23 MR JUSTICE DAVID RICHARDS: Is this the one that went on 24 appeal? 25 MR ISAACS: It is, in which Lord Justice Bradman gave the</p> <p style="text-align: center;">Page 85</p>	<p>1 consistent of the following items." 2 Down the bottom we see the subordinated loan capital 3 and paragraph 2 on the next page, the concept of own 4 funds is defined in 1 to 8 and is the maximum number of 5 items. 6 MR JUSTICE DAVID RICHARDS: Where are you? 7 MR ISAACS: On the next page, article 2, paragraph 2. 8 MR JUSTICE DAVID RICHARDS: Yes. 9 MR ISAACS: Your Lordship recalls at tab 3, paragraph 23, 10 which is the next directive, there was a reference back 11 to this one. 12 MR JUSTICE DAVID RICHARDS: Yes, okay. Good. Thank you 13 very much. 14 MR ISAACS: We rely on Lines Brothers for the statement 15 which we submit is a statement of general principle set 16 out by Mr Justice Slade which appears on page 25. The 17 main paragraph starts with the words: 18 "When the winding up occurs. 19 "The creditor obtains new statutory rights to 20 participate under the statutory scheme of distribution 21 in respect of its debt as it exists at the winding up 22 date. For the reasons already given, however, the 23 nature of ...(Reading to the words)... will not 24 necessarily be the same as the original contractual 25 right. The statute may compel some adjustment of that</p> <p style="text-align: center;">Page 87</p>
<p>1 dictum that is relied upon. 2 MR JUSTICE DAVID RICHARDS: Yes. 3 MR ISAACS: That's correct. I will come back to it again in 4 that context. For the present purposes I want to rely 5 on it for the statement of the law at tab 65. 6 MR JUSTICE DAVID RICHARDS: This is? 7 MR ISAACS: Tab 65, bundle 1(c). 8 MR JUSTICE DAVID RICHARDS: Thank you. Let us come back to 9 this at 2 o'clock. 10 (1.00pm) 11 (The luncheon adjournment) 12 (2.03 pm) 13 MR ISAACS: Before we return to Lines Brothers your Lordship 14 asked a question about Marine -- 15 MR JUSTICE DAVID RICHARDS: Yes. 16 MR ISAACS: If your Lordship takes bundle 3A, tab 2, which 17 is the 89 directive that I took your Lordship to this 18 morning. Article 1, tab 2: 19 "Wherever a Member State lays down ...(Reading to 20 the words)... own funds it shall bring the term or 21 concept into line with the definition in the following 22 articles." 23 "The next article, general principles, article 2, 24 subject to the limits imposed in article 6 the 25 unconsolidated own funds of credit institutions shall</p> <p style="text-align: center;">Page 86</p>	<p>1 right so that practical effect may be given to what 2 I describe as the two central features of the statutory 3 scheme." 4 For your Lordship's note at page 16 they are, just 5 go back to page 16, down at the bottom left: 6 "One central feature is a division of available 7 assets to be effected as soon as reasonably 8 practicable." 9 Does your Lordship see that in the penultimate 10 paragraph? 11 MR JUSTICE DAVID RICHARDS: Yes. 12 MR ISAACS: Then the second central feature, which is the 13 next paragraph, is <i>pari passu</i> distribution. 14 MR JUSTICE DAVID RICHARDS: Yes. 15 MR ISAACS: So going back to page 25: 16 "In some cases the adjustment within the event will 17 be shown to have operated to the advantage of the 18 creditor concerned. In other cases it will be shown to 19 have operated to the disadvantage as it has 20 unfortunately operated to the disadvantage of the bank 21 in the present case. The creditor however who lodges 22 with the liquidator ...(Reading to the words)... must, 23 in my judgment, accept the rights conferred on him by 24 the statutory scheme of distribution in respect of 25 pre-liquidation debts, for better or worse ...(Reading</p> <p style="text-align: center;">Page 88</p>

<p>1 to the words)... are necessarily preserved intact under</p> <p>2 the statutory scheme, even if in the event there proves</p> <p>3 to be a surplus available for return to the</p> <p>4 contributories or for payment of post-liquidation</p> <p>5 interest."</p> <p>6 We obviously rely on this last sentence and the</p> <p>7 whole paragraph heavily because it underlies a lot of</p> <p>8 the submissions I will make.</p> <p>9 MR JUSTICE DAVID RICHARDS: Then the next paragraph, what he</p> <p>10 is actually talking about is the foreign currency</p> <p>11 claims.</p> <p>12 MR ISAACS: Yes, he is indeed and I will come --</p> <p>13 MR JUSTICE DAVID RICHARDS: Is the argument -- okay, you</p> <p>14 will come back to this.</p> <p>15 MR ISAACS: I will indeed. I take the point, that the</p> <p>16 context in which this is made is foreign currency</p> <p>17 claims.</p> <p>18 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>19 MR ISAACS: The next case is Danka Business Systems. We</p> <p>20 have seen that once or twice already. It is</p> <p>21 at bundle 1B, tab 95. I wonder if you Lordship --</p> <p>22 MR JUSTICE DAVID RICHARDS: This is the first instance.</p> <p>23 MR ISAACS: It is His Honour Judge Pelling QC at first</p> <p>24 instance.</p> <p>25 MR JUSTICE DAVID RICHARDS: So paragraph?</p> <p style="text-align: center;">Page 89</p>	<p>1 MR ISAACS: Where Lord Justice Patten says:</p> <p>2 "There are I think real difficulties in seeing how</p> <p>3 a liquidator who has already valued the contingent</p> <p>4 claims ...(Reading to the words)... comes under a legal</p> <p>5 duty to provide for contingency ...(Reading to the</p> <p>6 words)... any distribution."</p> <p>7 The reference to the company's liabilities in</p> <p>8 section 107 must be to the liabilities as determined in</p> <p>9 accordance with the 1986 ..."</p> <p>10 That obviously is not a current -- I beg your</p> <p>11 pardon. That principle we say can be illustrated by two</p> <p>12 examples. One in relation to future debts and one in</p> <p>13 relation to contingent debts. A simple example, we</p> <p>14 posit a case where a company owes a creditor a debt with</p> <p>15 a face value of £1,000 which is payable in 20 years'</p> <p>16 time. That falls in accordance with rule 2.105. The</p> <p>17 amount of the proof is 1,000 divided by 1.05 to the</p> <p>18 power of 20, which is 20 years of discounting at</p> <p>19 5~per cent per annum compound which is £376.89. If</p> <p>20 dividends were paid on the administration date and the</p> <p>21 company were able to pay all its debts as they fell due</p> <p>22 the creditor would receive that sum of £376 odd. If the</p> <p>23 company then had a massive surplus after payment no</p> <p>24 further amount would be payable to the creditor in</p> <p>25 respect of principal, leaving aside statutory interest.</p> <p style="text-align: center;">Page 91</p>
<p>1 MR ISAACS: Paragraph 40. If your Lordship could read that</p> <p>2 please.</p> <p>3 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>4 MR ISAACS: So we emphasise the mandatory nature of the</p> <p>5 application of the rules and that the scheme is designed</p> <p>6 to place a present value on uncertain future claims in</p> <p>7 order to enable the process to be brought to a speedy</p> <p>8 conclusion following what was said by Lord Justice</p> <p>9 Slade. Then the Court of Appeal decision is at tab 100.</p> <p>10 If your Lordship goes to the judgment of Lord Justice</p> <p>11 Patten at paragraph 30 your Lordship sees there is</p> <p>12 reference there to the decision in Re House Property and</p> <p>13 Investment Co Ltd and that is discussed over the page at</p> <p>14 paragraph 32 where Lord Justice Patten says that that</p> <p>15 case, and I am reading from letters B:</p> <p>16 "... has been treated as authority for the</p> <p>17 proposition that a liquidator is under an obligation to</p> <p>18 compete the liquidation even though the effect of the</p> <p>19 winding up may be to defeat the contingent claims of its</p> <p>20 creditors. It follows from this that the liquidator is</p> <p>21 not obliged to set aside ...(Reading to the words)...</p> <p>22 and that the claims of contingent creditors ...(Reading</p> <p>23 to the words)... under what is now rule 4.8(6)."</p> <p>24 Over the page, paragraph 37E.</p> <p>25 MR JUSTICE DAVID RICHARDS: Yes.</p> <p style="text-align: center;">Page 90</p>	<p>1 So the creditor would never receive £1,000. So</p> <p>2 your Lordship put to me earlier the point that the</p> <p>3 stated position was in relation to foreign currency</p> <p>4 claims but the same thing happens here in relation to</p> <p>5 future claims. The same point or similar point may be</p> <p>6 made in relation to contingent debts if we assume once</p> <p>7 again that the debt is £1,000 payable in 20 years' time</p> <p>8 in the event that a remote contingency takes place, then</p> <p>9 there needs to be a valuation by the</p> <p>10 liquidator/administrator in accordance with 2.81. Now</p> <p>11 suppose he estimates the likelihood of the contingency</p> <p>12 occurring at 5 per cent.</p> <p>13 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>14 MR ISAACS: Let us suppose also that he discounts to take</p> <p>15 into account futurity at a rate of 5 per cent per annum.</p> <p>16 He might not use that rate but he might do. So then how</p> <p>17 much does he estimate the value of the debt at. It is</p> <p>18 5~per cent of 1,000 divided by 1.05 to the power of 20.</p> <p>19 That is £18.84.</p> <p>20 MR JUSTICE DAVID RICHARDS: So this is where in certain</p> <p>21 events an amount of £1,000 will become payable in</p> <p>22 20 years' time.</p> <p>23 MR ISAACS: Exactly, which is a contingent debt to be</p> <p>24 valued. The proof is for £18.84. So if dividends were</p> <p>25 paid on the administration date and the company was able</p> <p style="text-align: center;">Page 92</p>

<p>1 to pay all its debts as they fell due the creditor would</p> <p>2 receive £18.84. Once again, even if the company had</p> <p>3 a massive surplus after payment of that amount and all</p> <p>4 the other debts and liabilities, and ignoring statutory</p> <p>5 interest, no further amount, we would submit, would</p> <p>6 become payable to the creditor in respect of the</p> <p>7 principal sum, leaving aside hindsight for example,</p> <p>8 assuming that does not need to be --</p> <p>9 MR JUSTICE DAVID RICHARDS: So by the time the surplus is</p> <p>10 available for distribution to members the contingency</p> <p>11 has not occurred.</p> <p>12 MR ISAACS: Exactly, that is correct.</p> <p>13 MR JUSTICE DAVID RICHARDS: On one view he has had full</p> <p>14 value.</p> <p>15 MR ISAACS: Indeed he has but he has not had his debt paid</p> <p>16 in full --</p> <p>17 MR JUSTICE DAVID RICHARDS: That is a more difficult one</p> <p>18 because given that it is a contingent debt, what is</p> <p>19 payment of his debt in full?</p> <p>20 MR ISAACS: Well, perhaps I can answer that by reference to</p> <p>21 the future debt unless your Lordship were to say that</p> <p>22 payment of £376 of his payment in full of a debt of</p> <p>23 £1,000 -- we accept that if that is what payment in full</p> <p>24 means. But what is very clear is that in neither of</p> <p>25 these cases does the creditor get £1,000. That is the</p> <p style="text-align: center;">Page 93</p>	<p>1 being wound up in the Cayman Islands. Subsequent to the</p> <p>2 winding up order the bank was subject to a</p> <p>3 reconstruction scheme in Bangladesh. The effect of the</p> <p>4 scheme was to divest all of the assets and liabilities</p> <p>5 of the bank in a new bank. The question in that case</p> <p>6 was whether Eckhart's proof of debt should be admitted</p> <p>7 in the winding up. What Lord Hoffmann said in that</p> <p>8 case, speaking for the Privy Council, can be picked up</p> <p>9 at page 154H where he said that the scheme had the</p> <p>10 effect of discharging the debt.</p> <p>11 MR JUSTICE DAVID RICHARDS: Where are you reading?</p> <p>12 Paragraph?</p> <p>13 MR ISAACS: Paragraph 20:</p> <p>14 "By the law of Bangladesh the debt owed by the bank</p> <p>15 to Eckhardt was discharged."</p> <p>16 So [and this is at paragraph 25] Mr Lowe [and he</p> <p>17 was acting for Eckhardt] submits that the question of</p> <p>18 whether Eckhardt was owed a debt must be ascertained at</p> <p>19 the date of the winding up. If as is assumed to be the</p> <p>20 case ...(Reading to the words)... under the law of</p> <p>21 Bangladesh it cannot be deprived of its entitlement by</p> <p>22 subsequent events."</p> <p>23 Then Lord Hoffmann considered cases that we have</p> <p>24 looked at, considered Lines Brothers in 26. Over the</p> <p>25 page at 28 he referred to the Dynamics case that we have</p> <p style="text-align: center;">Page 95</p>
<p>1 point that we made by reference to these examples in the</p> <p>2 cases I have referred to.</p> <p>3 MR JUSTICE DAVID RICHARDS: Tell me what would be the</p> <p>4 position if you have got a creditor with a debt payable</p> <p>5 in 20 years' time but bearing interest at market rates</p> <p>6 in the meantime. What is he entitled to receive? He</p> <p>7 cannot prove the basic liquidation interest, so he gets</p> <p>8 interest, does he from -- he gets the statutory interest</p> <p>9 from the date of liquidation -- I am not quite sure</p> <p>10 where it says.</p> <p>11 MR ISAACS: If there is a surplus.</p> <p>12 MR JUSTICE DAVID RICHARDS: Yes, if there is a surplus.</p> <p>13 MR ISAACS: Maybe I can give your Lordship -- can I give</p> <p>14 your Lordship the same answer as I gave to a slightly</p> <p>15 different question earlier which is can I reflect and</p> <p>16 come back to that?</p> <p>17 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>18 MR ISAACS: Now, my Lord, it is said or might be said this</p> <p>19 is inconsistent with what was said by Lord Hoffmann in</p> <p>20 Wight v Eckhardt Marine which is relied on by my learned</p> <p>21 friends on the other side of the court and I would like</p> <p>22 to come to that and make four points about that case.</p> <p>23 That is at 1C/79. The first point we make is that</p> <p>24 context is important. The issue in that case concerned</p> <p>25 a claim by Eckhardt Marine against the bank which was</p> <p style="text-align: center;">Page 94</p>	<p>1 looked at. Then at 30 and 31 he referred to two cases</p> <p>2 that we have not looked at but your Lordship is familiar</p> <p>3 with them, I know, which is two of the hindsight cases:</p> <p>4 European Assurance and Northern Counties.</p> <p>5 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>6 MR ISAACS: He reached his conclusions at 32 and 33.</p> <p>7 I wonder if your Lordship could please read those?</p> <p>8 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>9 MR ISAACS: The ratio of this case is there set out. It is</p> <p>10 that:</p> <p>11 "Anyone who claims [and I am reading from between C</p> <p>12 and D] to participate in a distribution should have the</p> <p>13 status of creditor at the time when he makes the claim."</p> <p>14 That is what the case was about. It was in that</p> <p>15 context that one sees what was said in paragraph 27</p> <p>16 which is relied on by my learned friend. It is this:</p> <p>17 the.</p> <p>18 "Winding up leaves the debts of the creditors</p> <p>19 untouched. It only affects the way in which they can be</p> <p>20 enforced."</p> <p>21 Reading on:</p> <p>22 "The winding up does not either create new</p> <p>23 substantive rights in the creditors or destroy the old</p> <p>24 ones. They are debt if they ...(Reading to the</p> <p>25 words)... by the winding up to the extent that they have</p> <p style="text-align: center;">Page 96</p>

<p>1 paid out the difference."</p> <p>2 That is what they rely on. So the first point then</p> <p>3 is the context on what they rely on. The second point</p> <p>4 we make is we say what is said by Lord Hoffmann in this</p> <p>5 case is entirely consistent with the analysis of future</p> <p>6 and contingent debts, that is set out in both Lines</p> <p>7 Brothers and the Danka case. It is not the winding up</p> <p>8 that creates or destroys creditors' rights. It is the</p> <p>9 process of proof and payment.</p> <p>10 LIBE accepts that payment of the discounted element</p> <p>11 of a future liability discharges the whole debt so that</p> <p>12 no claims survive. That is paragraph 49(1) on page 18</p> <p>13 of their reply submissions.</p> <p>14 MR JUSTICE DAVID RICHARDS: The paragraph again?</p> <p>15 MR ISAACS: 49(1).</p> <p>16 MR JUSTICE DAVID RICHARDS: Thank you.</p> <p>17 MR ISAACS: They also accept what amounts to the same thing</p> <p>18 in relation to contingent liabilities. They say this:</p> <p>19 "As to any amount in excess of the estimated amount</p> <p>20 of the contingent liability, subject to any revaluation</p> <p>21 when the revalued amount will be proveable, the same</p> <p>22 analysis applies."</p> <p>23 That is page 18 as well. That is the third point.</p> <p>24 The fourth point is this: Lord Hoffmann was making</p> <p>25 a statement of general principle. What he says is of</p> <p style="text-align: center;">Page 97</p>	<p>1 MR ISAACS: The first point is it cannot be a condition of</p> <p>2 subordination that LIBE is able to pay all its</p> <p>3 liabilities in full, small L, because this would mean</p> <p>4 that contingent creditors would be paid more than that</p> <p>5 to which they are entitled under the rules.</p> <p>6 MR JUSTICE DAVID RICHARDS: Sorry, it cannot be...</p> <p>7 MR ISAACS: A condition of subordination that LIBE is able</p> <p>8 to pay all its liabilities, small L, in full, because</p> <p>9 that would mean the contingent creditors would be paid</p> <p>10 more than that to which they are entitled under the</p> <p>11 rules. It follows from that that the meaning of</p> <p>12 liabilities, with a capital L, is not all liabilities,</p> <p>13 with a capital L. The second point is this, the</p> <p>14 treatment of future liabilities shows that the subset of</p> <p>15 liabilities which fall within the defined term</p> <p>16 liabilities is narrower than proveable liabilities.</p> <p>17 MR JUSTICE DAVID RICHARDS: Sorry, the treatment of future</p> <p>18 liabilities shows that...</p> <p>19 MR ISAACS: Yes, the subset of liabilities that fall within</p> <p>20 the meaning of the word liabilities as defined in</p> <p>21 paragraph 5 has to be narrower than proveable</p> <p>22 liabilities.</p> <p>23 MR JUSTICE DAVID RICHARDS: Narrower.</p> <p>24 MR ISAACS: Narrower, yes. The reason I say that is</p> <p>25 because, as we have seen from rule 2.105, the dividend</p> <p style="text-align: center;">Page 99</p>
<p>1 course correct in relation to the generality of the</p> <p>2 claims, what I described earlier as: "Presently payable</p> <p>3 claims in Sterling". He did not refer to the specific</p> <p>4 rules in section C of chapter 10, that is to say the</p> <p>5 rules of 2.81 to 2.105 which specify particular regimes</p> <p>6 in relation to particular sorts of debts. The regimes</p> <p>7 I have in mind are those which apply to contingent</p> <p>8 debts, future debts, foreign currency debts and claims</p> <p>9 for interest. He referred to contingent debts only in</p> <p>10 the context of re-evaluation with the benefit of</p> <p>11 hindsight. He cannot possibly have meant, for example,</p> <p>12 either that a future creditor was entitled to receive</p> <p>13 more than the full amount provided for by rule 2.105 nor</p> <p>14 can he possibly have meant that the winding up does not</p> <p>15 create any new substantive rights in creditors. LIBE</p> <p>16 relies on the creation of such new rights, namely the</p> <p>17 right to statutory interest which creates a new right in</p> <p>18 relation to debt which does not bear interest.</p> <p>19 I turn now to the next part of my submissions which,</p> <p>20 as I say, is seven reasons why or reasons why the</p> <p>21 sub-debt is not subordinated to statutory interest.</p> <p>22 I start with seven reasons why a statutory interest is</p> <p>23 not a liability, with a capital L, within paragraph 5(2)</p> <p>24 of the subordinated loan agreement.</p> <p>25 MR JUSTICE DAVID RICHARDS: Yes.</p> <p style="text-align: center;">Page 98</p>	<p>1 is not payable on the full amount proved in respect of</p> <p>2 the future debt. It is paid on the proof as reduced in</p> <p>3 accordance with rule 2.105. What that means is that the</p> <p>4 meaning of liabilities in paragraph 5(2) is those</p> <p>5 liabilities which are proveable and payable in</p> <p>6 accordance with the rules. Otherwise unless you define</p> <p>7 it that way you cannot square what happens with</p> <p>8 contingent and future liability. The third argument</p> <p>9 relates to the treatment of a surplus in a winding up.</p> <p>10 Suppose LIBE was in liquidation and had paid all its</p> <p>11 expenses and all of its unsubordinated liabilities and</p> <p>12 there remained a substantial surplus, that would fall</p> <p>13 within the expression: "some liability or obligation,</p> <p>14 payable or owing by LIBE howsoever." Of course I am</p> <p>15 reading from page 233, if you look at the top, the</p> <p>16 definition of liability, with a capital L.</p> <p>17 "Liabilities means all present and future sums,</p> <p>18 liabilities and obligations, payable or owing by the</p> <p>19 borrow, whether actual or contingent ...(Reading to the</p> <p>20 words)... otherwise howsoever."</p> <p>21 So the surplus within that situation be a liability</p> <p>22 within paragraph 5 because it is a sum payable by LIBE.</p> <p>23 MR JUSTICE DAVID RICHARDS: I think of the surplus as being</p> <p>24 the money left after paying the proveable debts.</p> <p>25 MR ISAACS: Yes, my Lord. It is a sum of money which is</p> <p style="text-align: center;">Page 100</p>

25 (Pages 97 to 100)

<p>1 held by the company after payment of those debts.</p> <p>2 MR JUSTICE DAVID RICHARDS: It is not a liability.</p> <p>3 MR ISAACS: Your Lordship says it is not a liability. My</p> <p>4 point is that it is a sum payable by the borrower</p> <p>5 howsoever. That is how liabilities are defined, with a</p> <p>6 capital L. They purport to include all sums payable by</p> <p>7 the borrower, which your Lordship just said the surplus</p> <p>8 is a sum payable and it would therefore appear to fall</p> <p>9 within the definition of liabilities, with a capital L.</p> <p>10 Of course, my Lord, my point is that that would make no</p> <p>11 sense at all.</p> <p>12 MR JUSTICE DAVID RICHARDS: I agree.</p> <p>13 MR ISAACS: But the question is why does it make no sense.</p> <p>14 If, as your Lordship rightly says, we say that</p> <p>15 respectfully, that it is a sum payable then that</p> <p>16 informs.</p> <p>17 MR JUSTICE DAVID RICHARDS: I am sorry, is not the sum</p> <p>18 payable, if we are talking about statutory interest, the</p> <p>19 interest and that is payable out of the surplus. Taking</p> <p>20 from the left hand and the right hand --</p> <p>21 MR ISAACS: Yes, but once the statutory interest is paid.</p> <p>22 MR JUSTICE DAVID RICHARDS: Once it is paid. So you have</p> <p>23 still got a surplus after -- so you have paid all</p> <p>24 proveable debts. You have paid the statutory excess.</p> <p>25 You have still got the surplus. So you then look, have</p> <p style="text-align: center;">Page 101</p>	<p>1 borrower. My case is, and I --</p> <p>2 MR JUSTICE DAVID RICHARDS: You are right, you have to look</p> <p>3 at these words sort of in their context and with a view</p> <p>4 to the purpose of the agreement. That is absolutely</p> <p>5 clear; I agree. Anyway, you say, and I am not</p> <p>6 disagreeing with you, that to describe a surplus in</p> <p>7 a winding up as a sum payable does not make much sense.</p> <p>8 Sorry, is that your -- I have misunderstood the</p> <p>9 submission.</p> <p>10 MR ISAACS: My point is that it is a sum payable. It is</p> <p>11 a sum that is payable but it cannot possibly be</p> <p>12 a liability, with a capital L. That would not make any</p> <p>13 sense, because if it were then the subordinated debt</p> <p>14 could never be paid because it is the last thing to be</p> <p>15 paid. So we would say that informs the meaning of the</p> <p>16 word liabilities and it shows it does not mean all sums</p> <p>17 payable.</p> <p>18 The fourth point is that the statutory interest is</p> <p>19 not a liability under paragraph 5(2) as defined because</p> <p>20 of its peculiar incidents and there are four on which we</p> <p>21 rely. It is not a right in respect - this is the first</p> <p>22 one -- of which a creditor may at any stage sue the</p> <p>23 company. Secondly, prior to administration no question</p> <p>24 of entitlement arises because statutory interest only</p> <p>25 becomes payable, if at all, if the company not only goes</p> <p style="text-align: center;">Page 103</p>
<p>1 we got some other "liabilities". Probably sum means the</p> <p>2 amount payable. It does not mean the asset which you</p> <p>3 will apply in payment.</p> <p>4 MR ISAACS: We would say that the amount remaining is</p> <p>5 appropriately described as a sum.</p> <p>6 NEW SPEAKER: Well, is a liability.</p> <p>7 MR ISAACS: As a sum and therefore as a liability.</p> <p>8 MR JUSTICE DAVID RICHARDS: Take it this way, Mr Isaacs.</p> <p>9 Supposing the surplus is sufficient to provide a return</p> <p>10 to members, nobody is suggesting that the return to</p> <p>11 members is a liability for the purposes of this</p> <p>12 agreement. It would make no sense at all.</p> <p>13 MR ISAACS: That is my point.</p> <p>14 MR JUSTICE DAVID RICHARDS: And therefore --</p> <p>15 MR ISAACS: What I mean, my Lord, when I say that, is</p> <p>16 it would make no sense for it to be a liability so that</p> <p>17 informs how one reads the words liabilities.</p> <p>18 MR JUSTICE DAVID RICHARDS: I agree.</p> <p>19 MR ISAACS: My point is we therefore have to read it as</p> <p>20 excluding certain sums, liabilities or obligations which</p> <p>21 are owing by the borrower.</p> <p>22 MR JUSTICE DAVID RICHARDS: I mean, a return of capital to</p> <p>23 members or a return of surplus to member would not</p> <p>24 normally qualify as a liability of the company.</p> <p>25 MR ISAACS: No, but it would qualify as a sum payable by the</p> <p style="text-align: center;">Page 102</p>	<p>1 into administration but also has a surplus after paying</p> <p>2 its proved debts. Even then -- and this is the third</p> <p>3 point -- no creditor has a right to prove the statutory</p> <p>4 interest. It is payable, if at all, by the</p> <p>5 administrator out of the assets as part of the statutory</p> <p>6 scheme. The fourth point is that the amount of</p> <p>7 statutory interest is limited by the amount of the</p> <p>8 surplus. Is your Lordship looking at the words of</p> <p>9 2.88(7)?</p> <p>10 MR JUSTICE DAVID RICHARDS: I am.</p> <p>11 MR ISAACS: "Any surplus remaining after payment of the</p> <p>12 debts proved shall be applied in paying interest on</p> <p>13 those debts."</p> <p>14 Those words are similar to the words that appeared</p> <p>15 in the predecessor -- in the Bankruptcy Act 1914.</p> <p>16 A convenient place to get that is from another Lyons'</p> <p>17 decision at tab 57, which is the one we have looked at:</p> <p>18 a decision of Mr Justice Mervin Davis.</p> <p>19 MR JUSTICE DAVID RICHARDS: That is in?</p> <p>20 MR ISAACS: It is in bundle 1C at 67.</p> <p>21 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>22 MR ISAACS: That is set out at page 219 between letters A</p> <p>23 and B. Your Lordship sees that the wording there is</p> <p>24 very similar in all material respect to 2.887 and also</p> <p>25 that Mr Justice Mervin Davis held that:</p> <p style="text-align: center;">Page 104</p>

<p>1 "The foregoing debts in section 33(8) are the debts 2 referred to." 3 MR JUSTICE DAVID RICHARDS: Yes. 4 MR ISAACS: Your Lordship has been shown the paragraph at 5 223D-E -- 6 MR JUSTICE DAVID RICHARDS: Yes. 7 MR ISAACS: -- where Mr Justice Mervin Davis said: 8 "At no stage can statutory interest be regarded as a 9 debt or liability of the company. It is an obligation 10 which is part of the statutory scheme ...(Reading to the 11 words)... at the outset of the winding up." 12 He was talking about the interest in section 33(8) 13 but for the reasons I have given the incidence of 14 statutory interest under 2.88(7) are exactly the same 15 and the reasoning of Mr Mervin Davis applies equally to 16 2.88(7) and we submit it is not therefore a liability 17 within the meaning of paragraph 5. The fifth point 18 relates to the factual matrix. I have taken 19 your Lordship to the (Inaudible) and the four relevant 20 EC directives relating to capital adequacy. I submit 21 that they provide very strong grounds to suggest that 22 this agreement was not intended to subordinate statutory 23 interest to subordinated liabilities. I will not go 24 back to them but your Lordship will recall the points 25 I made in relation to the purpose of the directive. We Page 105</p>	<p>1 amount of statutory interest which is payable is defined 2 by the amount of the surplus. Thirdly, it presupposes 3 that it is possible to determine in advance the amount 4 of statutory interest payable, but this cannot be done 5 because it depends on the time that elapses between the 6 date the company enters administration and the date or 7 dates of payment which cannot be known before the 8 administration. Sixthly, we have looked at the elements 9 which enter into the calculation of the financial 10 resources requirement. Whatever else they may mean, 11 they have nothing to do with an entitlement which arises 12 if and only if there is a surplus in the administration. 13 Now this submission if we are wrong there would be very 14 strange consequences. If you did have to take statutory 15 interest into account in deciding whether LIBE is 16 solvent it could well be solvent early in the 17 administration. So that in an administration like 18 LIBE's where interim dividends are paid the first 19 interim dividends will be paid pari passu on all debts 20 proved, including the subordinated debt. 21 MR JUSTICE DAVID RICHARDS: I am not sure I follow you. 22 I mean, you cannot -- even on your approach to this, the 23 subordinated debt cannot be paid unless following 24 payment LIBE is able to pay all its proveable debts in 25 full. Page 107</p>
<p>1 say none of them is relevant to subordinated statutory 2 interest for the followings reasons: firstly, in so far 3 as the soundness and stability of the international 4 banking system is concerned, statutory interest is 5 payable only in the event that there is a surplus after 6 proven debts have been paid and only to the extent of 7 the surplus. So once you get to that point you are not 8 concerned with soundness and stability. Secondly, it 9 self-evidently has no relationship to competitive 10 inequality amongst international banks or to mutual 11 recognition of authorisation and potential supervision 12 systems. Thirdly, for the same reason as the first 13 reason it is not relevant to the absorption of losses 14 because it is only payable in the event that there is 15 a surplus after all debts have been proved. 16 Fourthly, it is not relevant to the continuity of 17 institutions because it only becomes payable when the 18 company's assets have been distributed in the 19 administration. Fifthly, it is not relevant to the 20 assessment of the company's solvency. It cannot be 21 taken into account when determining the company's 22 solvency for at least three reasons: firstly, any 23 entitlement to it presupposes not only a formal 24 insolvency but also the company has able to and has paid 25 all its debts, proven debts in full. Secondly, the Page 106</p>	<p>1 MR ISAACS: That is correct, my Lord. I will stop there, if 2 I may? 3 MR JUSTICE DAVID RICHARDS: Right. 4 MR ISAACS: The sixth point. 5 MR JUSTICE DAVID RICHARDS: Hold on. 6 MR ISAACS: The fifth one was the factual matrix. 7 MR JUSTICE DAVID RICHARDS: The fifth one, yes. Oh, I see. 8 MR ISAACS: The fourth one was liability. Statutory 9 interest is not a liability because -- 10 MR JUSTICE DAVID RICHARDS: Yes, this is the sixth point. 11 MR ISAACS: This follows on from the characteristics of the 12 statutory interest referred to above. We say they are 13 such that statutory interest is not a liability for the 14 purpose of determining whether LIBE is insolvent, is 15 defined. The reason we say that is because when one 16 considers the meaning of a defined term one must not 17 assume that the word used is arbitrary. In other words, 18 the reason that the word solvent has been used is 19 because it is a well-known concept and it is more 20 precisely stated in the definition. I refer 21 your Lordship to authority for that proposition. 22 MR JUSTICE DAVID RICHARDS: So I am clear on this, we are 23 focusing on the use of the word "solvent" in inverted 24 commas. 25 MR ISAACS: Yes, and the submission is that that is Page 108</p>

<p>1 a well-known word. It is defined. When one is seeking 2 to understand its meaning one may have regard to the 3 fact that that particular word was chosen and the 4 incidence of that particular word. The authority for 5 that proposition is the Chartbrook case in the 6 House of Lords which is in the supplemental bundle at 7 tab 2. If we go to page 1012, at paragraph 17, 8 Lord-Hoffmann was referring to the judge's decision and 9 it related to the meaning of the term: "Minimum 10 guaranteed residential unit value". The judge declined 11 to regard the terms ...(Reading to the words)... minimum 12 guarantee residential unit value as indicative of an 13 intention that MGRUV [which is that term that I have 14 just read] was to be the minimum Chartbrook would 15 receive as the land value because both terms ...(Reading 16 to the words)... other parts of the agreement." 17 MR JUSTICE DAVID RICHARDS: Which may be as close as 18 Lord Hoffmann ever got to saying that words have 19 a natural meaning. You do not have to comment, 20 Mr Isaacs. (Laughter) 21 MR ISAACS: So the point I am making is analogous to the 22 point that was made by Mr Justice Mervin Davis in the 23 Lines Brothers when he was deciding whether a company 24 was insolvent for the purposes of section 10 of the 1875 25 Act. He said that one cannot consider insolvency by</p> <p style="text-align: center;">Page 109</p>	<p>1 MR JUSTICE DAVID RICHARDS: You are really addressing here 2 the circumstance where the borrower is not in 3 insolvency. You raise an interesting point I think but 4 we have to take account that the word liabilities is 5 defined as meaning "present and future liabilities". 6 MR ISAACS: Yes. 7 MR JUSTICE DAVID RICHARDS: So if you have got future 8 liabilities which, as you rightly said, is a feature, 9 how is this applied? 10 MR ISAACS: If you have, if you imagine a bank which has 11 very substantial liabilities falling due in 20 years' 12 time. 13 MR JUSTICE DAVID RICHARDS: Yes. So it has got a long dated 14 bond -- 15 MR ISAACS: Very long-dated. I would submit one 16 construction which is completely impossible to conceive 17 is that the full value of those has to be paid at the 18 date at which this comes to be applied. 19 MR JUSTICE DAVID RICHARDS: How do you, how does it? 20 MR ISAACS: Well, my submission is it applies in the same 21 way that one considers whether or not a going concern, a 22 company which is a going concern is solvent in deciding 23 whether or not the company needs to go into insolvency. 24 One values, one takes into account future debts and 25 liabilities. Companies do that all the time; banks do</p> <p style="text-align: center;">Page 111</p>
<p>1 reference to the obligation to pay statutory interest 2 because that is to suppose that the provision applies in 3 the first instance. My submission is to say that one 4 does not take into account statutory interest when one 5 looks at whether or not a company is solvent because 6 that would be to presume that it is so, because the 7 obligation to pay statutory interest only comes into 8 existence when it is solvent and there is a surplus. 9 MR JUSTICE DAVID RICHARDS: Yes, I see. 10 MR ISAACS: Your Lordship pointed out that paragraph 5(2) 11 applies whether or not LIBE is in -- I beg your pardon, 12 paragraph 5(1)(b) applies whether or not LIBE is in 13 insolvency. The factual context in which the EC 14 directives are applied to banks and investment firms 15 makes it likely that they may have substantial future 16 debts and liabilities and future assets. But it cannot 17 seriously be suggested, I submit, that the sub-debt 18 could not be paid until LIBE is able at a particular 19 date to be able to pay the full value of all of the 20 debts falling due for payment in, say, 20 years' time. 21 The use of the present tense "is able to pay", which 22 I referred to earlier, suggests some sort of cashflow 23 test. This again shows that the solvency test in 5(2) 24 does not require LIBE to pay the value of all its 25 liabilities in full in order to meet that test.</p> <p style="text-align: center;">Page 110</p>	<p>1 it all the time and they decide if they are solvent but 2 they never take into account statutory interest and they 3 could not do for the reasons I have already given. 4 MR JUSTICE DAVID RICHARDS: Just sticking for a moment with 5 these future liabilities. 6 MR ISAACS: Yes. 7 MR JUSTICE DAVID RICHARDS: In the balance-sheet of the 8 borrower, I think I am right in saying that the future, 9 those long-dated bonds would come in at nominal value. 10 So I mean if you looked at the balance-sheet you would 11 probably -- you would form a view, would you not, as to 12 whether the bank was able to pay all its liabilities and 13 you might well in those circumstances see the future 14 debts taken at face value; they do not normally discount 15 future liabilities on the basis of a value. 16 MR ISAACS: But the bank would never be able to pay its 17 future liabilities at face value. No bank would be able 18 to do that. 19 MR JUSTICE DAVID RICHARDS: Maybe -- well I mean, it may be 20 balance-sheet solvent though and clearly cashflow 21 solvent because the balance-sheet will show the surplus 22 of assets over liabilities, liabilities there including 23 all its longer-dated liabilities. 24 MR ISAACS: Yes, and in deciding whether it is cashflow 25 solvent one would look at the debts that are presently</p> <p style="text-align: center;">Page 112</p>

<p>1 due for payment and possibly look at it that(?) way.</p> <p>2 MR JUSTICE DAVID RICHARDS: I do not know.</p> <p>3 MR ISAACS: I will submit that it is not a sensible</p> <p>4 construction to suppose that the borrower would need to</p> <p>5 be able to pay a debt that did not fall due for 20 years</p> <p>6 in full.</p> <p>7 MR JUSTICE DAVID RICHARDS: So: "It is able to pay its</p> <p>8 liabilities in full" would take account of, you would</p> <p>9 say projecting forward to the 20 years this borrower,</p> <p>10 this company is able to pay those debts, just as you</p> <p>11 would, as you say, if you were considering an inability</p> <p>12 to pay debts of an insolvency process.</p> <p>13 MR ISAACS: "Is able to pay its debts as they fall due."</p> <p>14 MR JUSTICE DAVID RICHARDS: It is not quite the test here.</p> <p>15 "Able to pay its liabilities".</p> <p>16 MR ISAACS: In full.</p> <p>17 MR JUSTICE DAVID RICHARDS: In full. You would say you take</p> <p>18 account of the future -- it may be on the face of the</p> <p>19 balance-sheet the company can pay.</p> <p>20 MR ISAACS: It may be able to.</p> <p>21 MR JUSTICE DAVID RICHARDS: I am not sure how it --</p> <p>22 MR ISAACS: I do not know, my Lord, whether all the banks</p> <p>23 would be able to do that.</p> <p>24 MR JUSTICE DAVID RICHARDS: Well, they are not -- yes, okay.</p> <p>25 But the value of their assets will exceed the value of</p> <p style="text-align: center;">Page 113</p>	<p>1 MR ISAACS: For a whole bunch of reasons, including as</p> <p>2 I have given you.</p> <p>3 MR JUSTICE DAVID RICHARDS: You may recall I put a point to</p> <p>4 Mr Trace on Friday afternoon about interest and</p> <p>5 I wondered whether you had a response to that point.</p> <p>6 I do not know if you recall the point?</p> <p>7 MR ISAACS: I do not think I do.</p> <p>8 MR JUSTICE DAVID RICHARDS: Very well. The point was this,</p> <p>9 that if at the date when the borrower wishes to repay</p> <p>10 some subordinated debts there is outstanding, as there</p> <p>11 almost certainly will be, or there will be accrued</p> <p>12 interest on its customers, in the client's accounts, as</p> <p>13 at 1 May wants to repay some subordinated debt, there</p> <p>14 will be accrued interest on accounts. Now that I think</p> <p>15 you would agree would have to be taken into account in</p> <p>16 determining the borrower's solvency.</p> <p>17 MR ISAACS: Yes, it would do.</p> <p>18 MR JUSTICE DAVID RICHARDS: So let us say between 1 January</p> <p>19 and 1 May for the sake of argument sums totalling</p> <p>20 whatever have arisen, have accrued in respect of</p> <p>21 interest. Now let us postulate that you have a company</p> <p>22 that goes into administration, 1 January being the date</p> <p>23 of administration. So interest falling due or accruing</p> <p>24 due after that date is not proveable but is replaced by</p> <p>25 statutory interest.</p> <p style="text-align: center;">Page 115</p>
<p>1 all its liabilities, including its future liabilities.</p> <p>2 They may not all, clearly they are not going to be all</p> <p>3 capable of being turned into cash in the short term but</p> <p>4 there will be a surplus of assets over liabilities</p> <p>5 including future liabilities.</p> <p>6 MR ISAACS: Yes. If the borrower went along after this,</p> <p>7 before the due payment, and said, "Can I please have my</p> <p>8 sub debts?" and LIBE said, "No, we are not going to</p> <p>9 repay it because in 20-years' time you have a debt which</p> <p>10 falls due which is X million dollars and we cannot pay</p> <p>11 that now", that would be a bizarre response which shows</p> <p>12 that you do not take into account now the full value of</p> <p>13 all the liabilities which fall due in the future.</p> <p>14 MR JUSTICE DAVID RICHARDS: I do not know how this exercise</p> <p>15 is actually carried out for a company, a borrower which</p> <p>16 is a going concern. But it may be that either you do it</p> <p>17 on balance-sheet grounds in which case you say, well,</p> <p>18 there is a surplus of assets over liabilities or it may</p> <p>19 be you apply the sort of inability to pay debts type of</p> <p>20 approach and say they are --</p> <p>21 MR ISAACS: On either analysis what you do not do is take</p> <p>22 into account statutory interest. You never take into</p> <p>23 account statutory interest. It never appears in any</p> <p>24 balance-sheet.</p> <p>25 MR JUSTICE DAVID RICHARDS: No.</p> <p style="text-align: center;">Page 114</p>	<p>1 MR ISAACS: My Lord.</p> <p>2 MR JUSTICE DAVID RICHARDS: You say that come 1 May when you</p> <p>3 say that a subordinated debt should be repaid, all</p> <p>4 proveable debts having by then been repaid in full, the</p> <p>5 subordinated debt can be repaid before any interest</p> <p>6 which would otherwise have accrued due since 1 January.</p> <p>7 You say that is the effect of it because the statutory</p> <p>8 interest is, as it were, taken out of account and is not</p> <p>9 a liability to which you are subordinated. Why should</p> <p>10 the agreement make that distinction to the detriment of</p> <p>11 ordinary creditors?</p> <p>12 MR ISAACS: I will come back to that but I will just state,</p> <p>13 if I may now, what the answer to that is and I will</p> <p>14 explain it in due course. The answer is that there is</p> <p>15 no right to statutory interest which accrues.</p> <p>16 MR JUSTICE DAVID RICHARDS: Is it a question of the</p> <p>17 construction of this agreement.</p> <p>18 MR ISAACS: As I understood the question, it turns on the</p> <p>19 existence of a right to statutory interest which accrues</p> <p>20 in administration or liquidation.</p> <p>21 MR JUSTICE DAVID RICHARDS: What I put to you is the</p> <p>22 contrast between the position when the company is</p> <p>23 a going concern when, as you agree, the subordinated</p> <p>24 debt is subordinated to the accrued interests with the</p> <p>25 position in an insolvency where there is no proveable</p> <p style="text-align: center;">Page 116</p>

<p>1 debt in respect of contractual interest but there is 2 substituted statutory interest.</p> <p>3 MR ISAACS: Yes, but is it that premise that I reject. 4 There is no substitution of statutory interest and the 5 reason is -- I will develop it in time but I have 6 already touched on it where I took your Lordship to 7 page~887 and I said this, that statutory interest exists 8 if and only if there is a surplus and only to the extent 9 that there is a surplus. So before one gets to the 10 point where one has a surplus there is no right to 11 statutory interest at all. It does not exist. That is 12 the argument that I develop. But that is why there is 13 a difference. It is a difference which follows not from 14 the way anything has been treated but from the intrinsic 15 nature of statutory interest which is a curious creature 16 of this statute. If they are different, if 17 your Lordship's reference to interest accruing under the 18 contract in the first example is substantively different 19 to the right to statutory interest, as I say it is, 20 there is no contrast. There is no proper analogy 21 because they are completely different beasts.</p> <p>22 MR JUSTICE DAVID RICHARDS: From the point of view of the 23 creditor who has a debt which carries interest there is 24 clearly a very different treatment, is there, depending 25 on whether the company has gone into administration.</p> <p style="text-align: center;">Page 117</p>	<p>1 only correct if the "it" refers to the statutory scheme. 2 In other words, the "it" that advances the interest, the 3 statutory scheme which provides that there is no --</p> <p>4 MR JUSTICE DAVID RICHARDS: No, it is the agreement. I am 5 talking about the agreement.</p> <p>6 MR ISAACS: That is my response, my Lord. No, the agreement 7 does not have that effect. What has the effect of 8 accelerating the position of the subordinated debt is 9 the statutory scheme because --</p> <p>10 MR JUSTICE DAVID RICHARDS: No, because it is a question of 11 construing the agreement to see what is or is not 12 included within the terms against the statutory scheme.</p> <p>13 MR ISAACS: If I am correct in my submissions that what is 14 included is the debts and liabilities, presently payable 15 and proveable in accordance with that scheme, then one 16 does not get to statutory interest because it is not in 17 there after the liquidation. Beforehand you have 18 a different beast. Beforehand you have contractual 19 interest which clearly is proveable, clearly is payable. 20 I will develop that, if I may, as I come to that. That 21 comes up at a number of points in the argument.</p> <p>22 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>23 MR ISAACS: So we are on the seventh point now. That is the 24 mechanism which is used to achieve subordination. My 25 learned friend Mr Trower reminds me that it might be</p> <p style="text-align: center;">Page 119</p>
<p>1 MR ISAACS: Absolutely and that is why I started to 2 developed a theme that in relation to the four regimes 3 that I referred to: future debt, contingent debt, 4 interest and currency, the position in liquidation or 5 administration is very different after the onset of the 6 insolvency process than before. There are fundamental 7 changes, unlike the generality of cases dealt with by 8 Lord Hoffmann. In those four instances there are real 9 substantive differences. The easiest way to see it is 10 in relation to statutory interest where there is no 11 interest-bearing debt at all. That particular creditor 12 suddenly becomes entitled to a right of interest that it 13 never had before. So if there is no proper analogy 14 between the two sorts of interest then there is no 15 problem to explain away because it is explained by the 16 difference in the nature of the interest itself rather 17 than anything to do with the contract.</p> <p>18 MR JUSTICE DAVID RICHARDS: But it has the effect, does it 19 not, I mean we are talking about businesses here, banks 20 and investment firms which will have a lot of 21 interest-bearing debt. So it has the effect of, as it 22 were, advancing the position of a subordinated creditor 23 in an insolvency as against the position out of 24 insolvency.</p> <p>25 MR ISAACS: When your Lordship says "it" I think that is</p> <p style="text-align: center;">Page 118</p>	<p>1 appropriate for a break.</p> <p>2 MR JUSTICE DAVID RICHARDS: Do you want a break now or shall 3 we go on for 5 minutes or...</p> <p>4 MR ISAACS: This next point is 10 to 15 minutes.</p> <p>5 MR JUSTICE DAVID RICHARDS: Let us break now then.</p> <p>6 (3.08 pm)</p> <p>7 (A short break)</p> <p>8 (3.15pm)</p> <p>9 MR ISAACS: The seventh point relates to the mechanism used 10 to achieve subordination. There are a number of ways in 11 which contractual subordination may be effected, for 12 example firstly by postponement of payment of 13 subordinated liabilities. Secondly by use of 14 a subordination trust or turnover provision and thirdly 15 by postponement of proof of subordinated liabilities. 16 Your Lordship has seen that the subordinated debt 17 agreement uses the first two but not the third. There 18 is no reference to proof in the agreement. As 19 an example of the third, one looks to the case in the 20 bundle -- it has been overruled on the law but there is 21 a nice example of a postponement of proof -- the SSL 22 case in the Court of Appeal which is bundle 1C tab 84.</p> <p>23 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>24 MR ISAACS: Page 618-paragraph 3. Lord Justice Chadwick 25 describes the subordination provisions. If your</p> <p style="text-align: center;">Page 120</p>

<p>1 Lordship sees at clause 8.2 of the deed:</p> <p>2 "Postponement of indemnitor's rights. Until all</p> <p>3 payments which may be or become payable by the</p> <p>4 indemnitors to the surety under the deed have been</p> <p>5 irrevocably paid in full no indemnitor shall, after</p> <p>6 a claim has been made by the surety hereunder or by</p> <p>7 virtue of any payment made by it under the deed."</p> <p>8 Then (b):</p> <p>9 "Claim, rank, prove or vote as a creditor of any</p> <p>10 indemnitor or its estate in competition with the</p> <p>11 surety."</p> <p>12 We say that is an example of the sort of term that</p> <p>13 could be used. It might not be entirely appropriate but</p> <p>14 it is very easy to provide for the postponement of proof</p> <p>15 if that is what is intended. The fact that it was not</p> <p>16 done here, we submit, shows that it was not intended to</p> <p>17 be done here.</p> <p>18 My learned friends rely on paragraph 7(e) of the</p> <p>19 subordinated debt agreement, which is at page 237.</p> <p>20 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>21 MR ISAACS: 7(d) says:</p> <p>22 "Attempt to obtain repayment of any of the</p> <p>23 subordinated liabilities otherwise than in accordance</p> <p>24 with the agreement."</p> <p>25 7(e) says:</p> <p style="text-align: center;">Page 121</p>	<p>1 but not postponement of proof of the sub-debt will have</p> <p>2 the result that statutory interest is not payable until</p> <p>3 after the subordinated debt because the subordinated</p> <p>4 debt is proven and statutory debt is payable after</p> <p>5 approval of all of the paid debts. That is why on this</p> <p>6 case there could be a difference depending on the</p> <p>7 mechanism used to achieve subordination.</p> <p>8 The subordination of the agreement as a result of</p> <p>9 the postponement of the payment of the sub-debt has the</p> <p>10 logical result which is lacking from the result</p> <p>11 contended for by my learned friends. The reason it is</p> <p>12 logical is if one considers the Waterfall set out in the</p> <p>13 Nortel case in the Supreme Court the subordination has</p> <p>14 the sensible result of pushing the subordinated debt</p> <p>15 down to the bottom of tier 5. In other words it comes</p> <p>16 immediately after all of the other proved debts. That</p> <p>17 is consistent with the general approach in insolvency,</p> <p>18 which is proved debts are paid before non-proved debts.</p> <p>19 The contention advanced by my learned friends to the</p> <p>20 contrary is to say that in fact you have a non-provable</p> <p>21 debt which is statutory interest but that is payable</p> <p>22 ahead after provable debt, which is the subordinated</p> <p>23 debt. That would be very strange.</p> <p>24 We say for those reasons statutory payment is not</p> <p>25 a liability in category 5, is not taken into account in</p> <p style="text-align: center;">Page 123</p>
<p>1 "Take or omit to take any action whereby the</p> <p>2 subordination may be terminated, impaired or adversely</p> <p>3 affected."</p> <p>4 Neither of these are part of the subordination</p> <p>5 provision. What they do is preserve the subordination</p> <p>6 created by paragraph 5. If paragraph 5 does not prevent</p> <p>7 or postpone proof until after payment of statutory</p> <p>8 interest any attempt to obtain payment or take the steps</p> <p>9 in paragraph 7(e) would be in accordance with the</p> <p>10 undertakings in paragraph 7. So it is circular to rely</p> <p>11 on 7(d) in particular, because that assumes that one has</p> <p>12 a particular sort of subordination in the first place.</p> <p>13 7(e) doesn't assist, either; it doesn't even purport to</p> <p>14 delay proof.</p> <p>15 The mechanism used to achieve subordination will</p> <p>16 often make little difference -- whether one postpones</p> <p>17 proof or payment -- but it will make a difference</p> <p>18 potentially when there is an issue as to whether</p> <p>19 statutory interest could be payable. The fact the</p> <p>20 postponement here is a payment rather than proof</p> <p>21 provides another reason why the subordinated debt is not</p> <p>22 subordinated to statutory interest, namely that</p> <p>23 statutory interest is defined by reference to the</p> <p>24 surplus after payment of the debts proved. What I mean</p> <p>25 by that is postponement of the payment of the sub-debt</p> <p style="text-align: center;">Page 122</p>	<p>1 terms of taking into account whether LBIE is solvent at</p> <p>2 the time of payment and therefore paragraph 5 does not</p> <p>3 subordinate a statutory debt to statutory interest.</p> <p>4 There is an argument to the alternative if I am</p> <p>5 wrong on all of those points and that relates to</p> <p>6 paragraph 5.2, in particular 5.2(a). That provides that</p> <p>7 obligations which are not payable or capable of being</p> <p>8 established or determined in the insolvency of the</p> <p>9 borrower have to be disregarded in establishing whether</p> <p>10 or not LBIE is solvent. We say that the meaning of the</p> <p>11 words "capable of being established or determined" is</p> <p>12 provable and payable. In other words you disregard</p> <p>13 obligations which are not payable, or provable and</p> <p>14 payable, in the insolvency of LBIE we say that</p> <p>15 construction is supported by three considerations.</p> <p>16 MR JUSTICE DAVID RICHARDS: There seems to be a distinction,</p> <p>17 does there not, between payable or capable of being</p> <p>18 established or determined.</p> <p>19 MR ISAACS: Indeed, my Lord. That is the first point I am</p> <p>20 going to make.</p> <p>21 MR JUSTICE DAVID RICHARDS: Right. You are saying that</p> <p>22 capable of being established or determined means</p> <p>23 provable?</p> <p>24 MR ISAACS: Provable and payable.</p> <p>25 MR JUSTICE DAVID RICHARDS: Whereas payable just means</p> <p style="text-align: center;">Page 124</p>

<p>1 payable.</p> <p>2 MR ISAACS: Yes. And there are three reasons that that is</p> <p>3 a sensible construction of this provision. The first is</p> <p>4 the use of the word "or" between payable and capable of</p> <p>5 being established or determined shows that there are two</p> <p>6 alternatives and one has to give meaning to both limbs.</p> <p>7 There is an "or". The first point you need not payable,</p> <p>8 but you also need to say capable of being established or</p> <p>9 determined in the insolvency means something apart from</p> <p>10 just payable, otherwise it would not be necessary.</p> <p>11 The second point is that section B of the chapter 10</p> <p>12 of the rules, that is the machinery of proving a debt.</p> <p>13 MR JUSTICE DAVID RICHARDS: Sorry, section?</p> <p>14 MR ISAACS: Section B of the chapter 10, which is the</p> <p>15 machinery of proving a debt.</p> <p>16 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>17 MR ISAACS: That is rules 2.72 to 2.80. Section C, which is</p> <p>18 quantification of claims, that is rules 2.81 to 2.105.</p> <p>19 In other words the very same rules that we have looked</p> <p>20 at also are the rules which govern whether obligations</p> <p>21 are capable be being established or determined in the</p> <p>22 administration. As a matter of ordinary language,</p> <p>23 capable of being established or determined in insolvency</p> <p>24 is capable of bearing the meaning and does bear the</p> <p>25 meaning capable of being proved or provable.</p> <p style="text-align: center;">Page 125</p>	<p>1 being determined.</p> <p>2 MR ISAACS: In my submission that would be a strange use of</p> <p>3 the word "payable".</p> <p>4 MR JUSTICE DAVID RICHARDS: On its own it would be but it is</p> <p>5 in contrast, as you rightly say, "or"; capable of being</p> <p>6 established or determined. Clearly the words "capable</p> <p>7 of being established or determined" refer to the</p> <p>8 obligations, the amount of which is not established or</p> <p>9 determined, does it not?</p> <p>10 MR ISAACS: In the insolvency. It is very important --</p> <p>11 MR JUSTICE DAVID RICHARDS: I think either, really. In the</p> <p>12 insolvency no, because this is all in the insolvency.</p> <p>13 MR ISAACS: That is important because it imports the rules,</p> <p>14 I would submit.</p> <p>15 MR JUSTICE DAVID RICHARDS: Yes, I see. Put it this way: if</p> <p>16 an obligation is of a certain amount, it is £100, it is</p> <p>17 not, is it, an obligation which needs to be established</p> <p>18 or determined? Or is it?</p> <p>19 MR ISAACS: No, that's correct my Lord. There are other</p> <p>20 obligations which are non-payable which are fixed.</p> <p>21 MR JUSTICE DAVID RICHARDS: Yes, I see. Obligations which</p> <p>22 are not payable or capable of being, yes.</p> <p>23 MR ISAACS: The reason, in my submission, the words "not</p> <p>24 payable" are used is because a company is not obliged to</p> <p>25 pay obligations which are not payable. So for example</p> <p style="text-align: center;">Page 127</p>
<p>1 Your Lordship may recall from the Danka case I read</p> <p>2 an extract from Lord Justice Patten at 137 where he</p> <p>3 referred to the liabilities as determined in accordance</p> <p>4 with the insolvency rules. There is nothing surprising</p> <p>5 about that use of language at all.</p> <p>6 MR JUSTICE DAVID RICHARDS: Mmm-hmm.</p> <p>7 MR ISAACS: One does ask why this particular wording is</p> <p>8 used, in other words why don't they say provable or</p> <p>9 capable of being proved.</p> <p>10 This is the third point: your Lordship will remember</p> <p>11 that I referred to the fact that the agreement</p> <p>12 contemplated insolvency regimes of different</p> <p>13 jurisdictions, not all of which are English. It is</p> <p>14 doubtful that all such regimes use the language of proof</p> <p>15 whereas this is appropriate to describe a proving type</p> <p>16 process in any regime. If that is correct, statutory</p> <p>17 interest will again not fall to be taken into account</p> <p>18 for the purposes of determining whether LBIE is solvent,</p> <p>19 because it would be excluded.</p> <p>20 MR JUSTICE DAVID RICHARDS: The distinction between payable</p> <p>21 on the one hand or capable of being established or</p> <p>22 determined on the other might suggest a difference</p> <p>23 between an obligation which is of a certain and</p> <p>24 ascertained amount on the one hand and one which is not</p> <p>25 ascertained but which is capable of establishment or</p> <p style="text-align: center;">Page 126</p>	<p>1 statute barred debts are obligations of a company which</p> <p>2 the company is not obliged to pay; foreign tax</p> <p>3 liabilities.</p> <p>4 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>5 MR ISAACS: They are non-payable.</p> <p>6 MR JUSTICE DAVID RICHARDS: I follow, yes, I see what you</p> <p>7 mean.</p> <p>8 MR ISAACS: That concludes the first section of my</p> <p>9 submissions, my Lord. The second --</p> <p>10 MR JUSTICE DAVID RICHARDS: We are leaving the subordinated</p> <p>11 agreement now?</p> <p>12 MR ISAACS: We are. Does your Lordship have any questions?</p> <p>13 MR JUSTICE DAVID RICHARDS: Well, having regard to the whole</p> <p>14 context and the background to this subordination</p> <p>15 agreement in all of the documents you have taken me to,</p> <p>16 consistently the word "capital" is used. Subordinated</p> <p>17 debt is treated as part of the capital. Now, capital,</p> <p>18 one natural connotation of capital is that it is</p> <p>19 something that ranks after liabilities. Does that</p> <p>20 inform the way one should look at this?</p> <p>21 MR ISAACS: Yes it does, my Lord, because one accepts that</p> <p>22 the subordinated debt ranks after liabilities. It ranks</p> <p>23 after all liabilities that are payable or provable in</p> <p>24 accordance with the rules. All of them.</p> <p>25 MR JUSTICE DAVID RICHARDS: I don't think you go that far.</p> <p style="text-align: center;">Page 128</p>

<p>1 You say that it ranks ahead of all debts which are</p> <p>2 provable and payable in an insolvency.</p> <p>3 MR ISAACS: Yes.</p> <p>4 MR JUSTICE DAVID RICHARDS: You don't say it ranks ahead of</p> <p>5 all debts which are payable.</p> <p>6 MR ISAACS: I am sorry, I intended to just say provable and</p> <p>7 payable in an insolvency.</p> <p>8 MR JUSTICE DAVID RICHARDS: I see. Nonetheless, capital</p> <p>9 would denote something that comes after any debt which</p> <p>10 is payable.</p> <p>11 MR ISAACS: We have seen, my Lord, that capital has various</p> <p>12 tiers and tier 3 at the very bottom of capital has a lot</p> <p>13 of characteristics which are nothing like capital at</p> <p>14 all. For example it is called subordinated debt. If</p> <p>15 your Lordship is looking at the meaning of the words</p> <p>16 what we are talking about here is a debt, which is</p> <p>17 generally not capital.</p> <p>18 MR JUSTICE DAVID RICHARDS: It clearly is debt, not share</p> <p>19 capital. That much is clear. There is a distinction</p> <p>20 there but it is nonetheless grouped and called capital.</p> <p>21 MR ISAACS: It is, my Lord. It is also something which is</p> <p>22 capable of grounding a petition to wind up the company.</p> <p>23 MR JUSTICE DAVID RICHARDS: Absolutely, yes.</p> <p>24 MR ISAACS: That is a rather unusual aspect as well when one</p> <p>25 is looking at capital; normally a capital cannot be used</p> <p style="text-align: center;">Page 129</p>	<p>1 MR ISAACS: My Lord, if one is looking at the</p> <p>2 characteristics of this instrument I would submit what</p> <p>3 is most important is that it is a debt repayable at</p> <p>4 a particular time and it is capable of grounding</p> <p>5 a winding up petition. In that sense it is rather</p> <p>6 difficult, for example --</p> <p>7 MR JUSTICE DAVID RICHARDS: A winding up petition, that is</p> <p>8 the only means by which a holder of subordinated debt</p> <p>9 can set in chain a process which may leads to the</p> <p>10 repayment of his debt. That is the significance of</p> <p>11 that.</p> <p>12 MR ISAACS: Well, it is also, my Lord, that it is not</p> <p>13 something that one would expect of equity type capital.</p> <p>14 Your Lordship was putting to me --</p> <p>15 MR JUSTICE DAVID RICHARDS: I am talking about the relative</p> <p>16 ranking of this as against on the one hand capital and</p> <p>17 on the other hand liabilities.</p> <p>18 MR ISAACS: Well, we accept, my Lord, that it is the very</p> <p>19 last --</p> <p>20 MR JUSTICE DAVID RICHARDS: No you don't, you say it is the</p> <p>21 last of the provable debts, not the very last.</p> <p>22 MR ISAACS: I had not finished the sentence, my Lord. Last,</p> <p>23 but before anything which is not taken into account. If</p> <p>24 one were to --</p> <p>25 MR JUSTICE DAVID RICHARDS: Yes --</p> <p style="text-align: center;">Page 131</p>
<p>1 in that way. It is repayable after two years, which</p> <p>2 again is another aspect which one would not expect of</p> <p>3 capital.</p> <p>4 MR JUSTICE DAVID RICHARDS: Yes. These are five years and</p> <p>5 ten years, actually, the ones we are concerned with.</p> <p>6 MR ISAACS: Yes, you are quite right my Lord.</p> <p>7 MR JUSTICE DAVID RICHARDS: It can be two years.</p> <p>8 MR ISAACS: It can be two years. The way the tiers work is</p> <p>9 one starts off with the capital which is equity and one</p> <p>10 moves away from the characteristics of capital and down</p> <p>11 at the bottom, tier 3, you have capital which has</p> <p>12 a number of features which don't characterise equity,</p> <p>13 for example.</p> <p>14 MR JUSTICE DAVID RICHARDS: These are capable of being lower</p> <p>15 tier 2, is that right?</p> <p>16 MR ISAACS: Capable.</p> <p>17 MR JUSTICE DAVID RICHARDS: They may not be, because you may</p> <p>18 have --</p> <p>19 MR ISAACS: Yes.</p> <p>20 MR JUSTICE DAVID RICHARDS: I think it may be in more than</p> <p>21 one place subordinated debt is put into the same</p> <p>22 category as preferential share capital.</p> <p>23 MR ISAACS: Yes.</p> <p>24 MR JUSTICE DAVID RICHARDS: Is that something I should take</p> <p>25 account of?</p> <p style="text-align: center;">Page 130</p>	<p>1 MR ISAACS: The contrast here, my Lord, is between the debt</p> <p>2 and the statutory interest. That is the real contest.</p> <p>3 MR JUSTICE DAVID RICHARDS: Let us have another one, because</p> <p>4 this is the one I put to Mr Trace. Let us take</p> <p>5 a non-provable debt. You accept that such a concept</p> <p>6 exists?</p> <p>7 MR ISAACS: My Lord, I know your Lordship is very familiar</p> <p>8 with that concept and it will make a fairly substantial</p> <p>9 part of the submissions I will come on to; one must not</p> <p>10 be influenced by a view that there exists a substantial</p> <p>11 category of non-provable debts.</p> <p>12 MR JUSTICE DAVID RICHARDS: Never mind whether it is</p> <p>13 substantial, but you accept that the concept exists.</p> <p>14 MR ISAACS: The concept certainly exists, my Lord. What</p> <p>15 I don't accept is there is anything at the moment in the</p> <p>16 context.</p> <p>17 MR JUSTICE DAVID RICHARDS: Well, Lord Neuberger clearly</p> <p>18 thought it existed as a category.</p> <p>19 MR ISAACS: I don't accept that my Lord.</p> <p>20 MR JUSTICE DAVID RICHARDS: I see, fair enough. Can I just</p> <p>21 postulate this to you. We all know that the decision in</p> <p>22 of the Supreme Court in Nortel could have been that the</p> <p>23 liability created by the issue of a contribution notice</p> <p>24 created a non-provable debt. That was a clearly</p> <p>25 possible outcome. Of course it was not the outcome, but</p> <p style="text-align: center;">Page 132</p>

<p>1 it could have been. Well, assume for the purposes of</p> <p>2 the question that it was. You would then have</p> <p>3 a non-provable debt, namely a contribution notice issued</p> <p>4 after the commencement of the administration. Now that</p> <p>5 would, from the moment of issue, create a liability to</p> <p>6 pay the amount specified in the contribution notice.</p> <p>7 You say, as I take it, well, subordinated debt would</p> <p>8 rank ahead of that.</p> <p>9 MR ISAACS: I do, yes my Lord.</p> <p>10 MR JUSTICE DAVID RICHARDS: Whereas -- go back to the case</p> <p>11 of the company as a going concern -- if a contribution</p> <p>12 notice were issued before there was a desire to repay</p> <p>13 a subordinated debt but it remained unpaid at that date,</p> <p>14 it would have to be taken into account for the purposes</p> <p>15 of clause 5.1(b).</p> <p>16 MR ISAACS: Yes my Lord.</p> <p>17 MR JUSTICE DAVID RICHARDS: So why the difference in</p> <p>18 treatment between a going concern and an insolvency</p> <p>19 looked at from the point of view of the subordination</p> <p>20 agreement?</p> <p>21 MR ISAACS: The first point I make -- I will come back to</p> <p>22 this -- is that in answer to a question about</p> <p>23 a hypothetical situation like that it is difficult to</p> <p>24 know what the position would be. We will say that there</p> <p>25 are, for very good reason, no meaningful categories of</p> <p style="text-align: center;">Page 133</p>	<p>1 directives are being used in that context and I would</p> <p>2 submit that there is no indication that it is</p> <p>3 contemplated that the capital adequacy directives would</p> <p>4 have to deal with these sorts of obscure non-provable</p> <p>5 liabilities.</p> <p>6 MR JUSTICE DAVID RICHARDS: I suppose would you say well,</p> <p>7 they are excluded under 2.52(a).</p> <p>8 MR ISAACS: I would say that in the alternative.</p> <p>9 MR JUSTICE DAVID RICHARDS: It is not payable in</p> <p>10 an insolvency.</p> <p>11 MR ISAACS: The other point I would make is when one</p> <p>12 analyses the contract one has to take account not just</p> <p>13 of what the liability is but the way it is being treated</p> <p>14 in an insolvency. All of the points I made at the</p> <p>15 beginning about contingent and future liabilities and</p> <p>16 how one is not actually looking at the liability in the</p> <p>17 abstract but one is looking at the treatment in</p> <p>18 accordance with the rules. Just like one does not have</p> <p>19 the payment of the entire amount of a future liability</p> <p>20 because of the rules, one doesn't have payment in</p> <p>21 an insolvency of a non-provable liability because of the</p> <p>22 rules.</p> <p>23 MR JUSTICE DAVID RICHARDS: Just coming back to my</p> <p>24 contribution notice, if a contribution notice is issued</p> <p>25 while the company borrower is a going concern then it is</p> <p style="text-align: center;">Page 135</p>
<p>1 non-provable debt. I will have to develop that and</p> <p>2 I appreciate for the moment your Lordship does not</p> <p>3 accept that submission. I will develop that. When your</p> <p>4 Lordship says it was a possibility, I would say no it</p> <p>5 was not a possibility. If I am forced to contemplate</p> <p>6 a situation where there is a category like this I will</p> <p>7 ask the question what is the nature of this liability.</p> <p>8 Your Lordship has given me the example of a liability</p> <p>9 arising under the Pension Act and the legislation</p> <p>10 governing that and I would submit that it is clear from</p> <p>11 our consideration of the four directives and the two</p> <p>12 Basel Accords that that is a million miles from the sort</p> <p>13 of liability that the directors in the Basel Accord were</p> <p>14 contemplating. They were interested in trading debt,</p> <p>15 they were not interested in this sort of thing. It was</p> <p>16 not within their contemplation that they would be</p> <p>17 dealing with this sort of liability, I would submit.</p> <p>18 MR JUSTICE DAVID RICHARDS: It is all liability, is it not,</p> <p>19 it is not just trading liability, it could be any number</p> <p>20 of liabilities.</p> <p>21 MR ISAACS: It is all liability, but in the context of</p> <p>22 trading --</p> <p>23 MR JUSTICE DAVID RICHARDS: Unless they are not payable.</p> <p>24 MR ISAACS: Your Lordship has seen the extensive reference</p> <p>25 to market risk and the like and the capital adequacy</p> <p style="text-align: center;">Page 134</p>	<p>1 difficult to see that it doesn't fall within the pretty</p> <p>2 wide definition of the word "liabilities".</p> <p>3 MR ISAACS: Yes.</p> <p>4 MR JUSTICE DAVID RICHARDS: So you would, I think, have to</p> <p>5 rest your case on 5.2(a), and say okay it is a liability</p> <p>6 but it is not an obligation payable in the insolvency.</p> <p>7 MR ISAACS: No my Lord, I wouldn't.</p> <p>8 MR JUSTICE DAVID RICHARDS: You wouldn't say that.</p> <p>9 MR ISAACS: No, for the same reason.</p> <p>10 MR JUSTICE DAVID RICHARDS: It would be payable?</p> <p>11 MR ISAACS: No, my Lord, the point is this: for the same</p> <p>12 reason the £950 of the future debt is a liability of the</p> <p>13 company when it is not in liquidation but is not</p> <p>14 a liability of the company when it is in liquidation.</p> <p>15 Going back to the future debt example.</p> <p>16 MR JUSTICE DAVID RICHARDS: No, stick with my contribution</p> <p>17 notice. Are you saying that the contribution notice in</p> <p>18 those circumstances is not payable in the insolvency?</p> <p>19 MR ISAACS: Because it is not provable.</p> <p>20 MR JUSTICE DAVID RICHARDS: Yes, you say that payable means</p> <p>21 provable.</p> <p>22 MR ISAACS: Yes, payable and provable.</p> <p>23 MR JUSTICE DAVID RICHARDS: Okay.</p> <p>24 MR ISAACS: My Lord, can I, if I may, the £950 out of the</p> <p>25 £1,000 that I started with at the very beginning, the</p> <p style="text-align: center;">Page 136</p>

<p>1 future liability, if the company has a future liability 2 of £1,000 that liability is payable and is not 3 an insolvency. But it is not payable when it is in 4 insolvency; it is only £50 worth. That is exactly the 5 same, my Lord, because one looks at what is payable in 6 the insolvency. I didn't take it that your Lordship had 7 a difficulty with the future debts.</p> <p>8 MR JUSTICE DAVID RICHARDS: That is an interesting case. 9 You say that because -- I don't quite know how it works. 10 In the future liability plainly it falls within the 11 definition of liability.</p> <p>12 MR ISAACS: It does.</p> <p>13 MR JUSTICE DAVID RICHARDS: But do you say -- you cannot 14 really apply 5.2(a) to that, can you, while the company 15 is a going concern because you can't really chop up the 16 future liability into an obligation, part of which is 17 payable and part of which isn't.</p> <p>18 MR ISAACS: It is all payable, my Lord.</p> <p>19 MR JUSTICE DAVID RICHARDS: It is all payable.</p> <p>20 MR ISAACS: That is the point I am making. It is the 21 contribution notice. Just like a contribution notice it 22 is all payable.</p> <p>23 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>24 MR ISAACS: What happens in liquidation? £950 of it has 25 just disappeared because it is no longer payable.</p> <p style="text-align: center;">Page 137</p>	<p>1 enter a distributor administration or liquidation before 2 LBIE makes distribution to LBHI2.</p> <p>3 I will turn to the first, which is whether or not 4 the potential section 74 liability is a potential 5 liability of LBHI2. I submit this follows from the 6 contingent liability set out in the Nortel case which is 7 in bundle 1 D tab 101.</p> <p>8 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>9 MR ISAACS: The analysis starts at page 524-paragraph 75.</p> <p>10 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>11 MR ISAACS: After reference to the imprecise meaning that 12 the word "liability" can have in the previous paragraph, 13 Lord Neuberger says: 14 "Where a liability arises after the insolvency event 15 as a result of a contract entered into by the company 16 there is no real problem. The contract, insofar as it 17 imposes any actual contingent liability on the company, 18 can fairly be said to impose the incurred obligation." 19 Then he says at 76: 20 "Where the liability arises other than under 21 a contract the position is not necessarily so 22 straightforward." 23 He goes on over the page to paragraph 77 to say 24 this: 25 "The mere fact that a company could become under</p> <p style="text-align: center;">Page 139</p>
<p>1 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>2 MR ISAACS: It is the same as the contribution.</p> <p>3 MR JUSTICE DAVID RICHARDS: It is the same as the 4 contribution, but the contribution notice is presently 5 payable.</p> <p>6 MR ISAACS: Not in accordance with the rules it is not.</p> <p>7 MR JUSTICE DAVID RICHARDS: As a non-provable debt.</p> <p>8 MR ISAACS: Correct, it is not provable and payable.</p> <p>9 MR JUSTICE DAVID RICHARDS: That comes back to the point. 10 You say payable means provable check.</p> <p>11 MR ISAACS: It has to because of the way future liabilities 12 are treated. You don't get the full value of a provable 13 debt when it is a future debt.</p> <p>14 MR JUSTICE DAVID RICHARDS: Yes, I see.</p> <p>15 MR ISAACS: My Lord, the second section is contributory 16 rule.</p> <p>17 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>18 MR ISAACS: We submit that the future section 74 liability 19 of LBHI2 is not to be taken into account in LBIE's 20 administration for the purposes of the contributory rule 21 for three reasons. Firstly it is not a contingent 22 liability of LBHI2 in LBIE's administration. Secondly, 23 even if it is a contingent liability the contributory 24 rule does not apply to contingent liabilities. Thirdly 25 it cannot be assumed, as LBIE does, that LBHI2 will</p> <p style="text-align: center;">Page 138</p>	<p>1 a liability pursuant to a provision in a statute which 2 was in force before the insolvency event cannot mean 3 that where the liability arises after the insolvency 4 event it falls within 13.12(1)(b). It would be 5 dangerous to try to suggest a universally applicable 6 formula."</p> <p>7 Then he sets out three characteristics. I am 8 particularly interested in the first and the third.</p> <p>9 MR JUSTICE DAVID RICHARDS: Mmm-hmm.</p> <p>10 MR ISAACS: He says: 11 "I would suggest that at least normally in order for 12 a company to have incurred a relevant obligation under 13 the rule it must have taken or be subjected to some step 14 or combination of steps which (a) had some legal effect, 15 such as putting it under some legal duty or into some 16 legal relationship." 17 And (b), which is about real prospects of the 18 liability being incurred, which I don't refer to and 19 then (c): 20 "Whether it would be consistent with the regime 21 under which the liability is imposed to conclude that 22 the step or combination of steps gave rise to 23 an obligation under the rule." 24 He then at paragraph 86 over the page considers 25 whether this requirement is met in this case and he</p> <p style="text-align: center;">Page 140</p>

<p>1 says:</p> <p>2 "I would simply refer back to the points at</p> <p>3 paragraphs 58 to 63."</p> <p>4 If you go back to 58 to 63, you see that he made</p> <p>5 a number of points there. We can go through those:</p> <p>6 "Before I turn to examine in detail the arguments on</p> <p>7 the two sides it is right to say, at any rate on the</p> <p>8 face of it, the sensible and fair answer [and</p> <p>9 I emphasise those words] would appear to be that the</p> <p>10 potential liability of a target under a FSD issued after</p> <p>11 an insolvency event and in particular the liability</p> <p>12 under a CN issued thereafter should be treated as</p> <p>13 a provable debt. There seems no particular sense in the</p> <p>14 rights of the trustees to receive a sum which the</p> <p>15 legislature considers they should be entitled to receive</p> <p>16 having any greater or lesser priority."</p> <p>17 He is arguing about the common sense of a particular</p> <p>18 position. In 59, if your Lordship can read that please.</p> <p>19 MR JUSTICE DAVID RICHARDS: Mmm-hmm. Yes.</p> <p>20 MR ISAACS: There is the emphasis there on the arbitration</p> <p>21 of a particular rule. 60, again in your Lordship could</p> <p>22 read that please. (Pause).</p> <p>23 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>24 MR ISAACS: So there, there is an emphasis on how it would</p> <p>25 be strange if there was a difference in treatment</p> <p style="text-align: center;">Page 141</p>	<p>1 respects the section 74 liability differs from the</p> <p>2 liability to pay unpaid capital.</p> <p>3 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>4 MR ISAACS: A number of the arguments made by LBIE and</p> <p>5 (inaudible) fail to pay regard to the important</p> <p>6 differences between the two. I will develop that</p> <p>7 submission. There are five material differences between</p> <p>8 the statutory liability and the contractual one. The</p> <p>9 first one is that very distinction, namely that the</p> <p>10 section 74 liability, actually the form is contractual,</p> <p>11 I have mentioned that. The second is that the latter</p> <p>12 statutory liability, but not the former, exists only in</p> <p>13 a winding up.</p> <p>14 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>15 MR ISAACS: The third is that the latter but not the former</p> <p>16 is enforceable only by a liquidator. The fourth is that</p> <p>17 the latter does not form part of the capital of an</p> <p>18 un-limited company, by which of course I mean the</p> <p>19 amounts contributed, whereas the former does form part</p> <p>20 of the capital.</p> <p>21 MR JUSTICE DAVID RICHARDS: The former being the contractual</p> <p>22 liability to pay cause.</p> <p>23 MR ISAACS: To pay capital, to pay cause. Well, to pay</p> <p>24 cause for unpaid capital not to pay cause under</p> <p>25 section 74.</p> <p style="text-align: center;">Page 143</p>
<p>1 between the FSD and the section 75 debt. 61, your</p> <p>2 Lordship sees the reference to the arbitrary power that</p> <p>3 the regulator would have.</p> <p>4 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>5 MR ISAACS: And at 63 his Lordship says:</p> <p>6 "It seems unlikely it could have been intended that</p> <p>7 liability under the FSD regime could rank behind</p> <p>8 provable debts since it would mean that save in very</p> <p>9 unusual cases nothing would be paid."</p> <p>10 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>11 MR ISAACS: Now, the reason I emphasise those points is</p> <p>12 because I submit what they show is that in deciding</p> <p>13 whether the third condition is met in any case, one has</p> <p>14 to consider the matters relating to the scheme which</p> <p>15 imposes the liability. One has to consider the</p> <p>16 consequences if the liability is or is not contingent</p> <p>17 and one has to consider whether it is fair and sensible</p> <p>18 that the liability should be treated as contingent.</p> <p>19 That is why I emphasise the adjectives used by Lord</p> <p>20 Neuberger, because that is what he is doing.</p> <p>21 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>22 MR ISAACS: If one applies the analysis in Nortel to the</p> <p>23 section 74 liability, the first point is that the</p> <p>24 section 74 liability does not arise under a contract, it</p> <p>25 arises under a statute, and in this and other material</p> <p style="text-align: center;">Page 142</p>	<p>1 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>2 MR ISAACS: The fifth is that the latter, the statutory</p> <p>3 liability, is the liability to contribute to the assets.</p> <p>4 Alternatively it is not a liability owed to the company</p> <p>5 whereas the former is a liability owed to the company.</p> <p>6 These distinctions were what was said by Lord Jessel,</p> <p>7 the Master of the Rolls, in the White Rose case, which</p> <p>8 we have looked at. I would like to start by looking at</p> <p>9 that. It is bundle 1A tab 24.</p> <p>10 MR JUSTICE DAVID RICHARDS: Thank you.</p> <p>11 MR ISAACS: I would like to pick it up half way down the</p> <p>12 page where the Master of the Rolls said:</p> <p>13 "It must be remembered that -- "</p> <p>14 MR JUSTICE DAVID RICHARDS: Sorry, page?</p> <p>15 MR ISAACS: 599.</p> <p>16 MR JUSTICE DAVID RICHARDS: "It must be remembered" where is</p> <p>17 that?</p> <p>18 MR ISAACS: That is the 1862 Act, which is the predecessor</p> <p>19 of section 74:</p> <p>20 "Which directs what is to be paid in the case of</p> <p>21 a wind-up by the shareholders of a limited company</p> <p>22 creates new rights, rights which did not exist prior to</p> <p>23 the passing the Companies Act 1862 and rights which do</p> <p>24 not exist until there is a winding up. The point was</p> <p>25 decided in the House of Lords in Webb v Wiffin that it</p> <p style="text-align: center;">Page 144</p>

<p>1 was a new right and rather a new liability as regards 2 the shareholders, that section (inaudible) for this 3 purpose regulates their liability. When you come to 4 look at the section you find that it applies to all 5 kinds of winding up." 6 He then reads the section. 7 "That is a new liability. He is to contribute it as 8 a new contribution. It is a mistake to call that a debt 9 due the company, it is no such thing. It is not as has 10 been supposed in any way or shape a debt due to the 11 company but is a liability to contribute to the assets 12 of the company. When we look further into the Act it 13 will be seen it is a liability to contribute to be 14 enforced by the liquidator. It is quite true that 15 a call made before the winding up, and in the case 16 before me a call was made before the winding up, is 17 a debt due to the company but that doesn't effect this 18 new liability to contribution. The distinctions I have 19 referred to where also discussed by Mr Justice Fry." 20 [unclear] 21 MR JUSTICE DAVID RICHARDS: Just let me -- the distinction 22 we are drawing here is between the statutory basis under 23 in this case section 86 of the Companies Act 1862, which 24 is contingent on a winding up. 25 MR ISAACS: My Lord, if I may, that is the very point.</p> <p style="text-align: center;">Page 145</p>	<p>1 take the shares. Nonetheless they are separate rights. 2 Yes, I see. You are drawing the point that it is the 3 distinction between the contractual and the statutory 4 right and obligation. 5 MR ISAACS: Yes. 6 MR JUSTICE DAVID RICHARDS: You are also taking the point 7 about the nature of the statutory liability not being 8 one to the company. 9 MR ISAACS: I put it in the alternative, my Lord, and 10 I think it is important. I say either that it is 11 a liability to contribute to the assets to meet the 12 special demands of the fund or I say it is not 13 a liability owed to the company. 14 MR JUSTICE DAVID RICHARDS: I just want to be clear. The 15 points you derive from Whittaker is one the contract. 16 MR ISAACS: Did you say Whittaker, my Lord? 17 MR JUSTICE DAVID RICHARDS: Whitehouse, sorry. The contrast 18 between contract and statute as the basis of the 19 liability. Secondly, the statutory liability or right, 20 which ever way you look at it, does not exist until the 21 winding up. Thirdly, the statutory liability is not 22 a liability to the company. I am not meaning to put 23 words in your mouth, but is that what you are saying 24 that I derive from this? 25 MR ISAACS: Yes. Although on the last point, my Lord, I put</p> <p style="text-align: center;">Page 147</p>
<p>1 MR JUSTICE DAVID RICHARDS: Yes. 2 MR ISAACS: We say it doesn't exist. 3 MR JUSTICE DAVID RICHARDS: You say it doesn't exist. 4 MR ISAACS: Not that it is contingent on a winding up. 5 MR JUSTICE DAVID RICHARDS: I see. Rights which do not 6 exist until there is a winding up. Is what Sir George 7 Jessel says. A new right, as opposed to the right to 8 pay calls made by the company. 9 MR ISAACS: Yes, which is imposed by the statute contract. 10 MR JUSTICE DAVID RICHARDS: By the statutory contract. 11 MR ISAACS: Yes. The articles -- 12 MR JUSTICE DAVID RICHARDS: Although the liabilities may be 13 co-extensive in the case of a limited company. In other 14 words in a limited company the maximum liability of the 15 shareholder is the amount unpaid on his shares before 16 and after a winding up. 17 MR ISAACS: That is true my Lord, yes. The amount of money 18 may be the same, if that is what your Lordship means by 19 that. 20 MR JUSTICE DAVID RICHARDS: Yes, in a sense it highlights 21 your point. 22 MR ISAACS: Yes. 23 MR JUSTICE DAVID RICHARDS: Even though one is talking about 24 the same amount of money which is an amount of money 25 derived from the contract of membership, the contract to</p> <p style="text-align: center;">Page 146</p>	<p>1 it in the alternative. I say that the statutory 2 liability is a liability to contribute to the assets to 3 meet the special demands of the fund. 4 MR JUSTICE DAVID RICHARDS: Yes. 5 MR ISAACS: Alternatively I say it is not a liability owed 6 to the company. I put it either way. Both of those are 7 to be distinguished from the contractual liability. 8 MR JUSTICE DAVID RICHARDS: I apologise, the first way you 9 put it, namely a liability to contribute to the assets 10 to meet the special demands of the fund, is that 11 properly characterised as a liability owed to the 12 company? 13 MR ISAACS: That is why I am putting it in the alternative, 14 my Lord. 15 MR JUSTICE DAVID RICHARDS: I just want to be clear. You 16 are saying it is a liability owed to the company. 17 I just want to be quite clear. 18 MR ISAACS: The first one? 19 MR JUSTICE DAVID RICHARDS: Yes. 20 MR ISAACS: Well, no. 21 MR JUSTICE DAVID RICHARDS: There is no trap in this. You 22 say the second is not a liability owed to the company, 23 but the first one presumably is a liability owed to the 24 company. 25 MR ISAACS: Maybe I can put it this way. Even if it is</p> <p style="text-align: center;">Page 148</p>

<p>1 a liability owed to the company it is a liability to</p> <p>2 contribute to the assets of the company and in that</p> <p>3 sense it is to be distinguished from the contractual</p> <p>4 liability which is just a -- I missed out some words; to</p> <p>5 meet the special needs of the fund.</p> <p>6 MR JUSTICE DAVID RICHARDS: No, I heard that.</p> <p>7 MR ISAACS: Yes. That is to be contrasted with the</p> <p>8 contractual liability, which is a liability to the</p> <p>9 company.</p> <p>10 MR JUSTICE DAVID RICHARDS: I am finding it difficult,</p> <p>11 Mr Isaacs. You say it is to be contrasted with the</p> <p>12 liability to the company.</p> <p>13 MR ISAACS: I would submit there is a distinction to be</p> <p>14 made.</p> <p>15 MR JUSTICE DAVID RICHARDS: I am sure. Tell me, in your</p> <p>16 (iii) there are two halves. The second half, which is</p> <p>17 a liability, there is not a liability owed to the</p> <p>18 company.</p> <p>19 MR ISAACS: Correct.</p> <p>20 MR JUSTICE DAVID RICHARDS: Presumably the first half you</p> <p>21 are content if it is treated as a liability to the</p> <p>22 company.</p> <p>23 MR ISAACS: Yes, my Lord.</p> <p>24 MR JUSTICE DAVID RICHARDS: Thank you.</p> <p>25 MR ISAACS: Thank you.</p> <p style="text-align: center;">Page 149</p>	<p>1 MR ISAACS: 653, the top right-hand corner.</p> <p>2 MR JUSTICE DAVID RICHARDS: Did I see?</p> <p>3 MR ISAACS: Your Lordship sees about a third of the way down</p> <p>4 there is a reference to the "38th section provides for</p> <p>5 the liability of the members". Does your Lordship see</p> <p>6 that, under the sentence "undoubtedly".</p> <p>7 MR JUSTICE DAVID RICHARDS: No I don't.</p> <p>8 MR ISAACS: I am sorry, left-hand column.</p> <p>9 MR JUSTICE DAVID RICHARDS: I have it, 38th section, yes.</p> <p>10 MR ISAACS: That sets out and after that we find the words</p> <p>11 "the liability thus created..."</p> <p>12 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>13 MR ISAACS: "Is undoubtedly a statutory liability applicable</p> <p>14 to the case of companies formed under this Act and the</p> <p>15 corresponding liability exists in cases of companies</p> <p>16 registered under this Act."</p> <p>17 Then it is provided by the 75th section that:</p> <p>18 "The liability of any person to contribute to the</p> <p>19 assets of a company under this Act in the event of the</p> <p>20 same being wound up should be deemed to create a debt of</p> <p>21 the nature of a specialty. It appears to me that the</p> <p>22 liability to contribute to the assets of the company</p> <p>23 while it is a going concern and the liability to</p> <p>24 contribute to the assets of the company when it is being</p> <p>25 wound up are separate and distinct liabilities. The one</p> <p style="text-align: center;">Page 151</p>
<p>1 MR JUSTICE DAVID RICHARDS: Yes. Right, those are the</p> <p>2 points to be derived from Whitehouse.</p> <p>3 MR ISAACS: Yes.</p> <p>4 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>5 MR ISAACS: I mentioned five points when I started, five</p> <p>6 material differences. The difference between the</p> <p>7 statutory and the contractual nature of the obligations</p> <p>8 is obvious so I don't really need Whitehouse for that.</p> <p>9 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>10 MR ISAACS: And the other four all come from Whitehouse.</p> <p>11 Your Lordship has maybe put two together, but they all</p> <p>12 come from Whitehouse.</p> <p>13 MR JUSTICE DAVID RICHARDS: I think your fourth point is not</p> <p>14 derive from Whitehouse, dealing with an un-limited</p> <p>15 company.</p> <p>16 MR ISAACS: Quite right, that is part of the capital. That</p> <p>17 is Pyle Works, I will come on to that. Quite right.</p> <p>18 MR JUSTICE DAVID RICHARDS: Okay.</p> <p>19 MR ISAACS: The next case is ex parte Branwhite, which is</p> <p>20 unfortunately in very small print at the next tab.</p> <p>21 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>22 MR ISAACS: Page 653, left-hand column. Does your Lordship</p> <p>23 see about half way down, "the 38th section provides</p> <p>24 for".</p> <p>25 MR JUSTICE DAVID RICHARDS: Is this?</p> <p style="text-align: center;">Page 150</p>	<p>1 created in effect by the articles of association of the</p> <p>2 company and the deed of settlement and its registration</p> <p>3 under the 16th section, the other arising in the event</p> <p>4 of the company being wound up. These two liabilities</p> <p>5 appear to me to be very different in their nature. The</p> <p>6 one requires payment of the amount of the cause to the</p> <p>7 company, the other requires payment of the amount of the</p> <p>8 cause to the liquidator or officer of the court.</p> <p>9 A voluntary winding up to the voluntary liquidator. In</p> <p>10 the one case the payment must be made according to the</p> <p>11 discretion of the directors and in the other not, but</p> <p>12 under the discretion of the court or the voluntary</p> <p>13 liquidator. One is for the general purposes of the</p> <p>14 company and the other is to meet the special demands of</p> <p>15 the fund."</p> <p>16 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>17 MR ISAACS: Your Lordship sees why I was referring to the</p> <p>18 demands of the fund earlier.</p> <p>19 MR JUSTICE DAVID RICHARDS: I do.</p> <p>20 MR ISAACS: A point for your Lordship's note, in re: White</p> <p>21 Star Line -- a case we don't need to go to, the</p> <p>22 reference is 1B 54, page 480 -- the Court of Appeal said</p> <p>23 they could see no flaws in the reasoning in the</p> <p>24 Branwhite decision.</p> <p>25 MR JUSTICE DAVID RICHARDS: Yes.</p> <p style="text-align: center;">Page 152</p>

38 (Pages 149 to 152)

<p>1 MR ISAACS: My learned friend Mr Trower referred to two 2 cases, Westmoreland and Harrison. I don't propose to go 3 to them. They are at the supplementary volume 4 and 4 supplementary volume 5. The reason I mention them is 5 they were both cases relating to the contractual 6 liability to pay unpaid capital and not the statutory 7 liability to contribute. Your Lordship gets that from 8 page 25 of the Westmoreland case.</p> <p>9 MR JUSTICE DAVID RICHARDS: Just a moment. Westmoreland is 10 page 25?</p> <p>11 MR ISAACS: Yes and Harrison is a short case and your 12 Lordship will find it over the page.</p> <p>13 MR JUSTICE DAVID RICHARDS: Right, okay.</p> <p>14 MR ISAACS: They are both distinguishable on that ground. 15 Your Lordship has pressed me on the distinction 16 between a liability to the company and the liability to 17 contribute. That is reflected, that distinction is 18 reflected in the legislation and it is long standing. 19 One starts with section 16 of the Companies Act 1862 and 20 that is the statutory ancestor for which what is now 21 section 33 of the Companies Act 2006 and section 75 of 22 the Companies Act 1862, which is the ancestor of 23 section 80 of the Insolvency Act 1986. Now, it is only 24 the former provisions, those which relate to the 25 contractual liability, which provide that a debt is owed</p> <p style="text-align: center;">Page 153</p>	<p>1 MR ISAACS: This is the modern form of section 16 of the 2 Companies Act 1862: 3 "The provision of a company's constitution bind 4 a company and its members to the same extent as if they 5 were covenants in (?) the part of the company and of 6 each member to observe those provisions. Money payable 7 by a member to the company under its constitution is 8 a debt due upon and to the company." [unclear]</p> <p>9 Your Lordship has seen, but we can look at it again, 10 section 80 of the Insolvency Act: 11 "The liability of a contributory creates a debt 12 accruing due from him at the time when his liability 13 commenced but payable at times when cause is made for 14 enforcing the liability."</p> <p>15 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>16 MR ISAACS: My Lord, I am going to Pyle's case. It may be 17 now is a convenient time.</p> <p>18 MR JUSTICE DAVID RICHARDS: It might be. Can I just ask you 19 this: Mr Trower when he addressed me said the words 20 "accruing due from him at the time when his liability 21 commenced but payable at times when cause is made", the 22 reference to "accruing due from him at the time when his 23 liability commenced" referred to the time when the 24 contributory had become a member, had been registered as 25 the holder of the share. I don't know whether that was</p> <p style="text-align: center;">Page 155</p>
<p>1 to the company. My Lord, they are at volume 2-tab 3, 2 the 1862 Act. Your Lordship sees at the top of page 9: 3 "All monies payable by any member of the company in 4 pursuance of the conditions and regulations of the 5 company or any such conditions or regulations shall be 6 deemed to be a debt due from such member to the 7 company."</p> <p>8 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>9 MR ISAACS: If one turns over to section 75-page 38: 10 "The liability of any person to contribute to the 11 assets of the company under this Act in the event of the 12 same being wound up shall be deemed to create a debt 13 accruing due from such person at the time when his 14 liability commenced but payable at the time or 15 respective times when cause are made as herein after 16 mentioned, for instance forcing such liability." 17 There is no reference there to the liability being 18 due to the company, in contrast to the contractual 19 liability.</p> <p>20 MR JUSTICE DAVID RICHARDS: Yes.</p> <p>21 MR ISAACS: We say that can be no accident, my Lord. If 22 your Lordship goes to tab 14 of the same bundle.</p> <p>23 MR JUSTICE DAVID RICHARDS: Just give me one moment. Yes.</p> <p>24 MR ISAACS: Your Lordship sees page 19 at tab 14.</p> <p>25 MR JUSTICE DAVID RICHARDS: Yes.</p> <p style="text-align: center;">Page 154</p>	<p>1 a point you were intending to address or not. I suppose 2 it falls slightly within this area. Do you have any 3 submission on this?</p> <p>4 MR ISAACS: My Lord, we say that is correct but in 5 a particular sense it is correct. It is the point your 6 Lordship put to me a few moments ago that there was 7 a contingent liability and the contingency was the 8 winding up. I said no my Lord, it is not a contingency. 9 What we say is that until there is a winding up the 10 statutory liability has no existence whatsoever. But 11 once there was a winding up it springs back and it 12 originates from the time when the member becomes 13 a member. In that sense we accept it but we don't 14 accept that what that means is that there is some sort 15 of statutory liability that exists in any meaningful 16 sense before the making of a winding up order or 17 a winding up.</p> <p>18 MR JUSTICE DAVID RICHARDS: Right, thank you very much. 19 10.30 tomorrow. 20 (4.17pm) 21 (The hearing adjourned until 10.30am on Tuesday, 22 19 November 2013)</p> <p style="text-align: center;">Page 156</p>

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