

<p>1 Monday, 6 February 2017 2 (10.30 am) 3 Submissions by MR MARSHALL (continued) 4 MR MARSHALL: My Lord, I think we finished on Friday on the 5 subject of interpretation of express terms in the 6 subordinated loan agreements, and focusing in particular 7 on the provisions for repayment and payment that 8 contained. 9 My Lord, I gave your Lordship the well established 10 formulation as to the correct approach to contractual 11 interpretation derived from Investors Compensation 12 Scheme v West Bromwich Building Society. Could I just, 13 before embarking on the materials showing the become 14 ground, the relevant background that we say is 15 relevant -- 16 MR JUSTICE HILDYARD: The background to what? 17 MR MARSHALL: I am sorry, my Lord? 18 MR JUSTICE HILDYARD: I didn't quite catch that phrase. 19 MR MARSHALL: Before we get into the materials regarding the 20 background that we rely upon, could I just show your 21 Lordship one or two further points that are derived from 22 the Supreme Court, or House of Lords, authorities. 23 First of all, three points derived from Chartbrook, 24 if I could ask your Lordship to look at that. That is 25 in authorities bundle volume 3, tab 80. If I could go</p> <p style="text-align: center;">Page 1</p>	<p>1 "It is to decide what a reasonable person would have 2 understood the parties to have meant by using the 3 language which they did." 4 He then gives some examples from the 5 Mannai Investment case and also Investors Compensation 6 Scheme Limited itself, where rather different language 7 to that appearing on the contract was ultimately the 8 meaning that the court came to conclude was the 9 intention of the parties. 10 So the amount of red ink that one has to use doesn't 11 necessarily matter. 12 The second point from the case is concerning whether 13 or not one needs to find some sort of ambiguity in order 14 to have regard to the relevant context or background. 15 His Lordship deals with that at page 1118, at letter E, 16 to 1119, just below letter B. Could I invite your 17 Lordship to just read those passages. It is effectively 18 paragraphs 36 and 37. 19 (Pause) 20 MR JUSTICE HILDYARD: Yes. 21 MR MARSHALL: I am grateful. So ambiguity not needed to go 22 to the background, we submit, in the light of that. 23 Then the third point which we draw attention to is 24 on page 1120, which concerns the issue of an agreement 25 which is capable of assignment. What is the position</p> <p style="text-align: center;">Page 3</p>
<p>1 to the speech of Lord Hoffmann, your Lordship will see 2 the formulation derived from investors compensation 3 scheme at the top of page 1112, paragraph 14. In 4 particular, at letter B. 5 MR JUSTICE HILDYARD: Mm-hm. 6 MR MARSHALL: After setting that out, just one or two other 7 points that one can see from the decision. 8 Firstly, on page 113, at letter H, his Lordship drew 9 attention to the fact that you may have to use 10 additional language in the course of interpreting the 11 agreement to get to the outcome. If you like, the 12 amount of red ink that you have to use isn't something 13 that should affect the approach or deter the court from 14 adopting the construction advocated. Your Lordship will 15 see, just below letter H, he said that: 16 "I do not think that it is necessary to undertake 17 the exercise of comparing this language with that of the 18 definition in order to see how much use of red ink is 19 involved. When the language used in an instrument gives 20 rise to difficulties of construction, the process of 21 interpretation does not require one to formulate some 22 alternative form of words, which approximates as closely 23 as possible to that of the parties." 24 Then your Lordship will see he goes over the page in 25 saying:</p> <p style="text-align: center;">Page 2</p>	<p>1 then, given that possibly another party may come in as 2 an assignee and they might not know of the relevant 3 specific background to the contract's original 4 negotiation and formulation. His Lordship addresses 5 that on page 1120, in paragraph 40. Again, perhaps if 6 I can invite your Lordship to read that paragraph. 7 (Pause) 8 MR JUSTICE HILDYARD: Yes. 9 MR MARSHALL: So, my Lord, we respectfully submit that may 10 well be important when we come to consider Mr Trower's 11 case on the permissibility of considering the specific 12 context of this subordinated loan agreement, given the 13 provisions for assignment with the consent of the FSA. 14 We will respectfully submit, in the light of the 15 guidance provided by Lord Hoffmann there, that is not 16 a factor that would prohibit reference to the specific 17 background to the origination of the subordinated loan 18 agreements as between the LBHI2 and the FSA and LBIE. 19 In particular, we will be submitting to your 20 Lordship that if there were to be any assignments of the 21 subordinated loan agreements, realistically it was going 22 to be within the Lehman Group and any potential assignee 23 would be well aware, or had readily available to them, 24 the particular background that had led to their 25 formulation.</p> <p style="text-align: center;">Page 4</p>

<p>1 MR JUSTICE HILDYARD: Is that a fact? That it would be 2 within the Lehman Group? 3 MR MARSHALL: We submit when you see the materials which 4 I will take to you shortly -- 5 MR JUSTICE HILDYARD: Yes. 6 MR MARSHALL: -- your Lordship will see how the whole thing 7 came about through a restructuring. 8 MR JUSTICE HILDYARD: Yes. 9 MR MARSHALL: Given that, given the reasons for that 10 restructuring, how it all happened, we would submit that 11 it is highly unlikely, when one has seen all of that, 12 that all of that was going to be undone with the 13 subordinated loan agreements then being assigned out of 14 the Lehman Group to some totally independent third 15 party. We would respectfully submit that this is 16 a very, very unlikely scenario and we submit it is much 17 more likely any assignee would have been within the 18 group and therefore very much aware of how the 19 agreements were formulated and organised; bearing in 20 mind -- as your Lordship will see when we come to the 21 documents -- this was all done in a central way. There 22 was a centralised process here for the whole group, with 23 the FSA and Revenue, and it was all done by a department 24 which was representing everyone within the Lehman UK 25 Group at the relevant time.</p> <p style="text-align: center;">Page 5</p>	<p>1 Albeit that the variable terms to some extent one has to 2 apply guidance from the FSA in connection with. 3 MR JUSTICE HILDYARD: Yes. 4 MR MARSHALL: But one of the important aspects of the 5 variable part is that the type of borrower will vary. 6 In this case, it is an extremely unusual type of 7 borrower, namely an unlimited company. That is by no 8 means a standard type of borrower from the regulatory 9 perspective. The repayment terms could also vary. They 10 were part of the variable terms. So that, first of all, 11 that is the first qualification to applying the standard 12 form principle to interpretation. 13 The second is that even if one does apply the 14 approach that one has to find a meaning which is 15 applicable not only in our particular context, but more 16 widely, when one looks at the guidance that the FSA 17 published in combination with the way in which they 18 approached this matter -- which your Lordship will see 19 shortly -- it is very event that they did not have in 20 mind as a source of capital for LBIE, as a source of 21 support for LBIE, calls on members. Indeed, they have 22 viewed the matter as being one where the capital will 23 already be within LBIE, in the sense of paid up capital 24 on shares, and then various other things that they will 25 accrue in the form of capital over time, but not</p> <p style="text-align: center;">Page 7</p>
<p>1 MR JUSTICE HILDYARD: I am going to be very rude and it is 2 entirely my frailty, but would you speak up a little bit 3 when -- 4 MR MARSHALL: Of course, my Lord. 5 MR JUSTICE HILDYARD: Or have the microphone a little 6 closer, just so I can focus on your words rather than if 7 I am hearing them right. 8 MR MARSHALL: Of course, my Lord, I will move that closer if 9 that helps. 10 MR JUSTICE HILDYARD: I mean, the thing about standard forms 11 is that -- or one of the things about standard forms, is 12 that the assumption of the court is that it is the 13 expectation of the parties that that form will have the 14 same meaning for all parties who adopt it. You know, 15 one just has to get beyond these rules, doesn't one, and 16 just work out what people are saying, sub silentio, when 17 they adopt a standard form? One of them is: it is 18 a standard form, it is going to have the same meaning 19 whatever its context. 20 MR MARSHALL: Three points in response to that. I will come 21 to the detail of them soon. Firstly, this type of 22 subordinated loan agreement is not entirely standard 23 form. Part of it is standard form -- 24 MR JUSTICE HILDYARD: Yes. 25 MR MARSHALL: -- schedule 2. It is in fact a hybrid.</p> <p style="text-align: center;">Page 6</p>	<p>1 something in the form of a call on shareholders under 2 section 74. That doesn't feature at all. 3 That is perhaps not surprising, because the FSA's 4 approach, in itself, was dependent and based upon 5 a European Union approach. The idea of unlimited 6 companies under which people can be called in the way we 7 have, under our legislation, may well not be something 8 known within other European Union states. But it is not 9 too surprising, we submit, to see the FSA guidance in 10 the form it was. If one applies that, the standard 11 approach would appear to be that you don't rely upon 12 calls on shareholders or the rights equivalent to 13 section 74. That is not what they were interested in. 14 Even if that was all wrong, our fall back position 15 would be, this my Lord: the FSA regulations were wrong 16 about all of that. The FSA's regulations and focus in 17 this context is on a totally different type of 18 arrangement and entity from the type which we are 19 concerned with here; an unlimited company, which is 20 a very unusual beast in the modern day world. We would 21 then fall within the category of exception described by, 22 I think, Lord Mustill in the AIB case, which I think 23 your Lordship was taken to by Mr Trower and which we can 24 go back to. If it is a standard form used in a context 25 for which it was never really designed, then it is not</p> <p style="text-align: center;">Page 8</p>

<p>1 necessarily the case that you are confined to what would  2 be the standard meaning for everyone. It may then be  3 appropriate to consider the particular circumstances.  4 But those are the list of submissions, if you like,  5 which I will develop shortly, in answer to the  6 suggestion that it is just a standard form and you have  7 to apply it without regard to the background in this  8 particular case.  9 MR JUSTICE HILDYARD: But your approach, is it, is to look  10 at the contract and interpret it rather than focus on  11 the broader question, if you like, as to what the assets  12 of the company actually are?  13 I haven't put that very clearly, but you wish as  14 a matter of contract to say that the contract states  15 that it is only the assets apart from, as it were, the  16 call, which are contractually brought into account.  17 MR MARSHALL: Yes.  18 MR JUSTICE HILDYARD: Whereas, I think, Mr Atherton, for  19 example, might say, "Well, the cause of action made  20 available to a liquidator to enforce unlimited liability  21 is simply not within that bag", whatever the contract  22 may say.  23 MR MARSHALL: Yes.  24 MR JUSTICE HILDYARD: But you are a contractual --  25 MR MARSHALL: We are on a contractual interpretation point,</p> <p style="text-align: center;">Page 9</p>	<p>1 MR JUSTICE HILDYARD: Lord Neuberger.  2 MR MARSHALL: It is indeed. Bundle 4, tab 100. Your  3 Lordship will find Lord Neuberger's speech at page 6 of  4 the report, and your Lordship will see that, at letter  5 J, his Lordship gave some general guidance on the proper  6 interpretation of contractual provisions. He begins, at  7 paragraph 15, by adopting the test of Lord Hoffmann in  8 Chartbrook, which I took your Lordship to just a short  9 time ago. Then he sets out, at page 7, at letter A and  10 B, the types of matter that the court then takes into  11 account.  12 MR JUSTICE HILDYARD: Yes.  13 MR MARSHALL: Which are the same as those described, indeed,  14 by Lord Hoffmann.  15 He then set out various factors to bear in mind, and  16 they are listed then on page 7, at letter D, all of the  17 way through to page 8, letter H. There are seven  18 factors which he draws attention to. The first point  19 is: don't under value the language. Although one, of  20 course, has regard to commercial commonsense and  21 surrounding circumstances. He makes the point, in  22 paragraph 18, that the less clear the words, the more it  23 will be open to one to depart from their natural  24 meaning. Then, the third point, in paragraph 19, is  25 about not adopting commercial commonsense on</p> <p style="text-align: center;">Page 11</p>
<p>1 here. I, of course, adopt what Mr Atherton suggests,  2 that there is an additional argument --  3 MR JUSTICE HILDYARD: Yes.  4 MR MARSHALL: -- but our argument is based on interpretation  5 of the contract. When it talks about repaying these  6 loans, it is talking about repaying from the funds of  7 LBIE itself, rather than funded through calls on  8 shareholders, on a proper interpretation.  9 MR JUSTICE HILDYARD: Yes.  10 MR MARSHALL: My Lord, can I just add the final point  11 I wanted to make concerning the correct approach to  12 interpretation. This will be relevant, as your Lordship  13 will see, shortly.  14 This is what might be described as the  15 Aberdeen City Council approach, where one finds that  16 there is a gap. The parties might not have contemplated  17 a particular scenario but the court, as part of its  18 process of interpreting the express terms, will fill  19 that gap by looking at other provisions of the agreement  20 to see what the parties' intention was. One sees that  21 from the decision in Arnold v Britton, which your  22 Lordship has, I think, in authorities bundle 4.  23 MR JUSTICE HILDYARD: This is another Supreme Court  24 decision.  25 MR TROWER: It is indeed.</p> <p style="text-align: center;">Page 10</p>	<p>1 a retrospective basis. Paragraph 20 is that while  2 commercial commonsense is a very important factor, the  3 court will be very slow to reject the natural meaning of  4 a provision simply because it appears to be imprudent  5 for one of the parties.  6 Paragraph 21, the fifth point, is about what facts  7 were known. It has to be facts known or reasonably  8 available to both parties.  9 Then, when we get to the next point, paragraph 22,  10 where the Aberdeen City Council point is made.  11 MR JUSTICE HILDYARD: Yes.  12 MR MARSHALL: He then says:  13 "In some cases an event subsequently occurs which  14 was plainly not intended or contemplated by the parties  15 judging from the language of their contract. In such  16 a case, it is clear what the parties would have  17 intended, the court will give effect to that intention."  18 He gives, as an example, the Aberdeen City Council  19 decision, where the court concluded:  20 "Any approach other than that adopted would defeat  21 the parties' clear objectives, but the conclusion was  22 based on what the parties had in mind when they entered  23 into the contract."  24 The seventh point, that he mentions in paragraph 3,  25 is specific to service charges being construed</p> <p style="text-align: center;">Page 12</p>

<p>1 restrictively, which isn't relevant for our purposes.                  2 My Lord, can I then go to Lord Hodges' speech, where                  3 you will see in a little bit more detail what                  4 Aberdeen City Council was about, and how the Supreme                  5 Court dealt with it. That is on page 17, at                  6 paragraph 71.                  7 He makes the point:                  8 "In Aberdeen City Council the internal context of                  9 the contract provided the answer. In that case, the                  10 sale contract provided for the payment to the vendor of                  11 a further sum on disposal of land by the purchaser. Two                  12 of the methods of disposal required the parties to                  13 ascertain the market value of the property on disposal                  14 in calculating an additional payment. The other used                  15 the gross sales of proceeds in calculating the payment.                  16 The purchaser then sold the site at an undervalue to                  17 an associated company; that was a circumstance which, on                  18 the face of the contract, the parties had not                  19 contemplated. The courts, at each level, interpreted                  20 the provision which used the gross sales proceeds in the                  21 calculation as requiring a market valuation where there                  22 was a sale that was not at arm's ... (reading to the                  23 words)... as a whole and in particular from the fact                  24 that the other two methods of disposal required such                  25 a valuation."                   Page 13</p>	<p>1 supplies machinery where the parties have failed do so,                  2 but this principle goes further than that?                  3 MR MARSHALL: It does. It is quite close to implication of                  4 a term but it is being done as part of the express term,                  5 interpretation. There is a gap, but you fill it by                  6 reference to the internal context of the document and                  7 that's (Inaudible) interpretation of express terms,                  8 rather than implication of a term with the rules that                  9 one derives in Aberdeen City Council applying, rather                  10 than the implications of term rules, which are now to be                  11 found Marks and Spencer, which I will take your Lordship                  12 to later.                  13 My Lord, with that legal analysis, can I then take                  14 your Lordship to what we contend is the relevant context                  15 to these subordinated loan agreements.                  16 First and foremost, they were carried out in                  17 conjunction with a capital restructuring by the Lehman                  18 UK Group in 2006, which was done in order to meet tax                  19 and regulatory capital requirements. Your Lordship will                  20 find the description, in some detail in all of that, in                  21 the judgment of Mr Justice David Richards in the                  22 Waterfall I proceedings in trial bundle 1, tab 8. If                  23 your Lordship would be kind enough to go to page 9,                  24 paragraph 28, you Lordship will see the reference to the                  25 position prior to the capital restructuring, prior to                   Page 15</p>
<p>1 His Lordship commented on the fact that there had                  2 been some criticism from a Professor, Martin Hogg, on                  3 the ground that it protected the party from its                  4 commercial fecklessness. His Lordship thought it was                  5 the correct approach as the internal context contract                  6 pointed towards the commercially sensible                  7 interpretation.                  8 My Lord, we will shortly show your Lordship that                  9 there are other provisions of the subordinated loan                  10 agreements which point to the conclusion that LBIE's                  11 assets alone, or its resources alone, were to be used                  12 for the repayment of the loan, rather than anyone                  13 else's. If for any reason your Lordship concluded that                  14 having regard to the way the contract was formulated                  15 this question of whether they could call or not on                  16 rights under section 74 isn't something within anyone's                  17 contemplation. That gap can be filled in the same way                  18 as the gap was filled in Aberdeen City Council by                  19 considering the internal context and other provisions of                  20 the agreement. In particular, the one that we will be                  21 relying upon are contained in clause 6F and 7F of the                  22 subordinated loan agreement, which I will take your                  23 Lordship to shortly.                  24 MR JUSTICE HILDYARD: There is a case from the House of                  25 Lords, called Sedbrook (?), which is where the court                   Page 14</p>	<p>1 2006, with various facilities in place. Then, in                  2 paragraph 29, it is in order to utilise LBIE's foreign                  3 tax credits for US tax purposes:                  4 "Deciding to improve its profitability in part by                  5 restructuring its regulatory capital base so as to                  6 replace some of the subordinated debt with share capital                  7 and reduce its interest payments."                  8 LBHI2 is interposed as an intermediate company as                  9 part of that process.                  10 The regulatory background is then considered in                  11 quite some detail, at paragraphs 33 through to 47.                  12 His Lordship describes, in paragraph 35, the Basel 1                  13 rules. They are described in paragraphs 35 and 36.                  14 Your Lordship will see, in paragraph 37, that they are                  15 then given effect to by an EC council directive                  16 in April 1989. Article 2.1 of that provided that:                  17 "The unconsolidated own funds of credit institutions                  18 could consist of a number of items, including equity,                  19 share capital and preferential shares and subordinated                  20 loan capital."                  21 There is then a quotation which explains that the                  22 binding agreements that exist, they are designed so that                  23 the claim for subordinated debt will rank after the                  24 claims of all other creditors and are not to be repaid                  25 until all other debts outstanding at the time have been                   Page 16</p>

<p>1 settled.</p> <p>2 His Lordship ended up relying partly on that</p> <p>3 language in concluding in argument that it is all about</p> <p>4 trying to protect trade counter-parties of LBIE and</p> <p>5 other forms of creditors weren't really of significance</p> <p>6 in this context. That was rejected, in part based on</p> <p>7 this language used in the EC directive.</p> <p>8 My Lord, we respectfully submit that directive is</p> <p>9 important, because that seems then to be the foundation</p> <p>10 for our own regulation, which is then based on that. As</p> <p>11 your Lordship will see when one comes to it, the types</p> <p>12 of capital that need to be put in place do not seem to</p> <p>13 envisage capital coming in in the form of calls under</p> <p>14 a provision like section 74.</p> <p>15 MR JUSTICE HILDYARD: Is that because of the definition in</p> <p>16 annex 5 or because of our own domestic definition?</p> <p>17 MR MARSHALL: It is simply because the process, under</p> <p>18 section 74, of making calls like that, in an unlimited</p> <p>19 company, don't fall within one of the categories that</p> <p>20 the FSA have down as a source of capital for the</p> <p>21 purposes of their regulatory requirements, no doubt</p> <p>22 based on the EC directive that we can see being referred</p> <p>23 to here. That is no doubt because, within the EC, the</p> <p>24 concept of unlimited companies, such as the one that we</p> <p>25 have here, is not a familiar one.</p> <p style="text-align: center;">Page 17</p>	<p>1 specifying what sorts of capital will be available,</p> <p>2 which may be a slightly different matter than whether</p> <p>3 they are sources which are in fact capital, though not</p> <p>4 counted as available capital.</p> <p>5 MR MARSHALL: Well, as we will see, the main concern of all</p> <p>6 of the regulators -- including the FSA in the light of</p> <p>7 the legislation they had to work under -- is to protect</p> <p>8 external creditors, all the external creditors.</p> <p>9 MR JUSTICE HILDYARD: Yes.</p> <p>10 MR MARSHALL: Our case is that of course if you have</p> <p>11 a situation where you are looking at the relevant entity</p> <p>12 as part of a group, a regulated group -- which is in</p> <p>13 fact the case with Lehman as your Lordship will see</p> <p>14 shortly -- it would be invidious to that objective, of</p> <p>15 protecting external creditors, if you can, if you like,</p> <p>16 shift the burden of meeting the claims of the creditors</p> <p>17 from one entity within the group to another by virtue of</p> <p>18 a call, leaving other creditors of the group then</p> <p>19 exposed. As opposed to using whatever form of capital</p> <p>20 has been provided under these regulations and that loan,</p> <p>21 which is what we submit should happen if you want to</p> <p>22 achieve that objective. So if you have this call</p> <p>23 process available, and you are looking at that on</p> <p>24 a group wide basis, it potentially would be something</p> <p>25 that would undermine the objective of the regulations.</p> <p style="text-align: center;">Page 19</p>
<p>1 MR JUSTICE HILDYARD: Do we have annex 5?</p> <p>2 MR MARSHALL: Annex 5, I am not sure.</p> <p>3 MR JUSTICE HILDYARD: I think it is referred to in</p> <p>4 paragraph 38, and obviously it is tied to investment</p> <p>5 firms and credit institutions.</p> <p>6 MR MARSHALL: Yes. I am not sure we have it in the bundle</p> <p>7 at the moment but we can obtain it. We certainly have</p> <p>8 the FSA's own handbook provisions, which I think</p> <p>9 Mr Atherton took you to some of --</p> <p>10 MR JUSTICE HILDYARD: Yes.</p> <p>11 MR MARSHALL: -- and I will return to shortly. But we can</p> <p>12 try to obtain annex 5 as well.</p> <p>13 His Lordship then goes on to refer to further</p> <p>14 revisions on the Basel guidelines, and to Basel 2, which</p> <p>15 is then given effect to by a further EC directive, as</p> <p>16 one sees from paragraph 40. All of this then leads, in</p> <p>17 paragraph 42, to the introduction of the</p> <p>18 General Prudential sourcebook, which then provides</p> <p>19 guidance in accordance with the Basel 2 requirements.</p> <p>20 His Lordship then goes on to describe the different</p> <p>21 tiers of capital which are relevant: tier one through to</p> <p>22 tier 3, in paragraphs 44 through to 47.</p> <p>23 My Lord, just to --</p> <p>24 MR JUSTICE HILDYARD: Those lists, give one the initial</p> <p>25 impression, of both the FSA and the European directive,</p> <p style="text-align: center;">Page 18</p>	<p>1 Particularly if -- as we submit was in fact the case in</p> <p>2 the Lehman Brothers -- you have one company within the</p> <p>3 group which is in fact providing the services which are</p> <p>4 then coming from external creditors for the benefit of</p> <p>5 other trading companies within the group. So they gain</p> <p>6 the benefit of the agency, if you like, of that company,</p> <p>7 engaging landlords and other suppliers. Those creditors</p> <p>8 might in other circumstances be direct creditors of the</p> <p>9 trading company but because of the way the group is</p> <p>10 structured, it doesn't turn out to be that way because</p> <p>11 they have a service company in place. If you then have</p> <p>12 a subordinated loan from a shareholder which can then be</p> <p>13 called in and then the call made across to the service</p> <p>14 company, you then potentially leave those creditors</p> <p>15 exposed. That would be a very surprising outcome, given</p> <p>16 the intention of these regulations.</p> <p>17 MR JUSTICE HILDYARD: Does that mean that you have to</p> <p>18 persuade me that own capital has a particular meaning in</p> <p>19 the context, which would not necessarily apply in</p> <p>20 non-group contexts?</p> <p>21 MR MARSHALL: I will, but I do it by virtue of two routes.</p> <p>22 One is based on the way in which capital is described in</p> <p>23 the FSA handbook, and what they regard as the capital</p> <p>24 available to the company, which doesn't include calls</p> <p>25 under section 74 or anything like that. The second</p> <p style="text-align: center;">Page 20</p>

<p>1 route is by virtue of the particular context to these                  2 subordinated loan agreements, which show that the FSA                  3 was approaching the regulation of Lehman on a UK group                  4 wide basis, and with a view to protecting creditors of                  5 the group rather than just the creditors of LBIE; the                  6 resources provided under the subordinated loan agreement                  7 were intended to be resources for the group and the                  8 protection of creditors of the group.                  9 MR JUSTICE HILDYARD: Well, that second reason may be                  10 a reason why you do, but really I am clarifying with you                  11 that is what you say?                  12 MR MARSHALL: Yes.                  13 MR JUSTICE HILDYARD: Own funds has a special and particular                  14 meaning having regard to the deployment of these                  15 agreements in what is intended to be a group context.                  16 MR MARSHALL: Yes, indeed.                  17 MR JUSTICE HILDYARD: Yes.                  18 MR MARSHALL: Yes, indeed.                  19 MR JUSTICE HILDYARD: Does your interpretation also mean you                  20 must, as it were, interpolate the words "own funds                  21 counted as capital" for the purposes of the FSA                  22 regulations?                  23 MR MARSHALL: Yes, it does.                  24 MR JUSTICE HILDYARD: It does. You have to go that far?                  25 MR MARSHALL: I submit we can go that far and I rely on that</p> <p style="text-align: center;">Page 21</p>	<p>1 creditors, in terms of the widest possible group.                  2 MR JUSTICE HILDYARD: Yes.                  3 MR MARSHALL: Your Lordship will see in particular, from                  4 paragraph 61, His Lordship concluded that it was                  5 intended to provide the widest possible protection.                  6 MR JUSTICE HILDYARD: Yes.                  7 MR MARSHALL: If I then look at the matter more                  8 specifically, if your Lordship would be kind enough to                  9 take up trial bundle 5 and go to tab 1.                  10 MR JUSTICE HILDYARD: Trial bundle 5?                  11 MR MARSHALL: Trial bundle 5, my Lord, yes, tab 1.                  12 Your Lordship will see the first of a sequence of                  13 documents, and the first set are the correspondence                  14 between the Lehman Group and the FSA and Revenue leading                  15 up to the subordinated loan agreements, which explain                  16 the regulatory thinking at the relevant time and how it                  17 was approached as far as the regulators were concerned.                  18 The first document, on flag 1, is an email from                  19 a Mr Bowen, who is from UK regulatory reporting of the                  20 Lehman Group, to a Ms Edwards at the FSA, copied to                  21 various other people within the Lehman Group with                  22 a subject of "Group restructuring".                  23 The first part explains that there is going to be                  24 a restructuring, under which a limited liability partner                  25 would have as its partners a UK holding company and</p> <p style="text-align: center;">Page 23</p>
<p>1 as one of the points in our favour, in terms of how this                  2 regime operated.                  3 MR JUSTICE HILDYARD: So even if a call is an asset, even                  4 though only an asset which is realisable by                  5 a liquidator, contrary to what Mr Atherton submits, you                  6 say it still isn't within the phrase, either because the                  7 phrase has a particularly limited meaning in the context                  8 of the group and/or because in all contexts, the phrase                  9 is intended to be limited to capital recognised as                  10 available under the regulatory regime and the European                  11 directive?                  12 MR MARSHALL: Precisely. That is the way we would submit it                  13 works, within Lord Justice Briggs' view of the world, in                  14 terms of the assets of the company.                  15 My Lord, just to complete the review of the                  16 background in Mr Justice David Richards' judgment, after                  17 going through the regulatory capital background,                  18 His Lordship also, in paragraphs 60 through to 62 --                  19 MR JUSTICE HILDYARD: 60?                  20 MR MARSHALL: 60 to 62, on page 16.                  21 MR JUSTICE HILDYARD: Oh yes.                  22 MR MARSHALL: Dealt with the point I mentioned earlier about                  23 whether it was all intended to protect a narrow group of                  24 creditors, if you like, trading counter-parties, or                  25 rather was intended to provide protection to all</p> <p style="text-align: center;">Page 22</p>	<p>1 a Delaware incorporated company. Your Lordship will see                  2 that in the third paragraph, beginning with the number                  3 2, there was commentary about the permanence, the likely                  4 permanence of the structure. He explains that the                  5 relevant tax, or the tax department, had provided                  6 a commentary on that. The observations were that                  7 although there was a risk that US accounting standards                  8 could be changed, in particular a particular standard                  9 called APB23 might change, the view was that this was                  10 unlikely. Indeed, even if that relevant standard,                  11 APB23, was to go away, the structure could still operate                  12 in its proposed form. So the indications were that it                  13 was expected to be a reasonably permanent structure.                  14 Then he also refers, about half way down, to:                  15 "A summary of the relevant part of the UK group                  16 organisation chart and capital resources calculations                  17 pre and post the restructuring. This shows that all of                  18 the sub-debt issued by Lehman Brothers Delaware as being                  19 prepaid and replaced with equity between Lehman Brothers                  20 Delaware and the new LLP, and between New Co [which was                  21 to be the new holding company] and LBIE, elsewhere the                  22 sub-debt remains."                  23 Your Lordship will see, on pages 2, 3 and 4, the                  24 relevant charts there set out. There is no indication                  25 on the current and proposed capital structure, though</p> <p style="text-align: center;">Page 24</p>

<p>1 some further resource in terms of capital would be in                  2 the form of the ability to make calls, potentially on                  3 members. In terms of the group structure, unfortunately                  4 it has been split over two pages, but page 3,                  5 Your Lordship will see on the right-hand side is the                  6 proposed capital structure. At the bottom of page 3, on                  7 the right-hand side, Your Lordship sees the new holding                  8 company being inserted between LBH and, if one turns                  9 over the page, LBIE. There is in fact no reference to                  10 LBL in this chart at all. We submit that is interesting                  11 and perhaps of some significance because the only                  12 function of having LBL in the chart would be if you were                  13 expecting to have a source of capital from it,                  14 potentially, in the form of calls under section 74. The                  15 fact it is not even listed or mentioned or listed or                  16 referred to is indicative of the absence of any interest                  17 in that power to make calls.                  18 Your Lordship sees that on the key to the chart, the                  19 focus is upon equity, subordinated debt and preference                  20 shares, and then there is an accounting consolidation                  21 arrow as well. The focus is on the three forms of                  22 capital identified -- equity, subordinated debt,                  23 preference shares -- but nothing more than that.                  24 MR JUSTICE HILDYARD: But, of course, all that may show is                  25 that they were focusing on an unlimited company for its</p> <p style="text-align: center;">Page 25</p>	<p>1 see a letter from Lehman Brothers to the Revenue of                  2 18 August 2006. It is quite a long letter, setting out                  3 all sorts of details regarding the proposed transaction,                  4 how it was going to work, who is going to participate in                  5 it. But if I could ask Your Lordship first to look at                  6 page 8, there Your Lordship will find a heading:                  7 "Letter C. Details of the purpose of the                  8 transactions."                  9 MR JUSTICE HILDYARD: Page 8?                  10 MR MARSHALL: Just below that heading, Your Lordship will                  11 find a paragraph, about half way down, which says:                  12 "The primary purposes of the proposed restructuring                  13 are as follows."                  14 Then it says this:                  15 "LB Spain is currently the head of the LB UK Group                  16 from an accounting and regulatory perspective."                  17 Then this important statement:                  18 "The UK group is regulated on a consolidated basis                  19 by the FSA. With effect from 1 January 2007, new FSA                  20 rules will come into force under which the preference                  21 shares issued by LB Holdings and LB Plc to LBDI will                  22 have an adverse impact on the LB UK Group FSA capital                  23 ratios. It has therefore become necessary to redeem the                  24 preference shares and reissue them to a UK body in the                  25 corporate chain for FSA purposes."</p> <p style="text-align: center;">Page 27</p>
<p>1 tax benefits rather oblivious as to its other                  2 consequences.                  3 MR MARSHALL: Well, this is to show, also, the capital                  4 position. How is it going to be capitalised?                  5 The forms of capital all referred to there are                  6 actually in line -- as we will see soon -- with what the                  7 FSA looks at for sources of capital. It doesn't include                  8 the ability to include for money from members in an                  9 unlimited amount, under section 74.                  10 If one goes back to the email, on page 1, and if                  11 I could just ask Your Lordship to focus on the                  12 pre-penultimate paragraph where Mr Bowen says:                  13 "However, the final form of the restructuring would                  14 not lead to an overall reduction in capital at the group                  15 or reduction in the quality of the capital available to                  16 the group."                  17 My Lord, important, we respectfully submit because,                  18 with regard to the FSA, they were looking at the matter                  19 from the group perspective with a view to maintaining                  20 capital on a group basis, not by reference to a LBIE                  21 exclusive position. This is the start of a consistent                  22 theme that Your Lordship will see in the documentation.                  23 If one goes on from there to the next document,                  24 which is at tab 2, this is now a correspondence with the                  25 Revenue from August 2006. Behind it, Your Lordship will</p> <p style="text-align: center;">Page 26</p>	<p>1 So there Your Lordship sees the regulation is group                  2 wide and is intended to protect the capital position for                  3 the group.                  4 Just dropping down two paragraphs, one then has                  5 a paragraph beginning, "The main purpose":                  6 "The main purpose of these transactions is not to                  7 provide a UK tax advantage over and above reductions                  8 that would be available in the absence of the arbitrage                  9 resulting from the transactions. This is evidenced by                  10 the fact that the amount of UK ...(reading to the                  11 words)... new structure and are still subject to the                  12 HMRC thin capitalisation agreement, rather the main                  13 purposes of the transaction is to provide financing to                  14 the LB UK Group for business purposes in a manner that                  15 is efficient from both a regulatory and a US tax                  16 perspective."                  17 Then, the penultimate paragraph:                  18 "As the proposed transaction does not displace or                  19 alter the existing amount of debt funding to the UK                  20 group, it would seem that no comparison needs to be made                  21 here. The same loan amount is in place before and after                  22 the transaction and fulfils the same purpose, that of                  23 providing capital to support the general UK business                  24 activities."                  25 So, my Lord, the focus therefore is on this being</p> <p style="text-align: center;">Page 28</p>

<p>1 a capital preservation exercise for the UK group as 2 a whole, which is unsurprising, if the whole group was 3 being regulated on a consolidated basis by the FSA. 4 My Lord, one can also see, when one goes a little 5 bit back in the document to the details of the 6 transaction, which are set out in pages 6 through to 7, 7 under section B, towards the foot of page 6, that the 8 transaction is then set out and there is a reference to 9 an appendix. Then there is a reference: 10 "Under the new arrangements finance will be provided 11 to UK New Co as follows." 12 This is the new holding company. Then Your Lordship 13 sees the types of capital that are going to be 14 available. We have the subordinated loan equity funds 15 and further details regarding those. A reference, at 16 the end, to UK New Co will equity fund LBIE. No 17 indication of the prospect that, in effect, there will 18 be members who will be open to unlimited calls, under 19 section 74, as a potential source of capital in 20 addition. 21 If one goes to the appendix, Your Lordship will see, 22 on pages 10 and 11, where the current structure is set 23 out, in appendix 1, and the proposed structure is set 24 out, in appendix 2. There isn't any reference to any 25 potential source of capital in the form of calls and,</p> <p style="text-align: center;">Page 29</p>	<p>1 My Lord, I don't know whether this would be 2 a convenient -- I have several documents go through. 3 I wonder whether this would be a convenient moment to 4 break for the transcriber, or whether you would prefer 5 to break at 12? I can do either way, whichever 6 Your Lordship would think is convenient. 7 MR JUSTICE HILDYARD: You think it would be better in terms 8 of your organisation if we break now, do you? 9 MR MARSHALL: If I have 30 minutes, I can get through 10 probably the remaining items in this bundle and then 11 that would be a convenient point to break. 12 MR JUSTICE HILDYARD: Well, let's try for another half 13 an hour and then look forward to the down hill, from 14 your point of view, shorter bit. 15 MR MARSHALL: My Lord, then moving from there, the next 16 letter we need to look at is in tab 4 of the bundle, 17 which is a letter dated 29 September 2006 from Lehman 18 Brothers to the Revenue. Similar points emerge from 19 that. Your Lordship will see, in paragraph 1 -- 20 MR JUSTICE HILDYARD: When the heading is, "Lehman 21 Brothers," that means? 22 MR MARSHALL: That means the group, if effect. It is being 23 written by a lady called Jackie Dolby, Your Lordship 24 will see her being referred to on page 2. 25 MR JUSTICE HILDYARD: Yes.</p> <p style="text-align: center;">Page 31</p>
<p>1 indeed, there is no reference to LBL as being 2 a shareholder who would be potentially open to a call, 3 and providing a source of capital. So this is entirely 4 consistent with the earlier document that Your Lordship 5 saw. It focuses upon a different source. 6 My Lord, the final point that one gets from the 7 letter is that this is clearly a very carefully prepared 8 structure, organised not only with the FSA regulatory 9 requirements in mind but also with a view to ensuring 10 that certain US tax advantages were obtained. One sees 11 that from the earlier part of the letter and, in 12 particular, on page 3. Paragraph 10 on that page, where 13 there is a reference to a Luxembourg corporation having 14 been set-up, and there is reference to US "check the 15 box" regulations, whereby the Luxembourg company was a 16 disregarded entity, treated as a branch of its 100 per 17 cent parent, LB Spain holdings, which was a wholly owned 18 subsidiary of LBDI." 19 It then goes on to say: 20 "This structure was implemented to allow dividends 21 and interest to be paid within the LB UK Group without 22 immediately triggering US taxes." 23 As we will see in some of the later documentation, 24 the way in which the new holding company is put in place 25 is done very much with the US tax position in mind.</p> <p style="text-align: center;">Page 30</p>	<p>1 MR MARSHALL: Director of European taxation. There is a tax 2 department which is acting for the group, it would 3 appear. 4 MR JUSTICE HILDYARD: Is this Lehman Brothers Plc? 5 MR MARSHALL: I think her office happened to be at 6 Lehman Brothers Limited. 7 MR JUSTICE HILDYARD: Right. 8 MR MARSHALL: Our -- 9 MR JUSTICE HILDYARD: It may not matter. 10 MR MARSHALL: Sometimes the letters get written on behalf of 11 LBIE, but sometimes they are on a heading which is 12 Lehman Brothers Limited. Let me just see an example. 13 Yes, if Your Lordship looks back at the letter 14 I took you to a moment ago, in tab 2, if you look at 15 page 2 -- 16 MR JUSTICE HILDYARD: Yes. 17 MR MARSHALL: -- the bottom of the page, Your Lordship will 18 see it is a Lehman Brothers Limited document. 19 Yes, and, indeed, on page 1, where you see the memo 20 from the Revenue to Ms Dolby, she is European Taxation 21 Department, Lehman Brothers Limited. So she seems to be 22 based in Lehman Brothers Limited, but the department she 23 is part of seems to be dealing with matters on a group 24 wide basis. 25 Now, in this letter, of 29 September, in paragraph 1</p> <p style="text-align: center;">Page 32</p>

8 (Pages 29 to 32)



<p>1 she deals with the coming change in the FSA rules in                  2 relation to capital issues to companies outside the UK                  3 regulated group. She talks about the new ratio that has                  4 to be complied with. She then describes what the UK                  5 regulated group is, a couple of paragraphs down,                  6 represented by LB Spain Holdings and all entities under                  7 LB Spain, and it is said that they don't currently meet                  8 this requirement because preference shares were going to                  9 be treated at non-core tier 1 capital. She then goes on                  10 to say:                  11 "Therefore, to ensure that Lehman Brothers meets the                  12 FSA requirement from 1 January without ejecting                  13 additional equity LB needs to restructure so that the                  14 preference shares issued by LB Holdings and LB Plc are                  15 held by a member of the UK regulated group, hence the                  16 creation of an SLP [I think is a reference to a Scottish                  17 limited partnership] which will be treated as part of                  18 the UK regulated LB group and will hold the preference                  19 shares."                  20 She then attaches a diagram, prepared by our                  21 regulatory group, showing the equity of subordinated                  22 debt position of the group pre and post implementation,                  23 and asks them to note that the proposed changes to the                  24 structure require no additional injections of equity or                  25 debt into the UK group.</p> <p style="text-align: center;">Page 33</p>	<p>1 efficient management of the repatriation of funds to the                  2 US.                  3 "Secondly, it ensures the proposed reorganisation                  4 will be treated as tax free from the US tax                  5 perspective."                  6 So there clearly was careful preparation in terms of                  7 trying to ensure the US tax advantage was achieved, but                  8 the second point that one gets from the letter is of                  9 course that the UK Lehman companies are being looked at                  10 on a group basis, and capital preservation is being                  11 looked at on a group basis.                  12 When one looks at the restructuring charts, they                  13 follow in a familiar style, on page 3, in the sense that                  14 there is no reference to the ability to call on assets                  15 from members and, indeed, LBL as a member is not even                  16 actually mentioned.                  17 MR JUSTICE HILDYARD: Mr Marshall, you accept, do you, that                  18 the question is not whether, under these plans, this                  19 capital resource, if it is one, was to be included but                  20 whether there is clarity that it was to be excluded?                  21 MR MARSHALL: Yes. But what I am using this for is to show                  22 Your Lordship that, from the FSA perspective, the                  23 objective was to preserve capital for the group, thereby                  24 protecting creditors of the group; it would have been                  25 wholly inimical to that objective if, by virtue of</p> <p style="text-align: center;">Page 35</p>
<p>1 She then notes, at the end of page 1, that the                  2 diagram depicts two UK new companies between LBIE and                  3 LB Plc, and the previous letter of 18 August only                  4 referred to one. The additional new company was                  5 required for US tax purposes but had no impact on the                  6 overall tax position.                  7 She then goes on, on page 2, in the second paragraph                  8 down from the top of the page, to note:                  9 "As the business of LBIE expands new equity or debt                  10 will need to be injected into the group to meet the FSA                  11 prescribed capital ratios."                  12 She didn't have any projections as to the future                  13 capital requirement.                  14 Then, in paragraph 3, she refers back to her first                  15 point:                  16 "That in order to meet the FSA requirements, without                  17 injecting any additional equity, the LB Holdings/LB Plc                  18 preference shares have to be held by an entity/body                  19 within the UK regulated group."                  20 Then talks about the possible capital duty costs of                  21 doing that.                  22 Then, finally, on point 4, Your Lordship will see                  23 that the purpose of inserting two UK new companies was                  24 twofold. Firstly, it enabled earnings streams from                  25 subsidiaries to be isolated allowing for a US tax</p> <p style="text-align: center;">Page 34</p>	<p>1 a subordinated loan agreement which was meant to provide                  2 part of that capital, assets from one member were to be                  3 removed, leaving creditors of it exposed and unpaid with                  4 the money then going off, up chain, to the holding                  5 companies further up the chain, potentially perhaps                  6 outside of the UK group all together, ultimately.                  7 The idea was to protect the group, as a whole, to                  8 ensure capital was preserved within the group, not to                  9 allow it to escape in such a way that creditors of one                  10 of the group members were left exposed, which is what                  11 would happen if the subordinated debt could lead to the                  12 section 74 call.                  13 We submit it is therefore not at all surprising that                  14 the FSA's focus, in terms of what resources were going                  15 to be available to LBIE to meet the subordinated loan                  16 debt, was going to be its own resources. It wasn't                  17 going to be going round grabbing money from other people                  18 within the group in order to meet it, which would create                  19 that very danger. Your Lordship will see support for                  20 that, not only from this material, but actually also                  21 from other provisions of the subordinated loan                  22 agreement, itself, which we will come to. They include                  23 provisions which prevented LBIE obtaining a surety to                  24 support its position as a debtor, and prevented LBHI2                  25 from having any form of indemnity from someone else to</p> <p style="text-align: center;">Page 36</p>

<p>1 cover the debt, either. There was meant to be a focus                  2 purely upon the repayment obligations of the borrower,                  3 LBIE, and we would submit that is entirely consistent                  4 with the focus being upon its assets and resources alone                  5 without recourse to other people, whether under                  6 section 74 or some other similar obligation.                  7 My Lord, just to complete the picture, in terms of                  8 the pre November 2006 materials, Your Lordship has                  9 another letter, at tab 5, dated 6 October 2006. This is                  10 to the FSA. This one is written on LBIE paper from                  11 a lady called Sophie Hutcherson of the                  12 Prudential Advisory Group. In the third paragraph, on                  13 the first page, she refers to various change of                  14 controller forms for phase 1 of the European holding                  15 company restructure, and then for phase 2, once approval                  16 had been put in place for phase 1. She goes on to say,                  17 in the course of that paragraph:                  18 "We have provided an explanation of all the stages                  19 in the group reorganisation. This is supported by                  20 diagrams of the relevant parts of the group, details of                  21 the capitalisation of LBIE, copies of the forms and                  22 examples of the banner sheets for New Co 1 and 2, as                  23 at November."                  24 Your Lordship will then see a detailed explanation                  25 of the rationale as provided on the second page, and it</p> <p style="text-align: center;">Page 37</p>	<p>1 That approval, which is dated 30 October 2006,                  2 Your Lordship will see, on the second paragraph,                  3 a reference to the change of controller application                  4 having been approved. Then, in the next paragraph, the                  5 approval is given to the repayments of the existing                  6 subordinated loans. In the last sentence, Your Lordship                  7 will see:                  8 "This permission is granted on the understanding the                  9 facilities in question will be simultaneously replaced                  10 with three identical facilities from LBH Plc to LBHI2,                  11 and from LBHI2 to LBIE, as described in your letter.                  12 Therefore, the pre-payments will not have an adverse                  13 effect on the firm's UK capital structure."                  14 My Lord, in the context of this correspondence "the                  15 firm" we respectfully submit is Lehman Brothers group,                  16 not LBIE. LBIE was a UK company, so it wouldn't make                  17 much sense to refer to a UK capital structure for it.                  18 In the context, it must be a reference to the                  19 Lehman Group UK capital structure; that is consistent                  20 with all the earlier correspondence, where the concern                  21 of the FSA is to protect the group wide position.                  22 Now, my Lord, we have also have in the bundle some                  23 subsequent correspondence in 2007. We don't have it                  24 there for the purposes of showing or pointing to some                  25 statement by one of the parties to the subordinated loan</p> <p style="text-align: center;">Page 39</p>
<p>1 is in particular that as they were moving forward                  2 to January 2007, and the implementation of GENPRU and                  3 BIPRU rules:                  4 "We have considered what changes we need to make to                  5 the capital structure to LBSH UK Group. At the same                  6 time, as a matter of routine, our tax department has                  7 just received the optimal group structure for the                  8 purposes of tax efficiencies."                  9 Your Lordship will see then there is, in the latter                  10 part of page 2, under the heading, "Benefits", that                  11 there is an explanation of some of the US tax advantages                  12 that were designed to be achieved by the insertion of                  13 the Lehman Brothers Holdings Intermediate 1 company and                  14 LBHI2, as well.                  15 In terms of how the transaction then worked, there                  16 seems to have been an application for a change of                  17 controller, which Your Lordship sees at page 4.                  18 The FSA had to then give its approval for two things                  19 as part of this process. One was for the change of                  20 control, which they did give, as Your Lordship sees on                  21 tab 6, on 26 October. Then they also had to approve the                  22 replacement of the subordinated loan agreements, their                  23 repayment of the existing ones and replacement with new                  24 subordinated loan agreements involving LBHI2.                  25 Your Lordship finds the approval for that at tab 7.</p> <p style="text-align: center;">Page 38</p>	<p>1 agreement regarding what they understood the agreement                  2 to mean. We are not relying on it for that. We are not                  3 relying on subsequent conduct, or statements in that                  4 way, which we accept wouldn't be admissible.                  5 What we do rely upon this material for is to show                  6 Your Lordship what the FSA or regulatory concern was at                  7 the time when the agreements were entered into. It                  8 records the thinking prior to November 2006, and what                  9 the FSA's general approach was.                  10 If I go to tab 8, Your Lordship will find the first                  11 of those documents. It is dated 16 March 2007 to                  12 Mr Franklin at the FSA. It is explaining that there was                  13 a proposed change to the nature of some of the term                  14 "subordinated debt" that funded LBIE. The proposal                  15 seems to have been for replacement of some of the                  16 subordinated loan amounts with floating rates,                  17 subordinated notes. At the end of the first page of                  18 that letter, in the penultimate paragraph, Your Lordship                  19 will see there was a reference to diagrams of the                  20 existence and proposed flow of capital in the group.                  21 Then a statement:                  22 "We believe that the proposal described above, while                  23 enhancing Lehman Brothers funding structure, has no                  24 adverse regulatory consequences and, indeed, should                  25 strengthen Lehman Brothers capital base by providing new</p> <p style="text-align: center;">Page 40</p>

<p>1 founding for the regulated group."                  2 My Lord, therefore, entirely consistent with the                  3 earlier correspondence Your Lordship has seen, whereby                  4 the concern is to ensure that the group position is                  5 protected.                  6 My Lord, the next items of, perhaps, some interest                  7 are at tab 9. Another letter to the FSA and, in the                  8 second paragraph, there was a desire to just clarify the                  9 nature of some of the short-term subordinated debt that                  10 funded LBIE. There was an explanation of that and                  11 a statement that the current facility remained                  12 unchanged.                  13 There is then a chart, which is on the second page,                  14 and it follows in a very similar style to other earlier                  15 charts, which had lines showing the various forms of                  16 capital that were coming in, which are in the form of                  17 equity, subordinated debt, tier 1 preference shares,                  18 tier 2 preference shares and a guarantor or standby                  19 facility. No reference to a possible source of capital                  20 from members by virtue of section 74 or anything of that                  21 nature and, indeed, no reference in the charts to LBL at                  22 all but only to LBH12.                  23 My Lord, the final two items are in tabs 10 and 11.                  24 Tab 10 is a letter to the Revenue of around the same                  25 time, March 2007, and Your Lordship will see that this</p> <p style="text-align: center;">Page 41</p>	<p>1 to protect capital for the UK group. On page 9,                  2 Your Lordship will see, in the third paragraph, that                  3 assurances are sought to be provided to the Revenue that                  4 there is no intention to provide a UK tax advantage. In                  5 the last sentence, it is explained:                  6 "Rather, the main purpose of the transaction is to                  7 provide financing to the LB UK Group for business                  8 purposes in a manner that is efficient from both                  9 a commercial and a US tax perspective, as the proposed                  10 transaction does not displace or alter the existing                  11 amount of debt funding to the UK group. It would seem                  12 that no comparison needs to be made here. The same loan                  13 amount is in place before and after the transaction,                  14 befalls the same purpose, that of providing capital to                  15 support the general UK business activities."                  16 So, my Lord, entirely consistent, therefore, with                  17 the earlier correspondence Your Lordship has seen, and                  18 reflective of the regulatory approach at the time when                  19 the subordinated loan agreements were entered into.                  20 The document is accompanied by further charts, which                  21 Your Lordship has at pages 11, 12 and 13, where the                  22 current structure and the new structure are all                  23 described. Your Lordship sees the familiar types of                  24 capital being referred to, in the form of subordinated                  25 debt, preference shares, but with only one member of</p> <p style="text-align: center;">Page 43</p>
<p>1 is written -- and it is quite a long letter -- by                  2 Ms Dolby from the European taxation department and it                  3 states, on page 1, that the letter is being written on                  4 behalf of the Lehman Brothers UK Group. It is                  5 a clearance application in relation to avoidance                  6 involving arbitrage provisions.                  7 If I could go to section C, which is on page 8, and                  8 there are set out the details of the purpose of the                  9 transactions. Under that heading, in the second                  10 paragraph, there is another explanation, "The primary                  11 purpose of the proposed restructuring". It is said:                  12 "The funding provided through the current group                  13 structure must be provided to members of the regulated                  14 group. Under the current structure, funding provided by                  15 LBH SLP 1, this would cause interest income accrued to                  16 build up and would give negative impact on the group's                  17 regulatory capital position. Any repayment of funding                  18 by LBIE -- for example, in the instance it was able to                  19 reduce its regulatory capital requirements -- and any                  20 income accrued in LBH SLP 1 in such a scenario would not                  21 be permitted to be lent outside of the current UK                  22 regulatory chain structure, ie the structure outlined in                  23 appendix 1. This limits the flexibility of any new                  24 funding provided by the US parent."                  25 So, again, reflecting the current position, which is</p> <p style="text-align: center;">Page 42</p>	<p>1 LBIE being referred to, which is consistent with all of                  2 the previous charts and indicative of the fact that                  3 there was no interest at all in the possible source of                  4 capital funding through calls made on members such as                  5 LBL.                  6 My Lord, finally, we have, at tab 11, a further                  7 letter to the FSA. This time 12 April 2007 from                  8 Ms Hutchinson, the head of the                  9 Prudential Advisory Group. On the first page,                  10 Your Lordship will see the heading, "Lehman Brothers UK                  11 Group regulatory capital sources":                  12 "Further to my telephone conversation with you, on                  13 21 March, I am writing to notify you of changes Lehman                  14 Brothers proposes to implement in relation to the flow                  15 of regulatory capital within the Lehman Brothers UK                  16 consolidated group."                  17 She explains that they had been reviewing what the                  18 optimal structure was from a US tax perspective, and                  19 then says:                  20 "The proposed changes are being driven largely by US                  21 tax efficiencies and we believe should have no adverse                  22 regulatory consequences and no impact on UK tax                  23 perspective."                  24 She then accompanies that document with, again,                  25 a sequence of charts, which Your Lordship will find at</p> <p style="text-align: center;">Page 44</p>

<p>1 pages 4 and 5. We then see various figures being given,                  2 I think, on the charts, for equity, subordinated debt                  3 and two types of preference shares, and also a                  4 guarantor or standby letter of credit but no reference                  5 to potential calls under section 74, and no reference to                  6 LBL, at all.                  7 So, my Lord, all of that, we respectfully submit,                  8 effectively shows three things. One is that the                  9 structure, which led to the subordinated loan agreements                  10 provided by LBHI2, was very, very carefully organised,                  11 was designed to achieve specific advantages and meet the                  12 FSA regulatory requirements. It wasn't going to be                  13 something that would alter very easily.                  14 And, second, when engaging in these transactions, it                  15 was the UK regulated group which was considered and                  16 thereby the creditors of that group. What was sought to                  17 be achieved was a preservation of capital at the correct                  18 level for the group, which we submit is important when                  19 one considers how one should interpret what sources                  20 should be used to repay the subordinated debt. It would                  21 be extremely surprising if creditors who are providing                  22 services which were of benefit to the group via LBL were                  23 to be left out of pocket as a result of a repayment of                  24 subordinated debt funded by calls on members such as                  25 LBL. Wholly inimical to the whole purpose of the</p> <p style="text-align: center;">Page 45</p>	<p>1 submission you would get to the same answer because if                  2 one looks at the FSA handbook, which sets out the types                  3 of capital that were going to be available to the                  4 borrowing entity, one won't find any reference to the                  5 potential for a call upon members under section 74, or                  6 anything of that nature.                  7 One sees that from a document, I think, that                  8 Mr Atherton took Your Lordship to in the authorities                  9 bundle, volume 5, at tab 171, which is an extract from                  10 the interim Prudential sourcebook for investment                  11 business. The calculation of financial resources for                  12 a firm is dealt with in paragraph 10-62, and                  13 Your Lordship sees the provisions -- which I think your                  14 Lordship has looked at already -- for the calculation of                  15 financial resources in accordance with certain tables,                  16 A, B and C, which are then on the following pages.                  17 Table A, for example, consists of a combination of                  18 ordinary share capital, non-cumulative preference share                  19 capital, share premium account, reserves excluding                  20 valuation reserves, audited retained earnings and                  21 externally verified interim net profits of current                  22 account and partners' capital; similar provisions in                  23 table B and in table C.                  24 The sorts of things Your Lordship sees there are                  25 entirely consistent with the various tables for the</p> <p style="text-align: center;">Page 47</p>
<p>1 structure. My Lord, that might be a convenient moment                  2 to break.                  3 MR JUSTICE HILDYARD: Yes, well, a long 5 minutes.                  4 (11.58 am)                  5 (A short break)                  6 (12.10pm)                  7 MR MARSHALL: My Lord, we of course rely on that material                  8 I have taken Your Lordship to as part of the immediate                  9 context to the subordinated loan agreements and in                  10 explaining the objectives behind them. We respectfully                  11 submit that Your Lordship is entitled to have regard to                  12 all of that. Notwithstanding the standard form nature                  13 of schedule 2 to the subordinated loan agreements, given                  14 that there are variable terms in schedule 1, the                  15 agreements as a whole are hybrid. The important matters                  16 to bear in mind when considering these agreements is                  17 that the variable terms, of course, encompass the                  18 circumstances of the particular borrower and the                  19 repayment terms in connection with that borrower. It is                  20 important, therefore, to consider the particular context                  21 with regard to interpreting the repayment provisions.                  22 But, my Lord, if one had to also look at the matter                  23 more widely, in terms of how repayments would be                  24 considered more generally when looking at these FSA                  25 prescribed agreements, or standard forms, in our</p> <p style="text-align: center;">Page 46</p>	<p>1 restructuring of the Lehman Group, and what was thought                  2 to be relevant to the FSA for the purposes of that                  3 restructuring and the approval of the FSA for it that                  4 Your Lordship has already seen.                  5 There was no expectation that the borrowing entity                  6 would be relying upon capital from other sources than                  7 those listed on the sourcebook, in particular calls on                  8 other entities within the group, under section 74 or                  9 similar.                  10 MR JUSTICE HILDYARD: It may not matter, but you would                  11 accept that if there were unpaid share capital in                  12 a limited company, that would be --                  13 MR MARSHALL: Yes, indeed, it would be.                  14 MR JUSTICE HILDYARD: Why is that; because it falls within                  15 ordinary share capital?                  16 MR MARSHALL: Ordinary share capital. But what we are                  17 talking about is something very different from that, and                  18 that is certainly not within the contemplation of the                  19 FSA.                  20 MR JUSTICE HILDYARD: Well, Mr Trower's point is that the                  21 only difference, really, between a limited share and an                  22 unlimited share is that the limited share caps what                  23 would otherwise be an unlimited liability.                  24 MR MARSHALL: Yes.                  25 MR JUSTICE HILDYARD: But they are not different in nature.</p> <p style="text-align: center;">Page 48</p>

<p>1 That is what he says, amongst other things.                  2 MR MARSHALL: Well, we respectfully disagree with that.                  3 Where one is dealing with unlimited liability as                  4 opposed to a limited one -- if there is an exposure to                  5 a particular amount in relation to uncalled share                  6 capital for another entity in the group, for example,                  7 that would no doubt appear as a provision in the                  8 accounts of, let's say LBL, for example. LBL may                  9 potentially have a provision in its account for a small                  10 amount of uncalled share capital which is still owing                  11 and has to be dealt with. But an unlimited liability                  12 would be a different matter, and not something that any                  13 creditor dealing with LBL would necessarily be aware of                  14 or take account of, unless some specific mention was                  15 made of it. It is, in our submission, a very different                  16 type of liability.                  17 In the context of the type of regulation that the                  18 FSA was undertaking -- and Your Lordship has seen that                  19 they regulated on a group basis -- it would be very,                  20 very strange to leave other members of the UK group                  21 exposed to calls for the benefit of other members of the                  22 group, and shareholders of those members, leaving third                  23 party creditors exposed. That can't possibly have been                  24 what was sought to be achieved.                  25 If there was a limited amount of ordinary share</p> <p style="text-align: center;">Page 49</p>	<p>1 My Lord, if for any reason that analysis was                  2 incorrect and the standard form didn't quite work in                  3 that way, then if we have to apply the AIB approach,                  4 which is the one that Mr Trower has been advocating,                  5 I think that is the case that Your Lordship has in                  6 volume 3 of the authorities, at tab 74. Tab 74, page 96                  7 of the report. The judgment of Lord Millett. I think                  8 earlier I said Lord Mustill, it is Lord Millett. It is                  9 at paragraph 7. He made the point in that case that                  10 they were concerned with a standard form:                  11 "Designed for use in a wide variety of                  12 circumstances, not context specific, value much                  13 diminished if it could not be relied upon as having the                  14 same meaning on all occasions. Relevance of factual                  15 background of particular cases, interpretation is                  16 necessarily limited."                  17 But then he made this observation:                  18 "The danger, of course, is that a standard form may                  19 be employed in circumstances for which it was not                  20 designed. Unless the context in a particular case shows                  21 that this has happened, however, the interpretation of                  22 the form ought not to be effected by the fact all                  23 background."                  24 My Lord, if we were wrong in the analysis that                  25 I have provided Your Lordship with as to how the</p> <p style="text-align: center;">Page 51</p>
<p>1 capital that still had to be paid up, that obviously is                  2 still in a different category and no doubt creditors                  3 dealing with members of the group would take account of                  4 that. But an unlimited liability is in a different                  5 category. Particularly one arising from a very small                  6 shareholding, which was the case here.                  7 My Lord, we submit that there is nothing terribly                  8 surprising about the sourcebook provisions, given that                  9 the source of them seems to be an EC provision which                  10 I referred to earlier in Mr Justice David Richards'                  11 judgment, he referred to the EC judgments that led to                  12 all of this. These provisions in the sourcebook are no                  13 doubt reflective of that. We will get appendix 5 for                  14 Your Lordship, so that Your Lordship has it, but I am                  15 reasonably confident that the FSA was simply                  16 implementing and putting in place what the EC directives                  17 required. Those directives don't seem to have                  18 anticipated any type of source of capital by section to                  19 74.                  20 MR JUSTICE HILDYARD: Is it annex 5 to the directive?                  21 MR MARSHALL: I think it was annexe 5 that was referred to                  22 in the passage of Mr Justice David Richards' judgment                  23 Your Lordship referred to earlier.                  24 MR JUSTICE HILDYARD: Yes, whichever that is.                  25 MR MARSHALL: Indeed.</p> <p style="text-align: center;">Page 50</p>	<p>1 standard form should be approached, and if when one is                  2 to look at it in a rather different way, well, we would                  3 respectfully submit that it is evident that it is now                  4 being employed in circumstances for which it was not                  5 designed, namely unlimited companies. It is clearly, in                  6 our submission, designed for a rather different purpose,                  7 having regard to the list of types of capital that they                  8 had in contemplation. It is not the case that they had                  9 in mind unlimited companies with the provisions for                  10 calls that they envisage. If necessary, I would submit                  11 that the exception that Lord Millett recognised there                  12 would come into play to allow Your Lordship to have                  13 regard to the particular context.                  14 My Lord, I have already responded briefly to the                  15 further suggestion that because the subordinated loan                  16 agreement had provision allowing assignment with FSA                  17 consent, that that should deter Your Lordship from                  18 having regard to the particular context that led to its                  19 creation. Your Lordship has seen the passage from                  20 Chartbrook of Lord Hoffmann which suggests that the mere                  21 existence of an assignment provision doesn't lead to                  22 that result. You still can have regard to the context.                  23 Particularly so when the assignee might well be someone                  24 who would have a full awareness of the particular                  25 context; having regard to the way in which these</p> <p style="text-align: center;">Page 52</p>

<p>1       subordinated loan agreements were set-up, and the 2       purpose for which they were set-up, the advantages which 3       they were sought to achieve, we respectfully submit it 4       is unlikely, in the extreme, that one would see these 5       subordinated loan agreements being assigned to someone 6       outside of the Lehman Group. If they were going to be 7       assigned or changed, the likelihood was it would likely 8       be another Lehman Group entity, no doubt fulfilling some 9       new structure to achieve whatever advantage was sought 10       to be preserved in relation to the US tax position. 11       That is what we see from the way this was done. 12       My Lord, other points that we draw upon. We draw 13       upon a further point, which is that of course LBHI2, the 14       lender under the subordinated loan agreements, was also, 15       by a very large degree indeed, the majority shareholder 16       in LBIE. So if it really was the case that calls under 17       section 74 were to be used as a source of funding for 18       repayment of the subordinated loan, it would be very odd 19       because effectively the call would be going round to the 20       same party as the lender, which is a commercially odd 21       and we would submit rather absurd thing to be happening. 22       The answer to that that is put forward is: well, it 23       was always possible that LBHI2 might have transferred 24       its shares and also you have LBL, albeit a minority 25       shareholder, it is there as well.</p> <p style="text-align: center;">Page 53</p>	<p>1       subordinated loan agreements as being ones that were to 2       be repaid, potentially, from calls made on the lender, 3       itself, holds good. Notwithstanding the fact that LBL 4       have held a tiny proportion of the shares in LBIE. 5       My Lord, the final point which we would make on 6       interpretation of the express terms is based on the 7       Aberdeen City Council approach. 8       If Your Lordship concluded there was just a gap here 9       in the agreement, that something had occurred that no 10       one had really contemplated, then Your Lordship would be 11       entitled to look at the other provisions of the 12       agreement to see what the general objective was of the 13       parties. If one goes to the subordinated loan 14       agreement, that is in bundle 4, tab 1, and if you go to 15       clause 6F on page 11, your Lordship will see the 16       heading, "Representations and undertakings of the 17       borrower": 18       "From and after the date of this agreement, or 19       effective date if earlier, the borrower shall not 20       without the prior written consent of the FSA ..." 21       Then letter D is: 22       "Not to repay any of the subordinated liabilities 23       otherwise than in accordance with the terms of this 24       agreement." 25       Then letter F:</p> <p style="text-align: center;">Page 55</p>
<p>1       Well, as to the transfer of shares by LBHI2, 2       Your Lordship of course needs bear in mind that that is 3       not going to happen very easily. It would only be done 4       if FSA consent was given for a change of control. If 5       that was going to occur, it would, we would submit, only 6       be likely to happen in the context of some further 7       restructuring, whereby the subordinated debt that had 8       been provided by LBHI2 was going to be replaced by some 9       new subordinated debt, or some new arrangement under 10       which the relevant regulatory capital was provided. 11       Just in the same way as when LBH, which had previously 12       provided subordinated debt, ceased to be the holding 13       company. Its subordinated debt was repaid and replaced 14       with a new subordinated loan from the new holding 15       company. 16       We don't accept that there was any real prospect of 17       LBHI2 simply transferring its shares without a lot of 18       other things happening at the same time, which would 19       completely alter the over all position. 20       As far as LBL's shareholding is concerned, of course 21       it is our case that there was a nominee arrangement 22       under which we would be entitled to be indemnified by 23       LBHI2, and so claims against us, we would submit, would 24       have led, ultimately, to LBHI2 as well. So the same 25       point, that it is not commercial for one to read the</p> <p style="text-align: center;">Page 54</p>	<p>1       "Arrange or permit any contract of suretyship or 2       similar agreement relating to its liabilities under this 3       agreement to be entered into." 4       There was a further representation that that had not 5       happened prior to the date of this agreement. 6       My Lord, we would respectfully submit that is 7       a pointer, a strong pointer, to the fact that the 8       borrower's assets alone, its resources alone, were to be 9       the source of repayment, not other persons. 10       Similarly, clause 7, which has representations and 11       undertakings from the lender, Your Lordship will see: 12       "From and after the date of this agreement the 13       lender shall not, without the prior written consent of 14       the FSA ... " 15       Then, if you Lordship looks down to letter F, at the 16       bottom of page 12: 17       "Take or enforce any security, guarantee, or 18       indemnity from any person for all or any part of the 19       subordinated liabilities." 20       "The lender shall on obtaining or enforcing any 21       security ...(reading to the words)... notwithstanding 22       this undertaking hold the same and any proceeds thereof 23       on trust for the borrower." 24       Again, we would respectfully submit, a strong 25       pointer to the fact that there is not to be another</p> <p style="text-align: center;">Page 56</p>

<p>1 source for repayment beyond the borrower's own 2 resources. 3 My Lord, we would respectfully submit that if there 4 is a gap in the document in terms of no indication from 5 it as to what exactly the answer was to be as to the 6 source of repayment, those provisions give Your Lordship 7 a very strong indication of what the objective of the 8 parties or the intention of the party was in the same 9 way as an Aberdeen City Council. Your Lordship could 10 approach the matter on the basis of that, as a matter of 11 interpretation of the express terms. 12 My Lord, that is what I wanted to say about 13 interpretation or construction of the express terms of 14 the subordinated loan agreements. 15 If we are wrong about all of that, then in the 16 alternative we would respectfully submit that 17 Your Lordship should conclude that it is correct to 18 imply a term that repayment was to be made from LBIE's 19 own funds and without recourse to the funds of its 20 members. We submit that term would be required to give 21 commercial or practical coherence to the agreement or, 22 alternatively, would be so obvious as to go without 23 saying to a reasonable reader of the contract knowing 24 all of its provisions and the surrounding circumstances. 25 My Lord, I am using there the formulation of</p> <p style="text-align: center;">Page 57</p>	<p>1 Your Lordship will see that being reviewed beginning at 2 paragraph 21, on page 754. Your Lordship sees, at 754, 3 paragraph 21, just below letter F, he observes: 4 "It could be dangerous to reformulate the 5 principles, but I would add six comments on the summary 6 given by Lord Simon in BP Refinery." 7 The first of those is to echo observations of 8 Lord Steyn in <i>Equitable Life v Hyman</i>. 9 "The implication of a term was not critically 10 dependent on proof of an actual intention of the parties 11 when negotiating the contract. If one approaches the 12 question by reference to what the parties would have 13 agreed, one is not strictly concerned with the 14 hypothetical answer of the actual parties, but with that 15 of the notional reasonable person in the position of the 16 parties at the time at which they were contracting." 17 So it is an objective test by reference to what the 18 reasonable person in the position of the parties would 19 have considered. 20 The second point: 21 "A term should not be implied into a detailed 22 commercial contract merely because it appears fair or 23 merely because one considers that the parties would have 24 agreed to it if it had been suggested to them. Those 25 are necessary but not sufficient grounds for including</p> <p style="text-align: center;">Page 59</p>
<p>1 Lord Neuberger in <i>Marks and Spencer</i>. I wonder if I can 2 take Your Lordship to that case, just so Your Lordship 3 sees how the relevant principles work. It is in 4 bundle 4 of the authorities, at tab 103. If we could go 5 to, first of all, paragraph 18, on page 753, where 6 His Lordship referred to a formulation of Lord Simon in 7 the Privy Council in the case of <i>BP Refinery v Shire</i> 8 of <i>Hastings</i>, where he set out under the traditional 9 approach four conditions. As it was put: 10 "For a term to be implied [I am reading from the 11 quoted words] the following conditions which may overlap 12 must be satisfied: 13 "(1) It must be reasonable and equitable. 14 "(2) It must be necessary to give business efficacy 15 to the contract so that no term will be implied of the 16 contract that is effected without it. 17 "(3) It must be so obvious that it goes without 18 saying. 19 "(4) It must be capable of clear expression." 20 And then finally: 21 "(5) It must not contradict any express term of the 22 contract." 23 So there is a traditional formulation which is then 24 reviewed by Lord Neuberger in the light of the Attorney 25 General of Belize decision, and other subsequent cases.</p> <p style="text-align: center;">Page 58</p>	<p>1 the term. However, and thirdly, it is questionable 2 whether Lord Simon's first requirement, reasonableness 3 and equitableness, will usually, if ever, add anything. 4 If a term satisfies the other requirements it is hard to 5 think that it would not be reasonable and equitable." 6 So the first part of the traditional formulation may 7 well simply be superfluous. 8 "Fourthly, as Lord Hoffmann I think suggested in 9 Attorney General of Belize, although Lord Simon's 10 requirements are otherwise (inaudible), I would accept 11 that business necessity and obviousness, his second 12 third requirements, can be alternatives in the sense 13 that one of them needs to be satisfied, although 14 I expect that in practice it would be a rare case in 15 which only one of those requirements would be 16 satisfied." 17 So necessity and for business efficacy, and 18 obviousness, are potentially alternatives. 19 "Fifthly, if one approaches the issue by reference 20 to the efficacious bystander it is vital the formula (?) 21 of the question be posed to him with the utmost care. 22 "And sixthly, necessity for business efficacy 23 involves...(reading to the words)... the test is not 24 one of absolute necessity, not least because the 25 necessity is judged by reference to business efficacy.</p> <p style="text-align: center;">Page 60</p>

<p>1 It may well be that a more helpful way of putting                  2 Lord Simon's second requirement is, as suggested by                  3 Lord Sumption, that a term can be implied if without                  4 the term the contract would lack commercial or practical                  5 coherence."                  6 And just dropping down to paragraph 23, he is there                  7 considering some observations by Lord Hoffmann about the                  8 process of implying terms into a contract being part of                  9 the exercise of construction. He makes the observation                  10 at paragraph 23 that:                  11 "The notion that a term will be implied of                  12 a reasonable reader of the contract, knowing all of its                  13 provisions and the surrounding circumstances we would                  14 understand it to be applied, is quite acceptable                  15 provided that the reasonable reader is treated as                  16 reading the contract at the time it was made and he                  17 would consider the term to be so obvious as to go                  18 without saying or to be necessary for business                  19 efficacy."                  20 And he also goes on, I think, just below letter F to                  21 say:                  22 "The second proviso is important because otherwise                  23 Lord Hoffmann's formulation may be interpreted as                  24 suggesting that reasonableness is a sufficient ground                  25 for implying a term."</p> <p style="text-align: center;">Page 61</p>	<p>1 terms of implication of a term are firstly that the                  2 court has some sort of strong presumption against                  3 implication of a term when one is dealing with                  4 a detailed standard form contract. That is based on the                  5 judgment of Mrs Justice Gloster as she then was in the                  6 case of Great Ship India, which I think Your Lordship                  7 has in bundle 3 of the authorities at tab 92. If I can                  8 just show you that very quickly. This was a case                  9 concerning a standard form charterparty.                  10 (Pause).                  11 Your Lordship will see from the report at page 360,                  12 in the right-hand column, paragraph 2 it was an appeal                  13 from arbitrators and it raised a short point of                  14 construction in relation to a clause of the amended                  15 BIMCO supply time 1989 form of charterparty. And the                  16 relevant part that is relied upon, I think, is at                  17 page 366 of the report on the right-hand column at                  18 paragraph 41 and it is I think the last sentence of                  19 paragraph 41, where her Ladyship made this statement:                  20 "Moreover, there is a real difficulty in seeking to                  21 imply a term into a detailed standard form contract such                  22 as the supply time 1989 form where the strong                  23 presumption is likely to be the detailed terms of the                  24 contract are complete."                  25 And Your Lordship sees that there is then</p> <p style="text-align: center;">Page 63</p>
<p>1 Now, just applying the relevant test with those                  2 qualifications, we respectfully submit that the                  3 reasonable reader would have taken account of the other                  4 provisions of the subordinated loan agreement and in                  5 particular clauses 6F and 7F that Your Lordship has seen                  6 and would take account of all of the surrounding                  7 circumstances that we have been through, specifically                  8 the contents of the FSA handbook in terms of what type                  9 of capital was intended to be preserved. And we would                  10 submit the particular circumstances leading to these                  11 subordinated loan agreements under which a UK group                  12 position was intended to be protected, with creditors of                  13 the group as a whole intended to receive that                  14 protection.                  15 With that background we respectfully submit any                  16 reasonable reader would have treated it as an obvious                  17 conclusion that recourse was to be had to the assets of                  18 LBIE itself without recourse to those of its members for                  19 the repayment of the LBHI2 subordinated loan. And that                  20 only becomes even more obvious when one sees that LBHI2                  21 is by far and away the most significant member and that                  22 the other member holding a minority interest has a right                  23 of recourse as against LBHI2 concerning its own                  24 liability if a call was made under section 74.                  25 My Lord, the points that are made against us in</p> <p style="text-align: center;">Page 62</p>	<p>1 a reference to Attorney General of Belize and in                  2 particular the speech of Lord Hoffmann at paragraphs 17                  3 to 27, and then to the Mediterranean Salvage case and                  4 the speech of Lord Clarke at paragraphs 10 and 15 to 18.                  5 My Lord, with respect we submit unfortunately the                  6 analysis here seems to be incorrect, because in fact the                  7 two cases referred to don't support any suggestion that                  8 there is in fact a strong presumption rule of that kind.                  9 But in any event the contract Your Lordship is concerned                  10 with here, certainly on one view, is not a detailed                  11 standard form contract. It is actually quite a brief                  12 document. In terms of loan agreements, one knows from                  13 experience they certainly can be a great deal more                  14 comprehensive and detailed than the one that we have to                  15 consider in this particular instance.                  16 If one goes to Attorney General of Belize, which is                  17 the first authority referred to to support what                  18 Mrs Justice Gloster has there referred to, that is at                  19 bundle 3-tab 79 and the passages that were relied on                  20 were 17 to 27. That is in the report at                  21 tab 79-page 1993 through to 1995. It is actually quite                  22 a lengthy passage in which His Lordship was dealing with                  23 the correct principles for implication of a term                  24 generally. And among other things, Your Lordship sees                  25 on page 1994 at paragraphs 23 to 25, there is reference</p> <p style="text-align: center;">Page 64</p>



<p>1 to Lord Steyn's observations in Equitable Life that                  2 Lord Neuberger had referred to and he then refers to                  3 the Moorecock, and paragraph 25:                  4 "The requirement that the implied term must go                  5 without saying is no more than another way of saying                  6 that although the instrument does not expressly say so,                  7 that is what a reasonable person would have understood                  8 it to mean."                  9 Then, just above letter C on page 1995, he then said                  10 this:                  11 "Likewise, it is not necessary that the need for the                  12 implied term should be obvious in the sense of being                  13 immediately apparent, even upon a superficial                  14 consideration of the terms of the contract and the                  15 relevant background. The need for an implied term not                  16 infrequently arises when the draftsman of a complicated                  17 instrument has omitted to make express provision for                  18 some event because he has not fully thought through the                  19 contingencies which might arise even though it is                  20 obvious after a careful consideration of the express                  21 terms and the background that only one answer would be                  22 consistent with the rest of the instrument. In such                  23 circumstances, the fact that the actual parties might                  24 have said to the efficacious bystander could you please                  25 explain that again does not matter."</p> <p style="text-align: center;">Page 65</p>	<p>1 observations made by Sir Thomas Bingham in the case,                  2 I think, of Socimer Bank v Standard Bank Limited. There                  3 is a quotation, which Your Lordship will see in                  4 paragraph 18, from Sir Thomas Bingham, where he says:                  5 "The difficulties increase the further one moves                  6 away from these paradigm examples."                  7 MR JUSTICE HILDYARD: I think this is in                  8 Philips Electronique, is it not?                  9 MR MARSHALL: Yes, I am so sorry. I may have the wrong one.                  10 Your Lordship is right, yes:                  11 "It is much more difficult to infer with confidence                  12 what the parties must have intended when they have                  13 entered into a lengthy and carefully drafted contract                  14 but have omitted to make provision for the matter in                  15 issue. Given the rules which restrict evidence of the                  16 parties' intention when negotiating the contract, it may                  17 well be doubtful whether the omission was the result of                  18 the parties' oversight or of their deliberate decision                  19 if the parties appreciate that they were unlikely to                  20 agree on what is to happen a certain, not impossible,                  21 eventuality. They may well choose to leave the matter                  22 uncovered in their contract in the hope that the                  23 eventuality will not occur."                  24 The judgment then moves on to other aspects.                  25 So, my Lord, that is pretty much the only bit of the</p> <p style="text-align: center;">Page 67</p>
<p>1 So my Lord, from what we can see there doesn't seem                  2 to be any support for this suggestion that there is some                  3 sort of strong presumption when one is dealing with                  4 complicated agreements, or complicated standard form                  5 agreements. But rather, an indication that when one is                  6 dealing with a complicated instrument there may well be                  7 a basis for implication of a term, having regard to the                  8 factors that Lord Hoffmann refers to at 1995, C to D.                  9 So if anything, the authority is actually contrary to                  10 such an approach.                  11 If one goes to the Mediterranean Salvage case, which                  12 I think has been inserted into Your Lordship's bundle at                  13 tab 79A. This is the speech of Lord Clarke.                  14 Paragraph 10, which was the first of the passages                  15 referred to by Mrs Justice Gloster, is really a passage                  16 referring back to Lord Hoffmann's speech in Belize. It                  17 is also noting that it can be the inference that                  18 something is not provided for that nothing is intended                  19 to happen.                  20 Paragraphs 15 to 18, which is the other passage that                  21 was referred to by Mrs Justice Gloster, sets out the                  22 general approach to implication of terms. The relevant                  23 bit, which then refers to what might be the approach, or                  24 the special issue that arises when one is dealing with                  25 a lengthy or complicated contract, is with reference to</p> <p style="text-align: center;">Page 66</p>	<p>1 two judgments referred to that could possibly provide                  2 any kind of support for the proposition: well, it is                  3 more difficult to imply a term in a complex standard                  4 form agreement.                  5 But none of them go as far as to say there is any                  6 form of strong presumption. Lord Hoffmann rather                  7 suggests that in a complicated instrument it may well                  8 still be appropriate to imply a term, and                  9 Sir Thomas Bingham is simply indicating that it can be                  10 more difficult in a lengthy and carefully drafted                  11 contract because it might have been something that had                  12 been left in the air because the parties couldn't agree                  13 about it and they left it out for that reason. But we                  14 aren't, in our submission, dealing with a lengthy and                  15 complex agreement here. It is a relatively short                  16 standard form document that one is concerned with.                  17 And --                  18 MR JUSTICE HILDYARD: It is a very difficult test for the                  19 (inaudible) though, isn't it? I mean, at what stage of                  20 a contract? Does it have to be more than ten pages?                  21 MR MARSHALL: Well --                  22 MR JUSTICE HILDYARD: It can't be the length. Surely what                  23 they are getting at is along the lines of: where lots of                  24 people have worked hard to reach a standard form, which                  25 will be considered appropriate across a wide variety of</p> <p style="text-align: center;">Page 68</p>

1 transactions and has had a lot of input into it, to  
 2 cover all eventualities, it is rather presumptuous of  
 3 the court to suppose that they have just made a bog in  
 4 a certain area. It is more difficult to suppose that.  
 5 It's more likely that they simply haven't covered that  
 6 because it is too difficult and not intended.  
 7 MR MARSHALL: Or that --  
 8 MR JUSTICE HILDYARD: Isn't that all that is being said?  
 9 MR MARSHALL: Yes.  
 10 MR JUSTICE HILDYARD: Doesn't it stand to reason that the  
 11 more effort that has gone into a contract, and the more  
 12 general its application that is intended, the less  
 13 likely the court is to wade in and say, "Oh, well, they  
 14 haven't said it, but what they really meant is this".  
 15 Isn't that all --  
 16 MR MARSHALL: My Lord, I don't disagree with Your Lordship's  
 17 proposition that obviously if one is dealing with  
 18 a standard form contract, it is meant to cover a number  
 19 of eventualities, then you start from the position of  
 20 well, one would hope that they would have covered all of  
 21 the possible cases. But that is not necessarily always  
 22 so and, in this context, having regard to the material  
 23 behind the standard form contract, particularly the  
 24 handbook that Your Lordship has seen, it is a pretty  
 25 good indicator that they just didn't have in mind calls

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1 under section 74 at all, and that maybe because they  
 2 wanted to keep them out of the equation, in terms of  
 3 what sources could be called upon for repayment; another  
 4 option would be to conclude that they just didn't have  
 5 unlimited companies in mind, at all, for this type of  
 6 document. That wouldn't be at all surprising, because  
 7 unlimited companies are such a rare thing. Very rare  
 8 thing.  
 9 Not to focus on provisions that are going to cover  
 10 them perhaps wouldn't be that surprising. It wouldn't  
 11 be any criticism of the FSA in relation to that.  
 12 Particularly where what the FSA is doing is very much  
 13 based on the European background directives, which  
 14 certainly wouldn't have had English unlimited companies  
 15 as the focus.  
 16 So while accepting what Your Lordship has said, we  
 17 would respectfully submit this could well properly come  
 18 into the category of case where it is simply an area  
 19 which wasn't focused upon and for understandable  
 20 reasons.  
 21 For that reason, there is a gap in terms of what is  
 22 covered, and there needs to be appropriate implication  
 23 of a term to cover it, to make the document work  
 24 coherently, having regard to what its objective was.  
 25 Your Lordship has already heard from me as to the

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1 background as to what that objective was, at the time,  
 2 which was to preserve the position of the UK  
 3 Lehman Group generally and to protect the creditors of  
 4 that group generally.  
 5 MR JUSTICE HILDYARD: Just going back to Belize.  
 6 MR MARSHALL: Yes.  
 7 MR JUSTICE HILDYARD: I mean, part of what Lord Hoffmann was  
 8 saying, wasn't it, was that it is an unitary exercise.  
 9 Search of the court is what the parties intended, and  
 10 that same search applies in any of the three contexts in  
 11 which one is looking at the same question.  
 12 MR MARSHALL: Yes.  
 13 MR JUSTICE HILDYARD: The three contexts being: express  
 14 term, inference from the express terms and interpolation  
 15 into the contract of a fresh term, which it be supposed  
 16 is absolutely necessary and which the parties would have  
 17 agreed.  
 18 MR MARSHALL: Yes.  
 19 MR JUSTICE HILDYARD: Otherwise you get into the problem,  
 20 don't you, on your case, you look at the express term --  
 21 and I haven't covered it there -- you look at the  
 22 inference from the express terms, still at large, and  
 23 you think: well, how can they, at that third stage, if  
 24 it is sequential, have really left this out by accident  
 25 rather than by design?

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1 MR MARSHALL: Your Lordship said, "Absolute necessity",  
 2 I respectfully submit to Your Lordship that that is  
 3 putting it rather too high, because as Lord Neuberger --  
 4 MR JUSTICE HILDYARD: "Absolute necessity" in the Sumption  
 5 sense, to give coherence to the contract.  
 6 MR MARSHALL: To give coherence, yes.  
 7 MR JUSTICE HILDYARD: I only use that because one so easily  
 8 falls back into reasonableness.  
 9 MR MARSHALL: Yes.  
 10 MR JUSTICE HILDYARD: The constant refrain is you can't. At  
 11 least at the implication, you just can't.  
 12 MR MARSHALL: Yes. But, yes, I entirely accept  
 13 Your Lordship's --  
 14 MR JUSTICE HILDYARD: You don't urge me off Belize,  
 15 presumably? It just needs to be understood in the light  
 16 of the subsequent cases.  
 17 MR MARSHALL: Absolutely, my Lord, yes.  
 18 MR JUSTICE HILDYARD: You are a unitary man, aren't you?  
 19 MR MARSHALL: I am a unitary man, certainly. My Lord,  
 20 I don't urge Your Lordship off Belize, but Belize just  
 21 needs to be read the right way, and that is what  
 22 I believe Lord Neuberger was suggesting.  
 23 MR JUSTICE HILDYARD: Yes.  
 24 MR MARSHALL: My Lord, we have these three routes to the  
 25 conclusion, what we say the conclusion is -- whichever

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<p>1 one you take, and this is the last of it -- that the 2 obvious focus -- 3 MR JUSTICE HILDYARD: The most difficult -- 4 MR MARSHALL: -- was on the assets of the borrowing entity 5 and not with recourse to other persons within the group 6 via section 75, or indeed by other routes, like 7 indemnities and suretyships. 8 MR JUSTICE HILDYARD: Yes. The most difficult is the 9 Aberdeen City, isn't it, because a gap is one thing, but 10 curing (inaudible) bargains is another. 11 MR MARSHALL: Your Lordship has to, for that approach to 12 apply, Your Lordship is looking at the other provision 13 to see what the objective was. If one can see it 14 clearly enough Your Lordship can fill that gap, which is 15 what they did in that case. 16 My Lord, just a couple of other very short points 17 before we break, if I may. There was reference, 18 I think, in Mr Trower's skeleton argument to 19 Dairy Containers, which is a case to do with negotiable 20 contracts. This was relied upon to support the 21 proposition that you don't apply terms very readily. We 22 respectfully submit that is of no relevance. We are not 23 dealing with a negotiable contract. It is not some sort 24 of bond that was going to be traded around. Reliance 25 was also placed on the case of Mannai, and the</p> <p style="text-align: center;">Page 73</p>	<p>1 (1.03pm) 2 (The luncheon adjournment) 3 (2.05pm) 4 MR MARSHALL: My Lord, over the short adjournment those 5 behind me have been working industriously and have found 6 annex 5 to the council directive from 1993, which 7 I think is the one referred to by 8 Mr Justice David Richards, which then cross refers to 9 an earlier council directive of April 1989, which has 10 various definitions of what comprises own funds for the 11 purposes of the institutions that are regulated. Could 12 I hand up a copy of the relevant EU provisions. 13 (Handed) 14 MR JUSTICE HILDYARD: Thank you. 15 MR MARSHALL: I think Your Lordship will find the 1993 16 directive, annexe 5, is, I think, the penultimate 17 annexure and it cross refers, as Your Lordship will see, 18 in paragraph 2, sub-paragraph A, to: 19 "Own funds as defined in directive 89.299, excluding 20 certain items." 21 Then there is also reference to net trading book 22 profits, subordinated loan capital and liquid assets, 23 which are then defined, I think, on the following page. 24 (Pause) 25 MR JUSTICE HILDYARD: Yes.</p> <p style="text-align: center;">Page 75</p>
<p>1 observation of Lord Hoffmann that you can have some 2 agreements where certainty in terms of the meaning is 3 critical. Certainty is paramount. But the type of case 4 which is being considered there is where, for example, 5 you have a documentary credit which is going to be 6 presented to a third party, a bank, who then has to know 7 straight away with a high degree of clarity what has to 8 be done for payment to be made. We aren't in that 9 category either. There is no question of some third 10 party involvement, who doesn't know about the context of 11 the agreement, who has to look simply at the terms of 12 the document to work out what they have to do. It is 13 not that category of case. We respectfully submit 14 neither Dairy Containers nor Mannai provide 15 Your Lordship with any assistance. 16 The right approach is simply to apply the Marks and 17 Spencer principles, which have been set out by 18 Lord Neuberger. There is no reason to depart from the 19 approach that he has described as the correct approach 20 in this case. 21 My Lord, if that is a convenient moment, that is, 22 I think, the largely concluded issue 1. So I can move 23 on and I should certainly finish during the course of 24 this afternoon. 25 MR JUSTICE HILDYARD: 2.05.</p> <p style="text-align: center;">Page 74</p>	<p>1 MR MARSHALL: My Lord, the other council directive 2 of April 1989 has the definition of own funds in 3 Article 2. 4 MR JUSTICE HILDYARD: Yes. 5 MR MARSHALL: Then that has, in addition, on its list 6 something called: 7 "Other items within the meaning of Article 3." 8 Those are then set out on the following page. So: 9 "Items covering normal banking risks, whose 10 existence is disclosed on internal accounting records 11 and amount is determined by management of the credit 12 institution verified by auditors and made known to the 13 competent authorities." 14 Then there is also provision for securities of 15 indeterminate duration, which fulfil various criteria. 16 MR JUSTICE HILDYARD: Mm-hm. 17 MR MARSHALL: I think Your Lordship now has the relevant EU 18 materials. 19 My Lord, I wasn't proposing to say anything further 20 on the question of construction under issue 1. 21 In connection with the other issues which are 22 contentious, on issue 3, I adopt the submissions that 23 Your Lordship has had already from Mr Arden and 24 Mr Atherton, if the issue arises, which if we are 25 correct on issue 1 it doesn't, and if we are correct on</p> <p style="text-align: center;">Page 76</p>

<p>1 the rectification issue it doesn't as far as we are                  2 concerned. We would simply note that if those                  3 submissions are accepted on valuation, then any claim                  4 under the subordinated loan agreements would be                  5 extinguished by set-off as regards LBHI2, and there                  6 would not be anything left to claim over as against LBL.                  7 My Lord, as regards issue 7, which is the next one,                  8 we view that really as being in two parts, with parts of                  9 items (i) and (v) being considered together. (i) Was                  10 whether the obligations to contribute to the assets of                  11 LBIE were joint or several or otherwise, and (v) was                  12 whether the LBL administrators directed to assert less                  13 than 100 per cent of the contribution claim as against                  14 LBL or LBHI2 and, if so, what should the reduction be                  15 and what factors should be taken into account.                  16 My Lord, if we take that category first of all, our                  17 position on reflection is that whilst we accept that the                  18 jurisdiction exists to call for the full amount of the                  19 debt as against any member, irrespective of the size of                  20 shareholding, when it comes to actually making the                  21 decision to do that, to make a call under section 150,                  22 the court has a discretion and that discretion is not                  23 limited to just having regard to whether or not the                  24 relevant shareholder can pay or not, which is the                  25 particular factor averted to in decision 150.2.</p> <p style="text-align: center;">Page 77</p>	<p>1 down, again, to a single process.                  2 Now, looking at the authorities, there is no case,                  3 we submit, that is inconsistent with that approach. In                  4 the skeleton argument for Mr Trower, at paragraph 210,                  5 there is reference to a number of authorities beginning                  6 with re: Barnard's Banking Company, and then also to re:                  7 Cordova Union, and Helbert v Banner. They all, of                  8 course, emphasise that the process is for the benefit of                  9 creditors and that the court has to get on and see that                  10 creditors are paid. But, subject to that, if the                  11 process of calling in is going to achieve that                  12 objective, one can then take into account further                  13 factors which will make the process smoother, quicker                  14 and easier, which will include, where appropriate, to                  15 have regard to the size of shareholdings held and other                  16 factors, such as the nominee arrangements.                  17 If I could just go to the Helbert v Banner case,                  18 which I think is in bundle 1 of the authorities, at                  19 tab 22, what Your Lordship can see from the decision,                  20 particularly the passage that begins just about half way                  21 down, with reference to that part of the case. The                  22 emphasis is on the fact that the court is exercising                  23 a reasonable discretion and, in that particular case,                  24 the question is whether or not the court should make                  25 the call where there was a question over whether or not</p> <p style="text-align: center;">Page 79</p>
<p>1 My Lord, the rationale behind the reference to the                  2 ability to pay must be a practical consideration. There                  3 is no point in going through the process of seeking to                  4 call in money when it is, as a practical matter, not                  5 possible; one is simply going to waste time and effort                  6 by seeking to do so.                  7 If that is the rationale behind it, then one can                  8 foresee that there will be a number of other factors                  9 which may come into the court's consideration, which                  10 would have potentially the same effect. For example,                  11 why bother where both contributories are in funds but                  12 have very different sizes of shareholding and go through                  13 the process of making a call for the full amount as                  14 against each contributory, and then go through a further                  15 process of adjustment? One can simply save time and                  16 effort by making this a one stage process rather than                  17 a two stage process by basing the calls on the size of                  18 shareholding.                  19 Similarly, if one shareholder is simply holding that                  20 shareholder as a nominee on behalf of another, and that                  21 other is in funds, again, it in our submission makes                  22 more sense for the matters to be resolved in one court                  23 and in one process rather than two. Rather than having                  24 a call made on the shareholder who is holding as nominee                  25 and then them seeking to be indemnified, one can cut it</p> <p style="text-align: center;">Page 78</p>	<p>1 it was in fact necessary that there might in fact be                  2 other sources of payment. The observation is, from                  3 Lord Hatherley, the Lord Chancellor:                  4 "The court would in no case direct calls to be made                  5 if it was clear that there were assets actually in the                  6 possession of the liquidator which were sufficient for                  7 the payment of the debts."                  8 Then there was a question, really, of what level of                  9 proof was required for the court to be satisfied that it                  10 was appropriate for a call to be made given the question                  11 over whether or not the company would have funds                  12 available, itself, to meet the outstanding indebtedness.                  13 If it is a reasonable discretion of that kind, in our                  14 submission that sort of discretion is entirely                  15 consistent with the type of approach which I have                  16 indicated to Your Lordship can be properly taken. It is                  17 not surprising that Helbert v Banner and the other cases                  18 that have been referred to, like re: Cordova and                  19 Barnard's, have not referred to factors beyond the lack                  20 of assets to meet the relevant indebtedness, because                  21 most of these cases -- in fact I think in each one of                  22 these cases, the court was concerned with limited                  23 companies where the calls were tied only to the amount                  24 outstanding on the relevant debt, which certainly seems                  25 have been the case in Helbert v Banner, as one sees from</p> <p style="text-align: center;">Page 80</p>

<p>1 pages 29 to 30, where the shortfall on what had been 2 paid up is set out. 3 Here, one is of course dealing with an unlimited 4 company, and the sorts of factors that will come into 5 play, potentially, are more wide ranging, including 6 those which I have just indicated could potentially be 7 taken into account. 8 My Lord, we respectfully submit, although in theory 9 there is jurisdiction to make a call for the full 10 amount, a number of factors would come into play at the 11 point of the exercise of the discretion under 12 section 150. Not simply linked to the number of shares 13 held, but possibly also nominee arrangements and the 14 like. My Lord, as far as -- 15 MR JUSTICE HILDYARD: What proposition do I get from 16 Helbert v Banner, really? That was a case on, wasn't 17 it, as to whether the office holders had made sufficient 18 inquiries to bolster the affidavit which they had made 19 as to whether there was a deficiency. 20 MR MARSHALL: Yes. 21 MR JUSTICE HILDYARD: Beyond that, what do I get from it? 22 MR MARSHALL: Not much more than the fact that the court 23 clearly has -- well, as the expression is put: 24 a reasonable discretion. 25 MR JUSTICE HILDYARD: A reasonable discretion to accept or</p> <p style="text-align: center;">Page 81</p>	<p>1 adjust the position between the contributories where the 2 contribution, or adjustment, is required simply based on 3 the size of shareholdings. So taking account of 4 rateability. But where there is some independent right 5 between the members -- for example, a right to indemnity 6 because one is holding as nominee for another, so 7 indemnification on agency or trusteeship principles -- 8 it may be that is not capable of being dealt with by way 9 of the adjustment process, but that doesn't mean that 10 that right suddenly disappears. It still persists and 11 the right can still be asserted, and if the relevant 12 member, against whom the right exists, is in insolvency, 13 then it would be asserted, no doubt, as part of the 14 proofing process and appropriate set-off arrangements as 15 may be the case. 16 My Lord, two authorities, I think, are referred to 17 by Mr Trower to suggest that it is all really going to 18 be dealt with as part of an adjustment process and there 19 isn't any separate claim at that will be capable of 20 being advanced. 21 One of the main ones, I think, is the 22 Alexandra Palace case. We would respectfully submit 23 that one of the other authorities that has been referred 24 to, I think Overend &amp; Gurney, clearly anticipated that 25 there could be separate proceedings for an indemnity,</p> <p style="text-align: center;">Page 83</p>
<p>1 not the liquidator's say so? 2 MR MARSHALL: Well, I think it is expressed as being 3 a reasonable discretion under the provision as to 4 whether or not to make a call. It is page 34: 5 "As part of the exercise, reasonable discretion 6 would in no case direct the calls to be made if it was 7 clear that there were assets actually in the possession 8 of the liquidator." 9 If it has a reasonable discretion, in our 10 submission, it is not limited to just working out 11 whether the relevant member can pay or not. There is no 12 reason why one shouldn't take account of further 13 factors, which will mean that the whole process of 14 administration or winding up is carried out in a more 15 efficient manner, and having regard to the arrangements 16 between the various contributories. 17 My Lord, as regards the second aspect of issue 18 number 7, which is parts 2, 3 and 4, which is really 19 about entitlement to contribution or indemnity between 20 shareholders, and the extent to which any right or 21 contribution will be affected by other claims which 22 LBHI2 and LBL have against one and other, or against 23 other parties. We respectfully submit the right 24 approach to this is that, of course, the court has the 25 power of adjustment. That can properly be invoked to</p> <p style="text-align: center;">Page 82</p>	<p>1 independently of the call and adjustment process. There 2 is also nothing inconsistent with the existence of 3 a potentially independent process in the 4 Alexandra Palace case. 5 Overend &amp; Gurney, I think, is in the authorities 6 bundle, number 1, volume 1, at tab 19. If I can just go 7 first to that. 8 My Lord, this was a case in which there was 9 a contention that there ought to be a rectification of 10 the register on the basis that one of the shareholders 11 had in fact transferred shares away to another person. 12 Then there is a question of whether or not that transfer 13 had been completed, and could be the subject of some 14 form of order for specific performance. 15 Your Lordship will see one of the issues that arose 16 is described on page 202 of the report, in the fourth 17 paragraph down from the top of the page, where it is 18 recorded in the judgment of the Vice Chancellor that: 19 "It was contended by the counsel for Mr Hart there 20 was no contract between Messrs Musgrave and Mr Hart, but 21 Mr Hart intended to buy 30 shares in this company. It 22 was perfectly unimportant to him from whom he bought 23 them and the acceptance of the transfer from 24 Messrs Musgrave is in my opinion a conclusive permission 25 it was from them that the purchase was made and the</p> <p style="text-align: center;">Page 84</p>

<p>1 difference between that point is thus removed. The                  2 subsequent diminution in the value of the shares from                  3 a clause which both parties were in perfect ignorance at                  4 the time of the contract ...(reading to the words)...                  5 There was, therefore, I think, a binding contract                  6 between Messrs Musgrave and Mr Hart which I should have                  7 been bound to decrease specific performance if the case                  8 had been brought before me by a bill to enforce the                  9 contract."                  10 The court concluded there was a contract and could                  11 have been specifically performed had there been                  12 appropriate proceedings do it. What then happens is                  13 that the Vice Chancellor then goes on to consider                  14 whether all of this can be dealt with in the proceedings                  15 before him under one of the provisions of the 1862                  16 Companies Act.                  17 At page 204, he goes on to note that there were                  18 previous binding decisions in which there were opposing                  19 opinions. In particular, at the bottom of page 204,                  20 opposing opinions in the case of Ward v Henry's case.                  21 But then, at page 205, four lines down, he then                  22 says:                  23 "However, there is a later case of the greatest                  24 important which was not reported at the time of                  25 argument. I refer to Marino's case."</p> <p style="text-align: center;">Page 85</p>	<p>1 page 206, is that the Vice Chancellor, although finding                  2 it rather difficult to reconcile all of the decisions,                  3 comes to the conclusion that he is bound by the outcome                  4 in that case and he cannot order rectification of the                  5 register in the case before him, notwithstanding having                  6 concluded that there was a contract and in normal                  7 circumstances he would have ordered specific                  8 performance. So he concludes, I think, at the top of                  9 page 207, four lines down from the top:                  10 "Under these circumstances, I must reluctantly leave                  11 Messrs Musgrave to assert what remedies they have                  12 against Mr Hart by bill for a specific performance and                  13 indemnity or, as they may be advised, the present                  14 application must therefore be refused but considering                  15 the conduct of Mr Hart, it certainly must be so without                  16 costs."                  17 So that is the position that is arrived at in                  18 Overend &amp; Gurney, where the company had gone into                  19 liquidation and the question was rectification of                  20 register to alter the list of contributories. The                  21 conclusion is: can't alter the register, can't avoid you                  22 having a call made upon you, as a contributory, but you                  23 are still going to have your remedy for some form of                  24 contractual relief, whether for specific performance or                  25 damages in lieu, or compensation in lieu, as against the</p> <p style="text-align: center;">Page 87</p>
<p>1 And then he notes in that case:                  2 "Marino was registered shareholder of company and                  3 another party ...(reading to the words)... accepted the                  4 shares bought by the company and acted as agents on his                  5 behalf."                  6 He then goes on to describe further details of that                  7 case. At about ten lines up from the foot of page 205,                  8 he then notes:                  9 "There was therefore this defect, that while the                  10 transfer was executed by the seller and sent to the                  11 company for registration, it had not been executed by                  12 the purchaser."                  13 The case then came before the Court of Appeal. The                  14 conclusion of Lord Justice Turner was:                  15 "The respondent has to make out that the company was                  16 guilty of default in not taking his name off the                  17 register, although according to their ordinary practice,                  18 the name could not be taken off ...(reading to the                  19 words)... to deviate from the practice which they had                  20 always pursued."                  21 The conclusion, which appears about ten lines down                  22 from the top of the page, on page 206, is that Mr Marino                  23 had to continue upon the register and seek his remedy,                  24 if remedy he had, against Mr Issaverdens."                  25 The conclusion, after all that, at the bottom of</p> <p style="text-align: center;">Page 86</p>	<p>1 other party.                  2 We would respectfully submit that is entirely                  3 consistent with what you would expect. You still have                  4 your right. It may not be dealt with as part of the                  5 call process. It may not be dealt with as part of the                  6 adjustment process. It may not be capable of being                  7 dealt with as part of rectification of the register, but                  8 you still have a right which is then capable of being                  9 pressed. In the context of an insolvent respondent to                  10 the proceedings, would be dealt with, no doubt, by way                  11 of proof.                  12 My Lord, the Alexandra Palace decision, which                  13 I think is the one referred to in Mr Trower's skeleton                  14 argument, is also in bundle 1, at tab 40.                  15 The question that arose -- as one sees from the                  16 headnote -- is whether or not under the particular                  17 provision of the Companies Act, section 109, the 1862                  18 Companies Act, there was a possibility of adjusting                  19 rights which included equities between tortfeasors.                  20 There were some rights between the -- potentially rights                  21 between the contributories for contributions as joint                  22 tortfeasors. It is therefore focused simply upon the                  23 question of whether or not the adjustment process under                  24 the Act can take account of that sort of claim for                  25 contribution as a tortfeasor, a joint tortfeasor.</p> <p style="text-align: center;">Page 88</p>

<p>1 The conclusion is that it can't. There is no                  2 jurisdiction under the Act to deal with it as part of                  3 the adjustment process. That is from Mr Justice Fry's                  4 judgment, at page 300. Your Lordship sees what was                  5 trying to be asserted in, I think, the second paragraph                  6 down:                  7 "I do not find that I have any authority to make                  8 such an order for the purposes of working out such                  9 inequity between a tortfeasor to the company and                  10 creditors or contributories of the company."                  11 Then he addresses the question as to whether                  12 section 109 gave him the jurisdiction for the adjustment                  13 process. He concludes that it doesn't.                  14 At page 301, Your Lordship sees that he was purely                  15 focusing on whether he had the statutory jurisdiction                  16 and concluded that the statutory jurisdiction, among                  17 other things, wouldn't be appropriate because equities,                  18 of the sort that were raised, would need to be worked                  19 out by, potentially, other forms of proceedings. They                  20 wouldn't be convenient to be dealt with as part of the                  21 adjustment process in the winding up.                  22 That does not mean, however, that the right to                  23 contribution that existed then suddenly disappeared. It                  24 could still be asserted. It would just have to be dealt                  25 with by a more convenient and appropriate process. Of</p> <p style="text-align: center;">Page 89</p>	<p>1 this: in relation to an unlimited company, it is not                  2 clear how this would actually work prejudicially                  3 certainly as far as LBIE is concerned. Because if LBL                  4 was to make a claim as against LBHI2, and received any                  5 funds as a result of that, there could be a further call                  6 from LBIE, if necessary, as against LBL, assuming we are                  7 wrong in all of our other arguments about our defence to                  8 such a call, and any difficulty arising over double                  9 proof could be dealt with by the making of that further                  10 call.                  11 It is a similar explanation to the one that applies                  12 when considering the contributory rule in connection                  13 with an unlimited company. It is a point that is                  14 considered in the judgment of one of the members of the                  15 Court of Appeal in Black's case, which I think                  16 Your Lordship was taken to, which is in bundle 1 of the                  17 authorities, at tab 26.                  18 It is the judgment of Lord Justice Mellish, at                  19 page 265. He was really considering, specifically, the                  20 contributory rule here, but similar considerations, we                  21 submit, apply in connection with double proof as well.                  22 At 265, about eight lines down, there is a sentence                  23 beginning "although that section", and he is referring                  24 to section 101 of the 1862 Act:                  25 "Although that section does not in terms say that</p> <p style="text-align: center;">Page 91</p>
<p>1 course, if the respondent had been, itself, insolvent,                  2 by a proof in their bankruptcy, or whatever insolvency                  3 process was being undertaken.                  4 So, my Lord, that we submit is also the position                  5 here, in the sense that if there is a right of                  6 indemnity, for example, on the part of LBL, against                  7 other estates, irrespective of whether that can be dealt                  8 with as part of the adjustment process, the claim can                  9 still be made and it can still be proved for. If there                  10 is a right of set-off, or an appropriate set-off to be                  11 made in connection with it, then it will be dealt with                  12 as part of the set-off procedure. But, my Lord, the                  13 right to indemnity just doesn't disappear, it persists.                  14 My Lord, linked to issue 7 is issue 8, where it is                  15 said: well, if there is a right to claim contribution or                  16 indemnity against other contributories, then potentially                  17 the rule against double proof would come into play.                  18 That is the way it is put in paragraph 232 of                  19 Mr Trower's skeleton argument. Two rival claims are                  20 postulated as against LBHI2, for in substance the same                  21 debt. Their concern is raised, I think, in                  22 paragraph 222.1, that there would then be potential                  23 competition with the right to contribution made, or call                  24 for contribution made, by LBIE.                  25 My Lord, what we say in connection with that is</p> <p style="text-align: center;">Page 90</p>	<p>1 there is to be no set-off, it shows the legislature in                  2 framing that section the thought had already been                  3 enacted. There should be no set-off, because in the                  4 101st section they proceed to say: where there is                  5 unlimited liability in the case of any independent                  6 contract, there may be a set-off. The reasonable                  7 distinction between a company with unlimited and limited                  8 liability is obvious. In the case of ...(reading to the                  9 words)... is that it doesn't at all prejudice the rights                  10 of the other creditors, because all of the shareholders                  11 are liable to the fullest amount of everything they                  12 possess. Therefore, if that call does not pay the                  13 creditors all their debts, in the case of an unlimited                  14 company, then another call may be made on the                  15 shareholders, including this particular shareholder, and                  16 so on, until the shareholders have been made to pay                  17 everything they can pay and the debt has been                  18 satisfied."                  19 So issues over set-off, and what would normally be                  20 classified as the contributory rule, don't apply, in our                  21 submission, in quite the same way when dealing with an                  22 unlimited company. We would respectfully submit that                  23 the same goes for double proof considerations, because                  24 if there is a proof which ends up being a competing one                  25 from LBL, any money recovered from that proof, if there</p> <p style="text-align: center;">Page 92</p>

<p>1 is still a shortfall at LBIE, they can make a further 2 call as against LBL to recover.</p> <p>3 When one looks at the authorities that have been 4 cited in connection with issue 8, in the LBIE skeleton 5 argument, they all appear to be cases where the double 6 proof doctrine has been applied in connection with 7 a limited liability company, not an unlimited company.</p> <p>8 My Lord, that then leads on to the last, well, one 9 of the last, of the contentious issues involving our 10 side, which is issue 9A, the preliminary issue to issue 11 9, which concerns whether you can have an agreement 12 between a member and the company which enables the 13 member to avoid liability under section 74.</p> <p>14 In this context, it would seem the only agreement we 15 are really concerned with is in fact the recharge 16 agreement, which we are contending existed and which had 17 been in place for some time prior to LBL's involvement 18 with LBIE, and in particular prior to it having a share. 19 That recharge agreement, we contend, had a much wider 20 potential area of coverage. It is covering a number of 21 different services being provided for the Lehman Group, 22 and which was never entered into, of course, for the 23 purposes of avoiding the effect of section 74.</p> <p>24 Now, we contend that such an agreement, if it does 25 have the effect of negating a call by virtue of the</p> <p style="text-align: center;">Page 93</p>	<p>1 which gives one creditor more than its proper share.</p> <p>2 My Lord, it is also then noted that, I think at 3 paragraph 9 of Lord Collins' judgment, at page 398, that 4 the distinction between the two sub-rules is by no means 5 clear cut. He gives, as an example, the case of ex 6 parte McKay.</p> <p>7 Then notes, at page 400, paragraph 14, that it 8 doesn't follow from the fact that it is difficult in 9 some cases to draw the line between the two categories, 10 that there aren't relevant differences. He goes on to 11 describe:</p> <p>12 "The anti-deprivation rule applies only if the 13 deprivation is triggered by bankruptcy and has the 14 effect of depriving the debtor of property which would 15 otherwise be available to creditors, the pari passu rule 16 applies irrespective of whether bankruptcy or 17 liquidation is the trigger. There is a question of 18 whether the bone fides of the parties are equally 19 relevant to the application of the two principles."</p> <p>20 He then goes on to consider that. Your Lordship 21 will see that then dealt with, at page 413, paragraph 75 22 where he considers the limits of the anti-deprivation 23 rule. At paragraph 75, just beside letter G, on 24 page 413, he explains that the anti-deprivation rule had 25 been based on the notion of fraud or a direct fraud on</p> <p style="text-align: center;">Page 95</p>
<p>1 right to then seek indemnification from LBIE and 2 creating a defence of circuity of action, or set-off, 3 doesn't offend public policy and that is essentially for 4 three reasons. Whilst it is correct that there is 5 a general principle that you can't contract out of the 6 insolvency legislation, it is not the case that 7 principle is applied in precisely the same way in all of 8 the circumstances covered by it, and one can see that 9 from the Belmont Park Investments decision, which 10 Your Lordship was, I think, taken to last week, which is 11 in bundle 3 of the authorities, at tab 85. If one takes 12 it up in the judgment of Lord Collins, which is at 13 page 396, Your Lordship, I think, was taken to this 14 passage previously.</p> <p>15 Your Lordship will have seen that the 16 anti-deprivation rule, and the rule that it is contrary 17 to public policy to contract out of pari passu 18 distribution are two sub-rules of the general principle: 19 you can't contract out of the insolvency legislation.</p> <p>20 It is noted that there is some overlap, but they are 21 directed fundamentally at different situations; 22 anti-deprivation being aimed at attempts to withdraw 23 assets from bankruptcy liquidation; the pari passu rule 24 reflecting the principle that statutory principles for 25 pro rata distribution may not be extended by a contract,</p> <p style="text-align: center;">Page 94</p>	<p>1 the bankruptcy laws. At letter H, he then says:</p> <p>2 "The overall effect of the authorities is that where 3 the anti-deprivation rule has applied, it has been an 4 almost invariably expressed element that the party 5 seeking to take advantage of the deprivation was 6 intending to evade the bankruptcy rules. But where it 7 is not applied, the good faith or the commercial sense 8 of the transaction has been a substantial factor. By 9 contrast, the leading pari passu principle case, British 10 Eagle, it didn't matter whether there was a sensible 11 commercial arrangement not intended to circumvent the 12 pari passu principle."</p> <p>13 My Lord, there is then a conclusory section, at 14 page 421, where, firstly, in paragraph 102, the 15 anti-deprivation rule is treated as too well established 16 to discard. Then, at paragraph 103, he goes on to say 17 this:</p> <p>18 "As has been seen, commercial sense and absence of 19 intention to evade insolvency laws have been highly 20 relevant factors in the application of the 21 anti-deprivation rule, despite statutory inroads party 22 autonomy is at the heart of English commercial law. 23 Plainly, there are limits to party autonomy in the field 24 with which this field is concerned, not least because 25 the interests of third party creditors will be involved.</p> <p style="text-align: center;">Page 96</p>



<p>1 But, as Lord Neuberger stressed, it is desirable that                  2 insofar as possible the courts give effect to                  3 contractual terms which parties have agreed and there is                  4 a particularly strong case for autonomy in cases of                  5 complex financial instruments, such as those involved in                  6 this appeal. No doubt that is why, except in the case                  7 of a blatant attempt to deprive a party of property in                  8 the event of liquidation, the modern tendency has been                  9 to uphold commercially justifiable contractual                  10 provisions which have been said to offend the                  11 anti-deprivation rule."</p> <p>12 He then goes on to explain the policy behind the                  13 anti-deprivation rule being clear, and:                  14 "It is possible to give that policy a commonsense                  15 application which prevents its application to bone fide                  16 commercial transactions which do not have as their                  17 predominant purpose, or one of their main purposes, the                  18 deprivation of the property of one of the parties to the                  19 bankruptcy."</p> <p>20 My Lord, in the present case, we respectfully submit                  21 we are not concerned with the pari passu rule. We are                  22 concerned with a statutory provision for a call which,                  23 on one analysis, that of Lord Justice Briggs, is                  24 an asset of the company.                  25 On another analysis, that of Lord Justice Lewison,</p> <p style="text-align: center;">Page 97</p>	<p>1 My Lord, we would respectfully submit that the                  2 conclusory comments of Lord Collins in Belmont ought to                  3 be applied and ought to be the approach which the court                  4 adopts in connection with the recharge agreement. The                  5 commercial arrangement should be respected, given the                  6 absence of any objective other than a perfectly                  7 appropriate commercial objective, which does not have                  8 any connection with an attempt to undermine the effect                  9 of the insolvency legislation. Its effect insofar as it                  10 has deprived LBIE of an asset or a right of recourse is                  11 purely incidental to the overall arrangement which was                  12 entered into at a much earlier stage between the                  13 relevant parties. Perhaps that could be said to be                  14 reinforced by the fact that the effect of the                  15 arrangement is to bring about a result that could have                  16 been achieved directly by making appropriate provision                  17 in the contracts that LBIE issued, in which case                  18 section 72.4(e) could have been used directly, but the                  19 effect is one which has been able to be achieved                  20 indirectly.</p> <p>21 Now, my Lord, I think a number of points were made                  22 about the fact that there are older authorities                  23 suggesting that any attempts to issue shares at                  24 a discount is inconsistent with the insolvency                  25 legislation and can't be allowed, is not possible. In</p> <p style="text-align: center;">Page 99</p>
<p>1 although not an asset, is certainly a resource from                  2 which debts can be paid. Whichever way one categorises                  3 it, a contract, such as the recharge agreement, is one                  4 which deprives LBIE of the ability to exercise the right                  5 to call and, in our submission, is very closely                  6 analogous to, or indeed may properly be categorised as                  7 falling within, the anti-deprivation rule or something                  8 very close to it. Its effect is either to deprive LBIE                  9 of the asset, adopting Lord Justice Briggs' approach, or                  10 negates the ability to revert to that form of resource                  11 if one approaches it from Lord Justice Lewison's                  12 perspective.</p> <p>13 Looked at in that way, and if that is the right way                  14 to analyse it, what one is looking for is, first of all,                  15 a lack of good faith that, if you like, a nefarious                  16 intent in terms of the agreement. Was it designed to                  17 deprive LBIE of that ability? Was that the intention                  18 behind it when it was set-up?</p> <p>19 Secondly, also, if it is within the anti-deprivation                  20 rule, it has to be a right which is only triggered upon                  21 insolvency and doesn't apply outside of insolvency.</p> <p>22 In our submission, one can categorise the recharge                  23 agreement as falling within either of those two                  24 conditions for the application of that rule or anything                  25 analogous to it.</p> <p style="text-align: center;">Page 98</p>	<p>1 particular, I think reliance is also placed upon                  2 Welton v Saffery for the proposition that it doesn't                  3 matter whether there was any form of nefarious intent                  4 when setting up such arrangements. It is enough that                  5 they are simply inconsistent with the statutory                  6 provisions for shares to be fully paid up.</p> <p>7 My Lord, we contend that in those cases, in                  8 particular Welton v Saffery, are focusing, really, upon                  9 the power, the authority, to issue shares granted by the                  10 memorandum articles which are the ones that then have to                  11 comply with the statutory requirements. There wasn't                  12 authority in Welton v Saffery for shares to be issued in                  13 the form in which they were. So it ultimately ended up                  14 being a sort of ultra vires point, as opposed to                  15 a question of whether or not there was a contravention                  16 of public policy.</p> <p>17 My Lord, if I can just take Your Lordship to the                  18 Welton v Saffery case. It is in volume 2 of the                  19 authorities, tab 50. I think the relevant passage that                  20 is relied upon is at pages 304 to 305, and the argument                  21 was whether the previous case, the Ooregum case, could                  22 apply where there was a call simply to settle the rights                  23 of shareholders interse. That is recorded in the                  24 judgment of Lord Halsbury, at page 304, in the first                  25 paragraph.</p> <p style="text-align: center;">Page 100</p>

<p>1 He then goes on, in the second paragraph, at the 2 foot of page 304, to say that he thinks: 3 "The legislator, in permitting the existence of 4 a company limited by shares and with limited liability, 5 created a machinery which makes it impossible by any 6 expedient, either by company or shareholder, to act 7 otherwise than in pursuance of provision of the statute, 8 whether for the purposes of settling the rights interse 9 or for the purposes of satisfying creditors." 10 He then expresses a view as to what the decision in 11 Ooregum established: 12 "Unable to see how this artificial feature limited 13 within its sphere of action by the statute under which 14 it was created can do anything contrary to the 15 provisions of the statute is not a question for what 16 purpose it is done, dealing with it, as I think it must 17 be dealt with, as an artificial creation, it can only 18 act as a company or a shareholder in either of those 19 characters within the fetters created by the Act of 20 Parliament." 21 He then goes on to say: 22 "It is said and I think justly said that people have 23 been invited to take shares under the article of 24 association which expressly provided that shares might 25 be issued at a discount. It is I think hard for persons</p> <p style="text-align: center;">Page 101</p>	<p>1 contrary to the statutory objective. 2 In our submission, the cases that are referred to in 3 this section would be consistent with an approach which 4 categorised an attempt to evade, a deliberate attempt to 5 evade, the effect of the insolvency provisions as being 6 prohibited; that would be consistent with an application 7 of something similar to the anti-deprivation rule, as 8 opposed to a rule similar to the pari passu rule, where 9 no nefarious intent is required. 10 So, my Lord, in summary, we respectfully submit that 11 the recharge agreement is not contrary to public policy 12 per se. It would require establishing some form of 13 intent, on the part of those who entered into it, to act 14 contrary to the insolvency provisions before it could be 15 said to be unenforceable in any relevant respect. If we 16 are correct, that it is something that has to be looked 17 at by reference to the anti-deprivation doctrine, or 18 something akin to it, one would need to see, also, that 19 it was triggered by or intended to be triggered by 20 insolvency, which it clearly is not, it is something 21 that applied outside of that context. For those 22 reasons, it is not defeated simply because it may 23 incidentally result in a scenario whereby a call is made 24 under section 74, there may be a right of recourse back 25 again to LBIE because of its provisions.</p> <p style="text-align: center;">Page 103</p>
<p>1 who have relied upon that assurance to find out that the 2 Article which authorised the issue of the shares at the 3 discount was ultra vires of the company, because it is 4 in conflict with the memorandum of association by which 5 the statute itself that must determine the rights in 6 that respect." 7 It is evident, from the way that this analysis 8 works, that it is a question of the power of the company 9 to issue shares at a discount. His conclusion is 10 because of the way in which the company is set-up, as 11 a statutory creature, the memorandum is subject to the 12 statutory requirements, there wasn't the power to issue 13 shares in the form in which it was done. 14 My Lord, many of the other cases that concern 15 actions inconsistent with the statutory regime are ones 16 where one can see some form of nefarious intent has been 17 established. If one takes as an example of authorities 18 referred to, I think, in Mr Trower's skeleton argument, 19 at paragraph 275, this is on page 83. Your Lordship 20 will see reference at 275.1 to Booth v Pollard, and 21 there Your Lordship will see the focus is upon whether 22 there is a contrivance, an evasion of the statute, and 23 there is a discussion then about the provisions of 24 an Act of Parliament being evaded by shift or 25 contrivance. All indicative of an intent which is</p> <p style="text-align: center;">Page 102</p>	<p>1 My Lord, I think that largely dealt with the issues 2 which were the key ones for me to address. I think 3 there are also potentially issues raised in connection 4 with issue 10. But, my Lord, I think our position is 5 issue 10 was that that would not arise as a practical 6 issue because of either our arguments under issue 1, the 7 circuitry of action defence, or alternatively the correct 8 contractual interpretation, or as a result of the effect 9 of the rules on set-off. But this is in connection with 10 whether the recharge claim against LBIE in respect of 11 the sub-debt contribution claim and LBHI2's claim in 12 respect of the sub-debt are to be paid pari passu and, 13 if not, in what order of priority. 14 I think the main points made here are in relation to 15 the possibility, effectively, of a double proof in 16 respect of the same obligation. Our answer to that 17 is: if we are correct in our contentions as to how the 18 sub-debt works, we won't get to this scenario at all. 19 One way or another, it would be dealt with without their 20 being proof from our side, as well as that from LBHI2. 21 It is an entirely academic issue. 22 My Lord, as regards the agreed issues, I just wanted 23 to indicate to Your Lordship which of those we saw as 24 being potentially affected by the outcome in the Supreme 25 Court.</p> <p style="text-align: center;">Page 104</p>

<p>1 I think our position was that -- I will just find my 2 note in connection with it -- issue 1 potentially would 3 be affected by the Supreme Court's judgment to the 4 extent that it concerned the sub-debt and its 5 construction. 6 In terms of the agreed issues, we don't consider 7 that issues 5, 6 and 12 were likely to be affected by 8 the Supreme Court judgment, because the court wasn't 9 considering the position as between multiple 10 administrations but only the position in LBIE's 11 administration. But it does seem that the judgment 12 would impact on issue 2, because the ranking and 13 provability of the sub-debt are in issue, together with 14 the question of whether it may be included in the 15 insolvency set-off account. Similarly, those issues 16 might impact on issue 4, which concerns the availability 17 of the sub-debt or a sub-debt contribution claim for the 18 purposes of set-off. 19 My Lord, as far as the remaining issues are 20 concerned, issue 3 might be impacted if the Supreme 21 Court ventured into the issue of the valuation. 22 MR JUSTICE HILDYARD: If what? 23 MR MARSHALL: Issue 7 might be affected as well. Issue 3 24 might be impacted if the Supreme Court enters into the 25 issue of valuation. Issue 7 might be affected by any</p> <p style="text-align: center;">Page 105</p>	<p>1 MR MARSHALL: My Lord, I am just going to say that subject 2 to anything Your Lordship wanted to ask me, that does 3 conclude our submissions. 4 Mr Trower and I have discussed the question of 5 replies, and I think he is going to address 6 Your Lordship. 7 MR JUSTICE HILDYARD: Can I ask you something on the 8 circuitry of action? 9 MR MARSHALL: Yes, of course. 10 MR JUSTICE HILDYARD: The facts of the cases are not easy to 11 always to see clearly -- 12 MR MARSHALL: Yes. 13 MR JUSTICE HILDYARD: -- and I must look at them. But is 14 there any case, on which you rely, where the circuitry 15 did not depend on there being an equal and opposite 16 contractual indemnity in respect of the same amount? 17 MR MARSHALL: I think the ones that I have taken 18 Your Lordship to were ones in which there was 19 a contractual indemnity, but there are more cases which 20 we can consider. 21 I am just trying to remember. The Post Office case, 22 my Lord, the one about the telephone line. 23 MR JUSTICE HILDYARD: Yes. 24 MR MARSHALL: That was a tortious claim for 25 misrepresentation by the relevant telephone company to</p> <p style="text-align: center;">Page 107</p>
<p>1 determinations as to the scope of the section 74 2 liability and is operation. Issue 8 might be affected 3 by the Supreme Court's determination as to the 4 application of the contributory rule. We don't see any 5 likely impact from the Supreme Court on issue 9A or 10. 6 My Lord, that might be a convenient moment to break. 7 I can obviously just check whether there is anything 8 else for me to add, but I think we have pretty much come 9 to the end of our submissions. 10 MR JUSTICE HILDYARD: Have you all been discussing how we 11 should carry forward matters, both as regards the agreed 12 issues and as regard any replies? 13 MR MARSHALL: Briefly, but perhaps we can use the 14 opportunity of the short break to discuss it a little 15 further as to the right way forward. There was some 16 discussion about whether or not a break was still needed 17 and, if so, how much of a break. But perhaps I can 18 discuss that further with Mr Trower. 19 MR JUSTICE HILDYARD: Shall we take ten minutes now and then 20 you can report provisionally and we can work out how it 21 goes ahead? 22 MR MARSHALL: Yes, indeed. 23 (3.14pm) 24 (A short break) 25 (3.28pm)</p> <p style="text-align: center;">Page 106</p>	<p>1 the local authority -- the Post Office to the local 2 authority, which would have given the right to 3 compensation for the same amount that the local 4 authority was liable to the Post Office for, for 5 damaging their line. So that would be an example of 6 a non-contractual claim going in the other direction, 7 but they are generally cases about the same amount. 8 MR JUSTICE HILDYARD: I mean, they are the same claim. I am 9 grateful to you for pointing out that the Post Office is 10 the same claim in a different direction as regards 11 tortious basis of liability. 12 MR MARSHALL: Yes. 13 MR JUSTICE HILDYARD: That is helpful. It is not 14 a principle which has seen the light of day all that 15 often, as far as I can see. 16 MR MARSHALL: Yes. 17 MR JUSTICE HILDYARD: You have to stretch fairly hard to 18 find it. It is not the worse for that, but it does seem 19 to be confined when the court can say, "Well, look, come 20 on, you are simply saying on the one hand something 21 which on the other hand is going to result in an equal 22 and opposite amount. Therefore, we are not going to 23 have this moot about the whole thing". 24 MR MARSHALL: Yes. My Lord, it is right to say that the 25 cases have been considering claims which are directly</p> <p style="text-align: center;">Page 108</p>

<p>1 comparable in terms of the quantification. That is 2 certainly true. 3 MR JUSTICE HILDYARD: Yes. 4 MR MARSHALL: But the basis on which the claim may come back 5 need not necessarily be contractual, it would appear. 6 MR JUSTICE HILDYARD: No. There is either a contract or 7 some equal and opposite fault. 8 MR MARSHALL: Yes. 9 MR JUSTICE HILDYARD: Whereas one might think that the calls 10 on an unlimited share are simply a contractual matter. 11 They may or may not be confined to the particular 12 exposure. Mr Trower says they are not, you say all but 13 a penny or two they are, but they do seem rather 14 different in source; do you want to respond to that? 15 MR MARSHALL: Well, my Lord, fundamentally, if there is 16 a call made to meet this sub-debt, then necessarily its 17 quantification is based on the subordinated debt 18 agreement and, therefore, there is a right to recover 19 for precisely the same amount, but one can't see why, in 20 principle, that shouldn't come within the doctrine. 21 No one has suggested on any of the authorities, 22 including the Supreme Court decision advanced, that it 23 has to be a fault based claim going back for -- 24 MR JUSTICE HILDYARD: That case was a contractual indemnity. 25 MR MARSHALL: That was for contractual indemnity.</p> <p style="text-align: center;">Page 109</p>	<p>1 Court. But they may, we accept that. 2 We don't think, for our part, that any of the other 3 issues will be. 4 I think everyone is of the same mind in relation to 5 all of the other issues, apart from 7. I think there is 6 a slight divergence of view between counsel as to 7 whether there is any possibility of 7 being affected. 8 We don't see it ourselves at the moment, but that is one 9 of the things that we will think about before I do my 10 reply, now I know which area there is a little bit of 11 divergence of view in relation to the impact. I think 12 it is only issue 7. 13 My Lord, that is the position as far as the Supreme 14 Court is concerned. 15 My Lord, as far as replies are concerned, we have 16 discussed it. I think where we are is this: I think we 17 are all agreed that we should go back down the line, by 18 which I mean in the reverse order for the way we did 19 submissions first time round. With me finishing with 20 the last of the replies of right. Of course we accept 21 that if anyone raises new points, or new cases in their 22 replies, Mr Marshall will then have a go at the end, 23 insofar as, in accordance with normal practice. But, 24 otherwise, that is the way we think it will work. 25 We would respectfully suggest that we rise for a day</p> <p style="text-align: center;">Page 111</p>
<p>1 MR JUSTICE HILDYARD: That was a moot, on analysis. 2 MR MARSHALL: Yes. 3 MR JUSTICE HILDYARD: Yes. Well, if anyone knows of a case 4 which is not an equal and opposite claim, that would be 5 helpful. 6 MR MARSHALL: Of course, we will look for that, check that. 7 HOUSEKEEPING 8 MR TROWER: My Lord, we will also do a bit more work on that 9 as well. 10 MR JUSTICE HILDYARD: Yes. 11 MR TROWER: My Lord, just so I can tell Your Lordship where 12 we are we all are, first, so far as the Supreme Court is 13 concerned. First of all, we did make a further inquiry 14 this morning. We have been regularly inquiring and they 15 are probably bored of us asking, and I am afraid the 16 answer remains: they simply don't know and won't tell 17 us. Can't tell us, perhaps, but that is the position. 18 MR JUSTICE HILDYARD: Yes. 19 MR TROWER: The second point is: so far as the issues are 20 concerned, we agree with Mr Marshall that it is possible 21 that issues 1, 2, 3 and 4 may be impacted, although it 22 is very difficult to know to what extent. There are any 23 number of different ways of analysing the issues leading 24 to a conclusion that they might be impacted, and they 25 may well not be, whatever the result in the Supreme</p> <p style="text-align: center;">Page 110</p>	<p>1 and sit again on Wednesday morning to do the replies. 2 We are all confident we can get the replies dealt with 3 in a day. The great advantage of that is that it will 4 give us time to give Your Lordship, I hope, a little bit 5 more assistance in the way in which the issues actually 6 all do inter mesh in the light of the way the arguments 7 have gone. Subject to the court, we think that it will 8 make our replies crisper and more effective, if we can 9 do it that way. 10 So, unless there was anything else, I think that was 11 where we all were as to how we should take matters 12 forward, but we should invite Your Lordship to adjourn 13 now until 10.30 on Wednesday, when we will do the 14 replies in that way. It may also assist Your Lordship 15 in identifying those areas which you want to 16 cross-examine us a bit harder on. 17 MR JUSTICE HILDYARD: Are you each proposing to have 18 merely -- I don't mean that rudely -- oral replies, or 19 are you envisaging that there will be any written 20 replies? 21 MR TROWER: My Lord, I think there will be one or two aids 22 that Your Lordship will get. 23 MR JUSTICE HILDYARD: Yes. 24 MR TROWER: We weren't envisaging a full speaking note in 25 writing.</p> <p style="text-align: center;">Page 112</p>

1 MR JUSTICE HILDYARD: No.  
 2 MR TROWER: But there certainly will be aids to the reply,  
 3 I am sure. I think Mr Atherton mentioned to me that he  
 4 is thinking of one. We have, certainly, one in mind,  
 5 which will help Your Lordship I hope, on paper. I mean,  
 6 we are obviously very much in Your Lordship's hands as  
 7 to what else Your Lordship would find helpful. If you  
 8 would like more in writing. I can't promise a full  
 9 reply by Wednesday morning, though, in writing.  
 10 MR JUSTICE HILDYARD: No, no, I was just wondering about the  
 11 timing. It is a matter for you, really. I am not going  
 12 to direct --  
 13 MR TROWER: Yes.  
 14 MR JUSTICE HILDYARD: -- a written reply, especially as we  
 15 have a transcript at the end of the day.  
 16 MR TROWER: I mean, hopefully the transcript will read like  
 17 a written reply in any event if we get until Wednesday  
 18 to refine it.  
 19 MR JUSTICE HILDYARD: I am sure it will.  
 20 You are quite right in identifying that I am still  
 21 uncertain how all of the issues actually click together.  
 22 MR TROWER: Yes.  
 23 MR JUSTICE HILDYARD: And in some cases I am not clear where  
 24 the distinguishing lines are. For example, Mr Marshall,  
 25 between the deprivation and the pari passu, I was not

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1 absolutely clear where you say the line is drawn and why  
 2 you fall one side of it, which isn't really a matter for  
 3 reply but I dare say will be an issue raised by  
 4 Mr Trower.  
 5 MR TROWER: I think Your Lordship can rest assured that  
 6 I will certainly have something to say about that.  
 7 MR JUSTICE HILDYARD: Yes.  
 8 MR TROWER: I quite appreciate you might not feel you have  
 9 got everything you need.  
 10 MR JUSTICE HILDYARD: Well, I think I am going to leave it  
 11 and think if I have any particular questions, then I may  
 12 step out of the orderly sequence of reply, and in order  
 13 to just arm myself as best I can.  
 14 MR TROWER: Yes.  
 15 MR JUSTICE HILDYARD: I think if you can reach agreement,  
 16 possibly even commit to paper where you think and why  
 17 the issues that we are dealing with, especially 1 to 4,  
 18 possibly 7, are impacted or could be impacted by the  
 19 Supreme Court that would be an useful aide-memoire to  
 20 have.  
 21 MR TROWER: Yes.  
 22 MR JUSTICE HILDYARD: If on the other hand time gets away  
 23 from you and you have to deal with it orally by  
 24 agreement, that is fine, but I think I ought to have  
 25 somewhere on the record where it will be or could be

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1 impacted.  
 2 MR TROWER: Yes. Your Lordship may recall that at the PTR  
 3 we did actually say in our skeleton argument, I think  
 4 I addressed you on it as well, we would actually invite  
 5 Your Lordship not to give judgment until the Supreme  
 6 Court --  
 7 MR JUSTICE HILDYARD: Well, yes, that would be a welcome  
 8 excuse. The trouble is that the problem is once it all  
 9 goes away, you tend, such hard disk as you have, it just  
 10 gets written over by some other matter. So the more  
 11 I can -- and it is the reason why, by way of  
 12 explanation, if it is not already obvious, I intervene,  
 13 usually it is to remind myself of the question, as well  
 14 as to obtain your answer to it. That is the problem,  
 15 sometimes.  
 16 MR TROWER: Yes.  
 17 MR JUSTICE HILDYARD: Very well. Well, if Wednesday suits  
 18 you all. I would be prepared to give you longer if you  
 19 wished it, but it may not be necessary and you have  
 20 other things to do. If Wednesday is the sort of golden  
 21 space that enables you all to hone your submissions to  
 22 the maximum, well and good. We will do that and we will  
 23 be confident, you say, of getting it over with in a day.  
 24 MR TROWER: Yes.  
 25 MR JUSTICE HILDYARD: I will inform listing accordingly.

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1 On 1B there may be one slight glitch. Sorry, part  
 2 B. There may be some glitch in the timetable since  
 3 I have made a commitment which is in my interests to  
 4 honour, which I had forgotten and so I will let you know  
 5 that at the end of Wednesday, if you could let me know.  
 6 I am going to take a Friday towards the end of September  
 7 out of the schedule.  
 8 MR TROWER: Okay.  
 9 MR JUSTICE HILDYARD: Good, well, thank you. I look forward  
 10 to the reply.  
 11 (3.40 pm)  
 12 (the hearing adjourned until Wednesday, 8 February 2017)  
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 14  
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