Monday, 6 February 2017
(10.30 am)
Submissions by MR MARSHALL (continued)
MR MARSHALL: My Lord, I think we finished on Friday on the subject of interpretation of express terms in the subordinated loan agreements, and focusing in particular on the provisions for repayment and payment that contained.
My Lord, I gave your Lordship the well established formulation as to the correct approach to contractual interpretation derived from Investors Compensation Scheme v West Bromwich Building Society. Could I just, before embarking on the materials showing the become ground, the relevant background that we say is relevant --
MR JUSTICE HILDYARD: The background to what?
MR MARSHALL: I am sorry, my Lord?
MR JUSTICE HILDYARD: I didn't quite catch that phrase.
MR MARSHALL: Before we get into the materials regarding the background that we rely upon, could I just show your Lordship one or two further points that are derived from the Supreme Court, or House of Lords, authorities.
First of all, three points derived from Chartbrook, if I could ask your Lordship to look at that. That is in authorities bundle volume 3, tab 80. If I could go

to the speech of Lord Hoffmann, your Lordship will see the formulation derived from investors compensation scheme at the top of page 1112, paragraph 14. In particular, at letter B.
MR JUSTICE HILDYARD: Mm-hm.
MR MARSHALL: After setting that out, just one or two other points that one can see from the decision.
Firstly, on page 113, at letter H, his Lordship drew attention to the fact that you may have to use additional language in the course of interpreting the agreement to get to the outcome. If you like, the amount of red ink that you have to use isn't something that should affect the approach or deter the court from adopting the construction advocated. Your Lordship will see, just below letter H, he said that:
"I do not think that it is necessary to undertake the exercise of comparing this language with that of the definition in order to see how much use of red ink is involved. When the language used in an instrument gives rise to difficulties of construction, the process of interpretation does not require one to formulate some alternative form of words, which approximates as closely as possible to that of the parties."
Then your Lordship will see he goes over the page in saying:

"It is to decide what a reasonable person would have understood the parties to have meant by using the language which they did."
He then gives some examples from the Mannai Investment case and also Investors Compensation Scheme Limited itself, where rather different language to that appearing on the contract was ultimately the meaning that the court came to conclude was the intention of the parties.
So the amount of red ink that one has to use doesn't necessarily matter.
The second point from the case is concerning whether or not one needs to find some sort of ambiguity in order to have regard to the relevant context or background. His Lordship deals with that at page 1118, at letter E, to 1119, just below letter B. Could I invite your Lordship to just read those passages. It is effectively paragraphs 36 and 37.
(Pause)
MR JUSTICE HILDYARD: Yes.
MR MARSHALL: I am grateful. So ambiguity not needed to go to the background, we submit, in the light of that.
Then the third point which we draw attention to is on page 1120, which concerns the issue of an agreement which is capable of assignment. What is the position

then, given that possibly another party may come in as an assignee and they might not know of the relevant specific background to the contract's original negotiation and formulation. His Lordship addresses that on page 1120, in paragraph 40. Again, perhaps if I can invite your Lordship to read that paragraph.
(Pause)
MR JUSTICE HILDYARD: Yes.
MR MARSHALL: So, my Lord, we respectfully submit that may well be important when we come to consider Mr Trower's case on the permissibility of considering the specific context of this subordinated loan agreement, given the provisions for assignment with the consent of the FSA. We will respectfully submit, in the light of the guidance provided by Lord Hoffmann there, that is not a factor that would prohibit reference to the specific background to the origination of the subordinated loan agreements as between the LBHI2 and the FSA and LBIE.
In particular, we will be submitting to your Lordship that if there were to be any assignments of the subordinated loan agreements, realistically it was going to be within the Lehman Group and any potential assignee would be well aware, or had readily available to them, the particular background that had led to their formulation.

MR JUSTICE HILDYARD: Is that a fact? That it would be within the Lehman Group?
MR MARSHALL: We submit when you see the materials which I will take to you shortly --
MR JUSTICE HILDYARD: Yes.
MR MARSHALL: -- your Lordship will see how the whole thing came about through a restructuring.
MR JUSTICE HILDYARD: Yes.
MR MARSHALL: Given that, given the reasons for that restructuring, how it all happened, we would submit that it is highly unlikely, when one has seen all of that, that all of that was going to be undone with the subordinated loan agreements then being assigned out of the Lehman Group to some totally independent third party. We would respectfully submit that this is a very, very unlikely scenario and we submit it is much more likely any assignee would have been within the group and therefore very much aware of how the agreements were formulated and organised; bearing in mind -- as your Lordship will see when we come to the documents -- this was all done in a central way. There was a centralised process here for the whole group, with the FSA and Revenue, and it was all done by a department which was representing everyone within the Lehman UK Group at the relevant time.

MR JUSTICE HILDYARD: I am going to be very rude and it is entirely my frailty, but would you speak up a little bit when --
MR MARSHALL: Of course, my Lord.
MR JUSTICE HILDYARD: Or have the microphone a little closer, just so I can focus on your words rather than if I am hearing them right.
MR MARSHALL: Of course, my Lord, I will move that closer if that helps.
MR JUSTICE HILDYARD: I mean, the thing about standard forms is that -- or one of the things about standard forms, is that the assumption of the court is that it is the expectation of the parties that that form will have the same meaning for all parties who adopt it. You know, one just has to get beyond these rules, doesn't one, and just work out what people are saying, sub silentio, when they adopt a standard form? One of them is: it is a standard form, it is going to have the same meaning whatever its context.
MR MARSHALL: Three points in response to that. I will come to the detail of them soon. Firstly, this type of subordinated loan agreement is not entirely standard form. Part of it is standard form --
MR JUSTICE HILDYARD: Yes.
MR MARSHALL: -- schedule 2. It is in fact a hybrid.

Albeit that the variable terms to some extent one has to apply guidance from the FSA in connection with.
MR JUSTICE HILDYARD: Yes.
MR MARSHALL: But one of the important aspects of the variable part is that the type of borrower will vary. In this case, it is an extremely unusual type of borrower, namely an unlimited company. That is by no means a standard type of borrower from the regulatory perspective. The repayment terms could also vary. They were part of the variable terms. So that, first of all, that is the first qualification to applying the standard form principle to interpretation.

The second is that even if one does apply the approach that one has to find a meaning which is applicable not only in our particular context, but more widely, when one looks at the guidance that the FSA published in combination with the way in which they approached this matter -- which your Lordship will see shortly -- it is very event that they did not have in mind as a source of capital for LBIE, as a source of support for LBIE, calls on members. Indeed, they have viewed the matter as being one where the capital will already be within LBIE, in the sense of paid up capital on shares, and then various other things that they will accrue in the form of capital over time, but not

something in the form of a call on shareholders under section 74. That doesn't feature at all.

That is perhaps not surprising, because the FSA's approach, in itself, was dependent and based upon a European Union approach. The idea of unlimited companies under which people can be called in the way we have, under our legislation, may well not be something known within other European Union states. But it is not too surprising, we submit, to see the FSA guidance in the form it was. If one applies that, the standard approach would appear to be that you don't rely upon calls on shareholders or the rights equivalent to section 74. That is not what they were interested in.

Even if that was all wrong, our fall back position would be, this my Lord: the FSA regulations were wrong about all of that. The FSA's regulations and focus in this context is on a totally different type of arrangement and entity from the type which we are concerned with here; an unlimited company, which is a very unusual beast in the modern day world. We would then fall within the category of exception described by, I think, Lord Mustill in the AIB case, which I think your Lordship was taken to by Mr Trower and which we can go back to. If it is a standard form used in a context for which it was never really designed, then it is not

necessarily the case that you are confined to what would be the standard meaning for everyone. It may then be appropriate to consider the particular circumstances. But those are the list of submissions, if you like, which I will develop shortly, in answer to the suggestion that it is just a standard form and you have to apply it without regard to the background in this particular case.

MR JUSTICE HILDYARD: But your approach, is it, is to look at the contract and interpret it rather than focus on the broader question, if you like, as to what the assets of the company actually are?

I haven't put that very clearly, but you wish as a matter of contract to say that the contract states that it is only the assets apart from, as it were, the call, which are contractually brought into account.

MR MARSHALL: Yes.

MR JUSTICE HILDYARD: Whereas, I think, Mr Atherton, for example, might say, "Well, the cause of action made available to a liquidator to enforce unlimited liability is simply not within that bag", whatever the contract may say.

MR MARSHALL: Yes.

MR JUSTICE HILDYARD: But you are a contractual --

MR MARSHALL: We are on a contractual interpretation point,

here. I, of course, adopt what Mr Atherton suggests, that there is an additional argument --

MR JUSTICE HILDYARD: Yes.

MR MARSHALL: -- but our argument is based on interpretation of the contract. When it talks about repaying these loans, it is talking about repaying from the funds of LBIE itself, rather than funded through calls on shareholders, on a proper interpretation.

MR JUSTICE HILDYARD: Yes.

MR MARSHALL: My Lord, can I just add the final point I wanted to make concerning the correct approach to interpretation. This will be relevant, as your Lordship will see, shortly.

This is what might be described as the Aberdeen City Council approach, where one finds that there is a gap. The parties might not have contemplated a particular scenario but the court, as part of its process of interpreting the express terms, will fill that gap by looking at other provisions of the agreement to see what the parties' intention was. One sees that from the decision in Arnold v Britton, which your Lordship has, I think, in authorities bundle 4.

MR JUSTICE HILDYARD: This is another Supreme Court decision.

MR TROWER: It is indeed.

MR JUSTICE HILDYARD: Lord Neuberger.

MR MARSHALL: It is indeed. Bundle 4, tab 100. Your Lordship will find Lord Neuberger's speech at page 6 of the report, and your Lordship will see that, at letter J, his Lordship gave some general guidance on the proper interpretation of contractual provisions. He begins, at paragraph 15, by adopting the test of Lord Hoffmann in Chartbrook, which I took your Lordship to just a short time ago. Then he sets out, at page 7, at letter A and B, the types of matter that the court then takes into account.

MR JUSTICE HILDYARD: Yes.

MR MARSHALL: Which are the same as those described, indeed, by Lord Hoffmann.

He then set out various factors to bear in mind, and they are listed then on page 7, at letter D, all of the way through to page 8, letter H. There are seven factors which he draws attention to. The first point is: don't under value the language. Although one, of course, has regard to commercial commonsense and surrounding circumstances. He makes the point, in paragraph 18, that the less clear the words, the more it will be open to one to depart from their natural meaning. Then, the third point, in paragraph 19, is about not adopting commercial commonsense on

a retrospective basis. Paragraph 20 is that while commercial commonsense is a very important factor, the court will be very slow to reject the natural meaning of a provision simply because it appears to be imprudent for one of the parties.

Paragraph 21, the fifth point, is about what facts were known. It has to be facts known or reasonably available to both parties.

Then, when we get to the next point, paragraph 22, where the Aberdeen City Council point is made.

MR JUSTICE HILDYARD: Yes.

MR MARSHALL: He then says:

"In some cases an event subsequently occurs which was plainly not intended or contemplated by the parties judging from the language of their contract. In such a case, it is clear what the parties would have intended, the court will give effect to that intention."

He gives, as an example, the Aberdeen City Council decision, where the court concluded:

"Any approach other than that adopted would defeat the parties' clear objectives, but the conclusion was based on what the parties had in mind when they entered into the contract."

The seventh point, that he mentions in paragraph 3, is specific to service charges being construed

restrictively, which isn't relevant for our purposes.
My Lord, can I then go to Lord Hodges' speech, where you will see in a little bit more detail what Aberdeen City Council was about, and how the Supreme Court dealt with it. That is on page 17, at paragraph 71.
He makes the point:
"In Aberdeen City Council the internal context of the contract provided the answer. In that case, the sale contract provided for the payment to the vendor of a further sum on disposal of land by the purchaser. Two of the methods of disposal required the parties to ascertain the market value of the property on disposal in calculating an additional payment. The other used the gross sales of proceeds in calculating the payment. The purchaser then sold the site at an undervalue to an associated company; that was a circumstance which, on the face of the contract, the parties had not contemplated. The courts, at each level, interpreted the provision which used the gross sales proceeds in the calculation as requiring a market valuation where there was a sale that was not at arm's ...(reading to the words)... as a whole and in particular from the fact that the other two methods of disposal required such a valuation."

His Lordship commented on the fact that there had been some criticism from a Professor, Martin Hogg, on the ground that it protected the party from its commercial fecklessness. His Lordship thought it was the correct approach as the internal context contract pointed towards the commercially sensible interpretation.
My Lord, we will shortly show your Lordship that there are other provisions of the subordinated loan agreements which point to the conclusion that LBIE's assets alone, or its resources alone, were to be used for the repayment of the loan, rather than anyone else's. If for any reason your Lordship concluded that having regard to the way the contract was formulated this question of whether they could call or not on rights under section 74 isn't something within anyone's contemplation. That gap can be filled in the same way as the gap was filled in Aberdeen City Council by considering the internal context and other provisions of the agreement. In particular, the one that we will be relying upon are contained in clause 6F and 7F of the subordinated loan agreement, which I will take your Lordship to shortly.
MR JUSTICE HILDYARD: There is a case from the House of Lords, called Sedbrook (?), which is where the court

supplies machinery where the parties have failed do so, but this principle goes further than that?
MR MARSHALL: It does. It is quite close to implication of a term but it is being done as part of the express term, interpretation. There is a gap, but you fill it by reference to the internal context of the document and that's (Inaudible) interpretation of express terms, rather than implication of a term with the rules that one derives in Aberdeen City Council applying, rather than the implications of term rules, which are now to be found Marks and Spencer, which I will take your Lordship to later.
My Lord, with that legal analysis, can I then take your Lordship to what we contend is the relevant context to these subordinated loan agreements.
First and foremost, they were carried out in conjunction with a capital restructuring by the Lehman UK Group in 2006, which was done in order to meet tax and regulatory capital requirements. Your Lordship will find the description, in some detail in all of that, in the judgment of Mr Justice David Richards in the Waterfall I proceedings in trial bundle 1, tab 8. If your Lordship would be kind enough to go to page 9, paragraph 28, you Lordship will see the reference to the position prior to the capital restructuring, prior to

2006, with various facilities in place. Then, in paragraph 29, it is in order to utilise LBIE's foreign tax credits for US tax purposes:
"Deciding to improve its profitability in part by restructuring its regulatory capital base so as to replace some of the subordinated debt with share capital and reduce its interest payments."
LBHI2 is interposed as an intermediate company as part of that process.
The regulatory background is then considered in quite some detail, at paragraphs 33 through to 47. His Lordship describes, in paragraph 35, the Basel 1 rules. They are described in paragraphs 35 and 36. Your Lordship will see, in paragraph 37, that they are then given effect to by an EC council directive in April 1989. Article 2.1 of that provided that:
"The unconsolidated own funds of credit institutions could consist of a number of items, including equity, share capital and preferential shares and subordinated loan capital."
There is then a quotation which explains that the binding agreements that exist, they are designed so that the claim for subordinated debt will rank after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been

settled.
His Lordship ended up relying partly on that language in concluding in argument that it is all about trying to protect trade counter-parties of LBIE and other forms of creditors weren't really of significance in this context. That was rejected, in part based on this language used in the EC directive.
My Lord, we respectfully submit that directive is important, because that seems then to be the foundation for our own regulation, which is then based on that. As your Lordship will see when one comes to it, the types of capital that need to be put in place do not seem to envisage capital coming in in the form of calls under a provision like section 74.
MR JUSTICE HILDYARD: Is that because of the definition in annex 5 or because of our own domestic definition?
MR MARSHALL: It is simply because the process, under section 74, of making calls like that, in an unlimited company, don't fall within one of the categories that the FSA have down as a source of capital for the purposes of their regulatory requirements, no doubt based on the EC directive that we can see being referred to here. That is no doubt because, within the EC, the concept of unlimited companies, such as the one that we have here, is not a familiar one.

MR JUSTICE HILDYARD: Do we have annex 5?
MR MARSHALL: Annex 5, I am not sure.
MR JUSTICE HILDYARD: I think it is referred to in paragraph 38, and obviously it is tied to investment firms and credit institutions.
MR MARSHALL: Yes. I am not sure we have it in the bundle at the moment but we can obtain it. We certainly have the FSA's own handbook provisions, which I think Mr Atherton took you to some of --
MR JUSTICE HILDYARD: Yes.
MR MARSHALL: -- and I will return to shortly. But we can try to obtain annex 5 as well.
His Lordship then goes on to refer to further revisions on the Basel guidelines, and to Basel 2, which is then given effect to by a further EC directive, as one sees from paragraph 40. All of this then leads, in paragraph 42, to the introduction of the General Prudential sourcebook, which then provides guidance in accordance with the Basel 2 requirements.
His Lordship then goes on to describe the different tiers of capital which are relevant: tier one through to tier 3, in paragraphs 44 through to 47.
My Lord, just to --
MR JUSTICE HILDYARD: Those lists, give one the initial impression, of both the FSA and the European directive,

specifying what sorts of capital will be available, which may be a slightly different matter than whether they are sources which are in fact capital, though not counted as available capital.
MR MARSHALL: Well, as we will see, the main concern of all of the regulators -- including the FSA in the light of the legislation they had to work under -- is to protect external creditors, all the external creditors.
MR JUSTICE HILDYARD: Yes.
MR MARSHALL: Our case is that of course if you have a situation where you are looking at the relevant entity as part of a group, a regulated group -- which is in fact the case with Lehman as your Lordship will see shortly -- it would be invidious to that objective, of protecting external creditors, if you can, if you like, shift the burden of meeting the claims of the creditors from one entity within the group to another by virtue of a call, leaving other creditors of the group then exposed. As opposed to using whatever form of capital has been provided under these regulations and that loan, which is what we submit should happen if you want to achieve that objective. So if you have this call process available, and you are looking at that on a group wide basis, it potentially would be something that would undermine the objective of the regulations.

Particularly if -- as we submit was in fact the case in the Lehman Brothers -- you have one company within the group which is in fact providing the services which are then coming from external creditors for the benefit of other trading companies within the group. So they gain the benefit of the agency, if you like, of that company, engaging landlords and other suppliers. Those creditors might in other circumstances be direct creditors of the trading company but because of the way the group is structured, it doesn't turn out to be that way because they have a service company in place. If you then have a subordinated loan from a shareholder which can then be called in and then the call made across to the service company, you then potentially leave those creditors exposed. That would be a very surprising outcome, given the intention of these regulations.
MR JUSTICE HILDYARD: Does that mean that you have to persuade me that own capital has a particular meaning in the context, which would not necessarily apply in non-group contexts?
MR MARSHALL: I will, but I do it by virtue of two routes. One is based on the way in which capital is described in the FSA handbook, and what they regard as the capital available to the company, which doesn't include calls under section 74 or anything like that. The second

route is by virtue of the particular context to these subordinated loan agreements, which show that the FSA was approaching the regulation of Lehman on a UK group wide basis, and with a view to protecting creditors of the group rather than just the creditors of LBIE; the resources provided under the subordinated loan agreement were intended to be resources for the group and the protection of creditors of the group.
MR JUSTICE HILDYARD: Well, that second reason may be a reason why you do, but really I am clarifying with you that is what you say?
MR MARSHALL: Yes.
MR JUSTICE HILDYARD: Own funds has a special and particular meaning having regard to the deployment of these agreements in what is intended to be a group context.
MR MARSHALL: Yes, indeed.
MR JUSTICE HILDYARD: Yes.
MR MARSHALL: Yes, indeed.
MR JUSTICE HILDYARD: Does your interpretation also mean you must, as it were, interpolate the words "own funds counted as capital" for the purposes of the FSA regulations?
MR MARSHALL: Yes, it does.
MR JUSTICE HILDYARD: It does. You have to go that far?
MR MARSHALL: I submit we can go that far and I rely on that

as one of the points in our favour, in terms of how this regime operated.
MR JUSTICE HILDYARD: So even if a call is an asset, even though only an asset which is realisable by a liquidator, contrary to what Mr Atherton submits, you say it still isn't within the phrase, either because the phrase has a particularly limited meaning in the context of the group and/or because in all contexts, the phrase is intended to be limited to capital recognised as available under the regulatory regime and the European directive?
MR MARSHALL: Precisely. That is the way we would submit it works, within Lord Justice Briggs' view of the world, in terms of the assets of the company.
My Lord, just to complete the review of the background in Mr Justice David Richards' judgment, after going through the regulatory capital background, His Lordship also, in paragraphs 60 through to 62 --
MR JUSTICE HILDYARD: 60?
MR MARSHALL: 60 to 62, on page 16.
MR JUSTICE HILDYARD: Oh yes.
MR MARSHALL: Dealt with the point I mentioned earlier about whether it was all intended to protect a narrow group of creditors, if you like, trading counter-parties, or rather was intended to provide protection to all

creditors, in terms of the widest possible group.
MR JUSTICE HILDYARD: Yes.
MR MARSHALL: Your Lordship will see in particular, from paragraph 61, His Lordship concluded that it was intended to provide the widest possible protection.
MR JUSTICE HILDYARD: Yes.
MR MARSHALL: If I then look at the matter more specifically, if your Lordship would be kind enough to take up trial bundle 5 and go to tab 1.
MR JUSTICE HILDYARD: Trial bundle 5?
MR MARSHALL: Trial bundle 5, my Lord, yes, tab 1. Your Lordship will see the first of a sequence of documents, and the first set are the correspondence between the Lehman Group and the FSA and Revenue leading up to the subordinated loan agreements, which explain the regulatory thinking at the relevant time and how it was approached as far as the regulators were concerned.
The first document, on flag 1, is an email from a Mr Bowen, who is from UK regulatory reporting of the Lehman Group, to a Ms Edwards at the FSA, copied to various other people within the Lehman Group with a subject of "Group restructuring".
The first part explains that there is going to be a restructuring, under which a limited liability partner would have as its partners a UK holding company and

a Delaware incorporated company. Your Lordship will see that in the third paragraph, beginning with the number 2, there was commentary about the permanence, the likely permanence of the structure. He explains that the relevant tax, or the tax department, had provided a commentary on that. The observations were that although there was a risk that US accounting standards could be changed, in particular a particular standard called APB23 might change, the view was that this was unlikely. Indeed, even if that relevant standard, APB23, was to go away, the structure could still operate in its proposed form. So the indications were that it was expected to be a reasonably permanent structure.
Then he also refers, about half way down, to:
"A summary of the relevant part of the UK group organisation chart and capital resources calculations pre and post the restructuring. This shows that all of the sub-debt issued by Lehman Brothers Delaware as being prepaid and replaced with equity between Lehman Brothers Delaware and the new LLP, and between New Co [which was to be the new holding company] and LBIE, elsewhere the sub-debt remains."
Your Lordship will see, on pages 2, 3 and 4, the relevant charts there set out. There is no indication on the current and proposed capital structure, though

some further resource in terms of capital would be in the form of the ability to make calls, potentially on members. In terms of the group structure, unfortunately it has been split over two pages, but page 3, Your Lordship will see on the right-hand side is the proposed capital structure. At the bottom of page 3, on the right-hand side, Your Lordship sees the new holding company being inserted between LBH and, if one turns over the page, LBIE. There is in fact no reference to LBL in this chart at all. We submit that is interesting and perhaps of some significance because the only function of having LBL in the chart would be if you were expecting to have a source of capital from it, potentially, in the form of calls under section 74. The fact it is not even listed or mentioned or listed or referred to is indicative of the absence of any interest in that power to make calls.

Your Lordship sees that on the key to the chart, the focus is upon equity, subordinated debt and preference shares, and then there is an accounting consolidation arrow as well. The focus is on the three forms of capital identified -- equity, subordinated debt, preference shares -- but nothing more than that.

MR JUSTICE HILDYARD: But, of course, all that may show is that they were focusing on an unlimited company for its

see a letter from Lehman Brothers to the Revenue of 18 August 2006. It is quite a long letter, setting out all sorts of details regarding the proposed transaction, how it was going to work, who is going to participate in it. But if I could ask Your Lordship first to look at page 8, there Your Lordship will find a heading:

"Letter C. Details of the purpose of the transactions."

MR JUSTICE HILDYARD: Page 8?

MR MARSHALL: Just below that heading, Your Lordship will find a paragraph, about half way down, which says:

"The primary purposes of the proposed restructuring are as follows."

Then it says this:

"LB Spain is currently the head of the LB UK Group from an accounting and regulatory perspective."

Then this important statement:

"The UK group is regulated on a consolidated basis by the FSA. With effect from 1 January 2007, new FSA rules will come into force under which the preference shares issued by LB Holdings and LB Plc to LBDI will have an adverse impact on the LB UK Group FSA capital ratios. It has therefore become necessary to redeem the preference shares and reissue them to a UK body in the corporate chain for FSA purposes."

tax benefits rather oblivious as to its other consequences.

MR MARSHALL: Well, this is to show, also, the capital position. How is it going to be capitalised?

The forms of capital all referred to there are actually in line -- as we will see soon -- with what the FSA looks at for sources of capital. It doesn't include the ability to include for money from members in an unlimited amount, under section 74.

If one goes back to the email, on page 1, and if I could just ask Your Lordship to focus on the pre-penultimate paragraph where Mr Bowen says:

"However, the final form of the restructuring would not lead to an overall reduction in capital at the group or reduction in the quality of the capital available to the group."

My Lord, important, we respectfully submit because, with regard to the FSA, they were looking at the matter from the group perspective with a view to maintaining capital on a group basis, not by reference to a LBIE exclusive position. This is the start of a consistent theme that Your Lordship will see in the documentation.

If one goes on from there to the next document, which is at tab 2, this is now a correspondence with the Revenue from August 2006. Behind it, Your Lordship will

So there Your Lordship sees the regulation is group wide and is intended to protect the capital position for the group.

Just dropping down two paragraphs, one then has a paragraph beginning, "The main purpose":

"The main purpose of these transactions is not to provide a UK tax advantage over and above reductions that would be available in the absence of the arbitrage resulting from the transactions. This is evidenced by the fact that the amount of UK ...(reading to the words)... new structure and are still subject to the HMRC thin capitalisation agreement, rather the main purposes of the transaction is to provide financing to the LB UK Group for business purposes in a manner that is efficient from both a regulatory and a US tax perspective."

Then, the penultimate paragraph:

"As the proposed transaction does not displace or alter the existing amount of debt funding to the UK group, it would seem that no comparison needs to be made here. The same loan amount is in place before and after the transaction and fulfils the same purpose, that of providing capital to support the general UK business activities."

So, my Lord, the focus therefore is on this being

a capital preservation exercise for the UK group as a whole, which is unsurprising, if the whole group was being regulated on a consolidated basis by the FSA.

My Lord, one can also see, when one goes a little bit back in the document to the details of the transaction, which are set out in pages 6 through to 7, under section B, towards the foot of page 6, that the transaction is then set out and there is a reference to an appendix. Then there is a reference:

"Under the new arrangements finance will be provided to UK New Co as follows."

This is the new holding company. Then Your Lordship sees the types of capital that are going to be available. We have the subordinated loan equity funds and further details regarding those. A reference, at the end, to UK New Co will equity fund LBIE. No indication of the prospect that, in effect, there will be members who will be open to unlimited calls, under section 74, as a potential source of capital in addition.

If one goes to the appendix, Your Lordship will see, on pages 10 and 11, where the current structure is set out, in appendix 1, and the proposed structure is set out, in appendix 2. There isn't any reference to any potential source of capital in the form of calls and,

indeed, there is no reference to LBL as being a shareholder who would be potentially open to a call, and providing a source of capital. So this is entirely consistent with the earlier document that Your Lordship saw. It focuses upon a different source.

My Lord, the final point that one gets from the letter is that this is clearly a very carefully prepared structure, organised not only with the FSA regulatory requirements in mind but also with a view to ensuring that certain US tax advantages were obtained. One sees that from the earlier part of the letter and, in particular, on page 3. Paragraph 10 on that page, where there is a reference to a Luxembourg corporation having been set-up, and there is reference to US "check the box" regulations, whereby the Luxembourg company was a disregarded entity, treated as a branch of its 100 per cent parent, LB Spain holdings, which was a wholly owned subsidiary of LBDI."

It then goes on to say:

"This structure was implemented to allow dividends and interest to be paid within the LB UK Group without immediately triggering US taxes."

As we will see in some of the later documentation, the way in which the new holding company is put in place is done very much with the US tax position in mind.

My Lord, I don't know whether this would be a convenient -- I have several documents go through. I wonder whether this would be a convenient moment to break for the transcriber, or whether you would prefer to break at 12? I can do either way, whichever Your Lordship would think is convenient.

MR JUSTICE HILDYARD: You think it would be better in terms of your organisation if we break now, do you?

MR MARSHALL: If I have 30 minutes, I can get through probably the remaining items in this bundle and then that would be a convenient point to break.

MR JUSTICE HILDYARD: Well, let's try for another half an hour and then look forward to the down hill, from your point of view, shorter bit.

MR MARSHALL: My Lord, then moving from there, the next letter we need to look at is in tab 4 of the bundle, which is a letter dated 29 September 2006 from Lehman Brothers to the Revenue. Similar points emerge from that. Your Lordship will see, in paragraph 1 --

MR JUSTICE HILDYARD: When the heading is, "Lehman Brothers," that means?

MR MARSHALL: That means the group, if effect. It is being written by a lady called Jackie Dolby, Your Lordship will see her being referred to on page 2.

MR JUSTICE HILDYARD: Yes.

MR MARSHALL: Director of European taxation. There is a tax department which is acting for the group, it would appear.

MR JUSTICE HILDYARD: Is this Lehman Brothers Plc?

MR MARSHALL: I think her office happened to be at Lehman Brothers Limited.

MR JUSTICE HILDYARD: Right.

MR MARSHALL: Our --

MR JUSTICE HILDYARD: It may not matter.

MR MARSHALL: Sometimes the letters get written on behalf of LBIE, but sometimes they are on a heading which is Lehman Brothers Limited. Let me just see an example.

Yes, if Your Lordship looks back at the letter I took you to a moment ago, in tab 2, if you look at page 2 --

MR JUSTICE HILDYARD: Yes.

MR MARSHALL: -- the bottom of the page, Your Lordship will see it is a Lehman Brothers Limited document.

Yes, and, indeed, on page 1, where you see the memo from the Revenue to Ms Dolby, she is European Taxation Department, Lehman Brothers Limited. So she seems to be based in Lehman Brothers Limited, but the department she is part of seems to be dealing with matters on a group wide basis.

Now, in this letter, of 29 September, in paragraph 1

she deals with the coming change in the FSA rules in relation to capital issues to companies outside the UK regulated group. She talks about the new ratio that has to be complied with. She then describes what the UK regulated group is, a couple of paragraphs down, represented by LB Spain Holdings and all entities under LB Spain, and it is said that they don't currently meet this requirement because preference shares were going to be treated at non-core tier 1 capital. She then goes on to say:

"Therefore, to ensure that Lehman Brothers meets the FSA requirement from 1 January without ejecting additional equity LB needs to restructure so that the preference shares issued by LB Holdings and LB Plc are held by a member of the UK regulated group, hence the creation of an SLP [I think is a reference to a Scottish limited partnership] which will be treated as part of the UK regulated LB group and will hold the preference shares."

She then attaches a diagram, prepared by our regulatory group, showing the equity of subordinated debt position of the group pre and post implementation, and asks them to note that the proposed changes to the structure require no additional injections of equity or debt into the UK group.

She then notes, at the end of page 1, that the diagram depicts two UK new companies between LBIE and LB Plc, and the previous letter of 18 August only referred to one. The additional new company was required for US tax purposes but had no impact on the overall tax position.

She then goes on, on page 2, in the second paragraph down from the top of the page, to note:

"As the business of LBIE expands new equity or debt will need to be injected into the group to meet the FSA prescribed capital ratios."

She didn't have any projections as to the future capital requirement.

Then, in paragraph 3, she refers back to her first point:

"That in order to meet the FSA requirements, without injecting any additional equity, the LB Holdings/LB Plc preference shares have to be held by an entity/body within the UK regulated group."

Then talks about the possible capital duty costs of doing that.

Then, finally, on point 4, Your Lordship will see that the purpose of inserting two UK new companies was twofold. Firstly, it enabled earnings streams from subsidiaries to be isolated allowing for a US tax

efficient management of the repatriation of funds to the US.

"Secondly, it ensures the proposed reorganisation will be treated as tax free from the US tax perspective."

So there clearly was careful preparation in terms of trying to ensure the US tax advantage was achieved, but the second point that one gets from the letter is of course that the UK Lehman companies are being looked at on a group basis, and capital preservation is being looked at on a group basis.

When one looks at the restructuring charts, they follow in a familiar style, on page 3, in the sense that there is no reference to the ability to call on assets from members and, indeed, LBL as a member is not even actually mentioned.

MR JUSTICE HILDYARD: Mr Marshall, you accept, do you, that the question is not whether, under these plans, this capital resource, if it is one, was to be included but whether there is clarity that it was to be excluded?

MR MARSHALL: Yes. But what I am using this for is to show Your Lordship that, from the FSA perspective, the objective was to preserve capital for the group, thereby protecting creditors of the group; it would have been wholly inimical to that objective if, by virtue of

a subordinated loan agreement which was meant to provide part of that capital, assets from one member were to be removed, leaving creditors of it exposed and unpaid with the money then going off, up chain, to the holding companies further up the chain, potentially perhaps outside of the UK group all together, ultimately.

The idea was to protect the group, as a whole, to ensure capital was preserved within the group, not to allow it to escape in such a way that creditors of one of the group members were left exposed, which is what would happen if the subordinated debt could lead to the section 74 call.

We submit it is therefore not at all surprising that the FSA's focus, in terms of what resources were going to be available to LBIE to meet the subordinated loan debt, was going to be its own resources. It wasn't going to be going round grabbing money from other people within the group in order to meet it, which would create that very danger. Your Lordship will see support for that, not only from this material, but actually also from other provisions of the subordinated loan agreement, itself, which we will come to. They include provisions which prevented LBIE obtaining a surety to support its position as a debtor, and prevented LBHI2 from having any form of indemnity from someone else to

cover the debt, either. There was meant to be a focus purely upon the repayment obligations of the borrower, LBIE, and we would submit that is entirely consistent with the focus being upon its assets and resources alone without recourse to other people, whether under section 74 or some other similar obligation.

My Lord, just to complete the picture, in terms of the pre November 2006 materials, Your Lordship has another letter, at tab 5, dated 6 October 2006. This is to the FSA. This one is written on LBIE paper from a lady called Sophie Hutcherson of the Prudential Advisory Group. In the third paragraph, on the first page, she refers to various change of controller forms for phase 1 of the European holding company restructure, and then for phase 2, once approval had been put in place for phase 1. She goes on to say, in the course of that paragraph:

"We have provided an explanation of all the stages in the group reorganisation. This is supported by diagrams of the relevant parts of the group, details of the capitalisation of LBIE, copies of the forms and examples of the banner sheets for New Co 1 and 2, as at November."

Your Lordship will then see a detailed explanation of the rationale as provided on the second page, and it

is in particular that as they were moving forward to January 2007, and the implementation of GENPRU and BIPRU rules:

"We have considered what changes we need to make to the capital structure to LBSH UK Group. At the same time, as a matter of routine, our tax department has just received the optimal group structure for the purposes of tax efficiencies."

Your Lordship will see then there is, in the latter part of page 2, under the heading, "Benefits", that there is an explanation of some of the US tax advantages that were designed to be achieved by the insertion of the Lehman Brothers Holdings Intermediate 1 company and LBHI2, as well.

In terms of how the transaction then worked, there seems to have been an application for a change of controller, which Your Lordship sees at page 4.

The FSA had to then give its approval for two things as part of this process. One was for the change of control, which they did give, as Your Lordship sees on tab 6, on 26 October. Then they also had to approve the replacement of the subordinated loan agreements, their repayment of the existing ones and replacement with new subordinated loan agreements involving LBHI2. Your Lordship finds the approval for that at tab 7.

That approval, which is dated 30 October 2006, Your Lordship will see, on the second paragraph, a reference to the change of controller application having been approved. Then, in the next paragraph, the approval is given to the repayments of the existing subordinated loans. In the last sentence, Your Lordship will see:

"This permission is granted on the understanding the facilities in question will be simultaneously replaced with three identical facilities from LBH Plc to LBHI2, and from LBHI2 to LBIE, as described in your letter. Therefore, the pre-payments will not have an adverse effect on the firm's UK capital structure."

My Lord, in the context of this correspondence "the firm" we respectfully submit is Lehman Brothers group, not LBIE. LBIE was a UK company, so it wouldn't make much sense to refer to a UK capital structure for it. In the context, it must be a reference to the Lehman Group UK capital structure; that is consistent with all the earlier correspondence, where the concern of the FSA is to protect the group wide position.

Now, my Lord, we have also have in the bundle some subsequent correspondence in 2007. We don't have it there for the purposes of showing or pointing to some statement by one of the parties to the subordinated loan

agreement regarding what they understood the agreement to mean. We are not relying on it for that. We are not relying on subsequent conduct, or statements in that way, which we accept wouldn't be admissible.

What we do rely upon this material for is to show Your Lordship what the FSA or regulatory concern was at the time when the agreements were entered into. It records the thinking prior to November 2006, and what the FSA's general approach was.

If I go to tab 8, Your Lordship will find the first of those documents. It is dated 16 March 2007 to Mr Franklin at the FSA. It is explaining that there was a proposed change to the nature of some of the term "subordinated debt" that funded LBIE. The proposal seems to have been for replacement of some of the subordinated loan amounts with floating rates, subordinated notes. At the end of the first page of that letter, in the penultimate paragraph, Your Lordship will see there was a reference to diagrams of the existence and proposed flow of capital in the group. Then a statement:

"We believe that the proposal described above, while enhancing Lehman Brothers funding structure, has no adverse regulatory consequences and, indeed, should strengthen Lehman Brothers capital base by providing new

founding for the regulated group."
My Lord, therefore, entirely consistent with the earlier correspondence Your Lordship has seen, whereby the concern is to ensure that the group position is protected.
My Lord, the next items of, perhaps, some interest are at tab 9. Another letter to the FSA and, in the second paragraph, there was a desire to just clarify the nature of some of the short-term subordinated debt that funded LBIE. There was an explanation of that and a statement that the current facility remained unchanged.
There is then a chart, which is on the second page, and it follows in a very similar style to other earlier charts, which had lines showing the various forms of capital that were coming in, which are in the form of equity, subordinated debt, tier 1 preference shares, tier 2 preference shares and a guarantor or standby facility. No reference to a possible source of capital from members by virtue of section 74 or anything of that nature and, indeed, no reference in the charts to LBL at all but only to LBHI2.
My Lord, the final two items are in tabs 10 and 11. Tab 10 is a letter to the Revenue of around the same time, March 2007, and Your Lordship will see that this

is written -- and it is quite a long letter -- by Ms Dolby from the European taxation department and it states, on page 1, that the letter is being written on behalf of the Lehman Brothers UK Group. It is a clearance application in relation to avoidance involving arbitrage provisions.
If I could go to section C, which is on page 8, and there are set out the details of the purpose of the transactions. Under that heading, in the second paragraph, there is another explanation, "The primary purpose of the proposed restructuring". It is said:
"The funding provided through the current group structure must be provided to members of the regulated group. Under the current structure, funding provided by LBH SLP 1, this would cause interest income accrued to build up and would give negative impact on the group's regulatory capital position. Any repayment of funding by LBIE -- for example, in the instance it was able to reduce its regulatory capital requirements -- and any income accrued in LBH SLP 1 in such a scenario would not be permitted to be lent outside of the current UK regulatory chain structure, ie the structure outlined in appendix 1. This limits the flexibility of any new funding provided by the US parent."
So, again, reflecting the current position, which is

to protect capital for the UK group. On page 9, Your Lordship will see, in the third paragraph, that assurances are sought to be provided to the Revenue that there is no intention to provide a UK tax advantage. In the last sentence, it is explained:
"Rather, the main purpose of the transaction is to provide financing to the LB UK Group for business purposes in a manner that is efficient from both a commercial and a US tax perspective, as the proposed transaction does not displace or alter the existing amount of debt funding to the UK group. It would seem that no comparison needs to be made here. The same loan amount is in place before and after the transaction, befalls the same purpose, that of providing capital to support the general UK business activities."
So, my Lord, entirely consistent, therefore, with the earlier correspondence Your Lordship has seen, and reflective of the regulatory approach at the time when the subordinated loan agreements were entered into.
The document is accompanied by further charts, which Your Lordship has at pages 11, 12 and 13, where the current structure and the new structure are all described. Your Lordship sees the familiar types of capital being referred to, in the form of subordinated debt, preference shares, but with only one member of

LBIE being referred to, which is consistent with all of the previous charts and indicative of the fact that there was no interest at all in the possible source of capital funding through calls made on members such as LBL.
My Lord, finally, we have, at tab 11, a further letter to the FSA. This time 12 April 2007 from Ms Hutchinson, the head of the Prudential Advisory Group. On the first page, Your Lordship will see the heading, "Lehman Brothers UK Group regulatory capital sources":
"Further to my telephone conversation with you, on 21 March, I am writing to notify you of changes Lehman Brothers proposes to implement in relation to the flow of regulatory capital within the Lehman Brothers UK consolidated group."
She explains that they had been reviewing what the optimal structure was from a US tax perspective, and then says:
"The proposed changes are being driven largely by US tax efficiencies and we believe should have no adverse regulatory consequences and no impact on UK tax perspective."
She then accompanies that document with, again, a sequence of charts, which Your Lordship will find at

pages 4 and 5. We then see various figures being given, I think, on the charts, for equity, subordinated debt and two types of preference shares, and also a guarantor or standby letter of credit but no reference to potential calls under section 74, and no reference to LBL, at all.

So, my Lord, all of that, we respectfully submit, effectively shows three things. One is that the structure, which led to the subordinated loan agreements provided by LBHI2, was very, very carefully organised, was designed to achieve specific advantages and meet the FSA regulatory requirements. It wasn't going to be something that would alter very easily.

And, second, when engaging in these transactions, it was the UK regulated group which was considered and thereby the creditors of that group. What was sought to be achieved was a preservation of capital at the correct level for the group, which we submit is important when one considers how one should interpret what sources should be used to repay the subordinated debt. It would be extremely surprising if creditors who are providing services which were of benefit to the group via LBL were to be left out of pocket as a result of a repayment of subordinated debt funded by calls on members such as LBL. Wholly inimical to the whole purpose of the

structure. My Lord, that might be a convenient moment to break.

MR JUSTICE HILDYARD: Yes, well, a long 5 minutes.

(11.58 am)

(A short break)

(12.10pm)

MR MARSHALL: My Lord, we of course rely on that material I have taken Your Lordship to as part of the immediate context to the subordinated loan agreements and in explaining the objectives behind them. We respectfully submit that Your Lordship is entitled to have regard to all of that. Notwithstanding the standard form nature of schedule 2 to the subordinated loan agreements, given that there are variable terms in schedule 1, the agreements as a whole are hybrid. The important matters to bear in mind when considering these agreements is that the variable terms, of course, encompass the circumstances of the particular borrower and the repayment terms in connection with that borrower. It is important, therefore, to consider the particular context with regard to interpreting the repayment provisions.

But, my Lord, if one had to also look at the matter more widely, in terms of how repayments would be considered more generally when looking at these FSA prescribed agreements, or standard forms, in our

submission you would get to the same answer because if one looks at the FSA handbook, which sets out the types of capital that were going to be available to the borrowing entity, one won't find any reference to the potential for a call upon members under section 74, or anything of that nature.

One sees that from a document, I think, that Mr Atherton took Your Lordship to in the authorities bundle, volume 5, at tab 171, which is an extract from the interim Prudential sourcebook for investment business. The calculation of financial resources for a firm is dealt with in paragraph 10-62, and Your Lordship sees the provisions -- which I think your Lordship has looked at already -- for the calculation of financial resources in accordance with certain tables, A, B and C, which are then on the following pages.

Table A, for example, consists of a combination of ordinary share capital, non-cumulative preference share capital, share premium account, reserves excluding valuation reserves, audited retained earnings and externally verified interim net profits of current account and partners' capital; similar provisions in table B and in table C.

The sorts of things Your Lordship sees there are entirely consistent with the various tables for the

restructuring of the Lehman Group, and what was thought to be relevant to the FSA for the purposes of that restructuring and the approval of the FSA for it that Your Lordship has already seen.

There was no expectation that the borrowing entity would be relying upon capital from other sources than those listed on the sourcebook, in particular calls on other entities within the group, under section 74 or similar.

MR JUSTICE HILDYARD: It may not matter, but you would accept that if there were unpaid share capital in a limited company, that would be --

MR MARSHALL: Yes, indeed, it would be.

MR JUSTICE HILDYARD: Why is that; because it falls within ordinary share capital?

MR MARSHALL: Ordinary share capital. But what we are talking about is something very different from that, and that is certainly not within the contemplation of the FSA.

MR JUSTICE HILDYARD: Well, Mr Trower's point is that the only difference, really, between a limited share and an unlimited share is that the limited share caps what would otherwise be an unlimited liability.

MR MARSHALL: Yes.

MR JUSTICE HILDYARD: But they are not different in nature.

That is what he says, amongst other things.
MR MARSHALL: Well, we respectfully disagree with that.
Where one is dealing with unlimited liability as opposed to a limited one -- if there is an exposure to a particular amount in relation to uncalled share capital for another entity in the group, for example, that would no doubt appear as a provision in the accounts of, let's say LBL, for example. LBL may potentially have a provision in its account for a small amount of uncalled share capital which is still owing and has to be dealt with. But an unlimited liability would be a different matter, and not something that any creditor dealing with LBL would necessarily be aware of or take account of, unless some specific mention was made of it. It is, in our submission, a very different type of liability.
In the context of the type of regulation that the FSA was undertaking -- and Your Lordship has seen that they regulated on a group basis -- it would be very, very strange to leave other members of the UK group exposed to calls for the benefit of other members of the group, and shareholders of those members, leaving third party creditors exposed. That can't possibly have been what was sought to be achieved.
If there was a limited amount of ordinary share

capital that still had to be paid up, that obviously is still in a different category and no doubt creditors dealing with members of the group would take account of that. But an unlimited liability is in a different category. Particularly one arising from a very small shareholding, which was the case here.
My Lord, we submit that there is nothing terribly surprising about the sourcebook provisions, given that the source of them seems to be an EC provision which I referred to earlier in Mr Justice David Richards' judgment, he referred to the EC judgments that led to all of this. These provisions in the sourcebook are no doubt reflective of that. We will get appendix 5 for Your Lordship, so that Your Lordship has it, but I am reasonably confident that the FSA was simply implementing and putting in place what the EC directives required. Those directives don't seem to have anticipated any type of source of capital by section to 74.
MR JUSTICE HILDYARD: Is it annex 5 to the directive?
MR MARSHALL: I think it was annexe 5 that was referred to in the passage of Mr Justice David Richards' judgment Your Lordship referred to earlier.
MR JUSTICE HILDYARD: Yes, whichever that is.
MR MARSHALL: Indeed.

My Lord, if for any reason that analysis was incorrect and the standard form didn't quite work in that way, then if we have to apply the AIB approach, which is the one that Mr Trower has been advocating, I think that is the case that Your Lordship has in volume 3 of the authorities, at tab 74. Tab 74, page 96 of the report. The judgment of Lord Millett. I think earlier I said Lord Mustill, it is Lord Millett. It is at paragraph 7. He made the point in that case that they were concerned with a standard form:
"Designed for use in a wide variety of circumstances, not context specific, value much diminished if it could not be relied upon as having the same meaning on all occasions. Relevance of factual background of particular cases, interpretation is necessarily limited."
But then he made this observation:
"The danger, of course, is that a standard form may be employed in circumstances for which it was not designed. Unless the context in a particular case shows that this has happened, however, the interpretation of the form ought not to be effected by the fact all background."
My Lord, if we were wrong in the analysis that I have provided Your Lordship with as to how the

standard form should be approached, and if when one is to look at it in a rather different way, well, we would respectfully submit that it is evident that it is now being employed in circumstances for which it was not designed, namely unlimited companies. It is clearly, in our submission, designed for a rather different purpose, having regard to the list of types of capital that they had in contemplation. It is not the case that they had in mind unlimited companies with the provisions for calls that they envisage. If necessary, I would submit that the exception that Lord Millett recognised there would come into play to allow Your Lordship to have regard to the particular context.
My Lord, I have already responded briefly to the further suggestion that because the subordinated loan agreement had provision allowing assignment with FSA consent, that that should deter Your Lordship from having regard to the particular context that led to its creation. Your Lordship has seen the passage from Chartbrook of Lord Hoffmann which suggests that the mere existence of an assignment provision doesn't lead to that result. You still can have regard to the context. Particularly so when the assignee might well be someone who would have a full awareness of the particular context; having regard to the way in which these

subordinated loan agreements were set-up, and the purpose for which they were set-up, the advantages which they were sought to achieve, we respectfully submit it is unlikely, in the extreme, that one would see these subordinated loan agreements being assigned to someone outside of the Lehman Group. If they were going to be assigned or changed, the likelihood was it would likely be another Lehman Group entity, no doubt fulfilling some new structure to achieve whatever advantage was sought to be preserved in relation to the US tax position. That is what we see from the way this was done.

My Lord, other points that we draw upon. We draw upon a further point, which is that of course LBHI2, the lender under the subordinated loan agreements, was also, by a very large degree indeed, the majority shareholder in LBIE. So if it really was the case that calls under section 74 were to be used as a source of funding for repayment of the subordinated loan, it would be very odd because effectively the call would be going round to the same party as the lender, which is a commercially odd and we would submit rather absurd thing to be happening.

The answer to that that is put forward is: well, it was always possible that LBHI2 might have transferred its shares and also you have LBL, albeit a minority shareholder, it is there as well.

Well, as to the transfer of shares by LBHI2, Your Lordship of course needs bear in mind that that is not going to happen very easily. It would only be done if FSA consent was given for a change of control. If that was going to occur, it would, we would submit, only be likely to happen in the context of some further restructuring, whereby the subordinated debt that had been provided by LBHI2 was going to be replaced by some new subordinated debt, or some new arrangement under which the relevant regulatory capital was provided. Just in the same way as when LBH, which had previously provided subordinated debt, ceased to be the holding company. Its subordinated debt was repaid and replaced with a new subordinated loan from the new holding company.

We don't accept that there was any real prospect of LBHI2 simply transferring its shares without a lot of other things happening at the same time, which would completely alter the over all position.

As far as LBL's shareholding is concerned, of course it is our case that there was a nomineeship arrangement under which we would be entitled to be indemnified by LBHI2, and so claims against us, we would submit, would have led, ultimately, to LBHI2 as well. So the same point, that it is not commercial for one to read the

subordinated loan agreements as being ones that were to be repaid, potentially, from calls made on the lender, itself, holds good. Notwithstanding the fact that LBL have held a tiny proportion of the shares in LBIE.

My Lord, the final point which we would make on interpretation of the express terms is based on the Aberdeen City Council approach.

If Your Lordship concluded there was just a gap here in the agreement, that something had occurred that no one had really contemplated, then Your Lordship would be entitled to look at the other provisions of the agreement to see what the general objective was of the parties. If one goes to the subordinated loan agreement, that is in bundle 4, tab 1, and if you go to clause 6F on page 11, your Lordship will see the heading, "Representations and undertakings of the borrower":

"From and after the date of this agreement, or effective date if earlier, the borrower shall not without the prior written consent of the FSA ..."

Then letter D is:

"Not to repay any of the subordinated liabilities otherwise than in accordance with the terms of this agreement."

Then letter F:

"Arrange or permit any contract of suretyship or similar agreement relating to its liabilities under this agreement to be entered into."

There was a further representation that that had not happened prior to the date of this agreement.

My Lord, we would respectfully submit that is a pointer, a strong pointer, to the fact that the borrower's assets alone, its resources alone, were to be the source of repayment, not other persons.

Similarly, clause 7, which has representations and undertakings from the lender, Your Lordship will see:

"From and after the date of this agreement the lender shall not, without the prior written consent of the FSA ... "

Then, if you Lordship looks down to letter F, at the bottom of page 12:

"Take or enforce any security, guarantee, or indemnity from any person for all or any part of the subordinated liabilities."

"The lender shall on obtaining or enforcing any security ...(reading to the words)... notwithstanding this undertaking hold the same and any proceeds thereof on trust for the borrower."

Again, we would respectfully submit, a strong pointer to the fact that there is not to be another

source for repayment beyond the borrower's own resources.

My Lord, we would respectfully submit that if there is a gap in the document in terms of no indication from it as to what exactly the answer was to be as to the source of repayment, those provisions give Your Lordship a very strong indication of what the objective of the parties or the intention of the party was in the same way as an Aberdeen City Council. Your Lordship could approach the matter on the basis of that, as a matter of interpretation of the express terms.

My Lord, that is what I wanted to say about interpretation or construction of the express terms of the subordinated loan agreements.

If we are wrong about all of that, then in the alternative we would respectfully submit that Your Lordship should conclude that it is correct to imply a term that repayment was to be made from LBIE's own funds and without recourse to the funds of its members. We submit that term would be required to give commercial or practical coherence to the agreement or, alternatively, would be so obvious as to go without saying to a reasonable reader of the contract knowing all of its provisions and the surrounding circumstances.

My Lord, I am using there the formulation of

Lord Neuberger in Marks and Spencer. I wonder if I can take Your Lordship to that case, just so Your Lordship sees how the relevant principles work. It is in bundle 4 of the authorities, at tab 103. If we could go to, first of all, paragraph 18, on page 753, where His Lordship referred to a formulation of Lord Simon in the Privy Council in the case of BP Refinery v Shire of Hastings, where he set out under the traditional approach four conditions. As it was put:

"For a term to be implied [I am reading from the quoted words] the following conditions which may overlap must be satisfied:

"(1) It must be reasonable and equitable.

"(2) It must be necessary to give business efficacy to the contract so that no term will be implied of the contract that is effected without it.

"(3) It must be so obvious that it goes without saying.

"(4) It must be capable of clear expression."

And then finally:

"(5) It must not contradict any express term of the contract."

So there is a traditional formulation which is then reviewed by Lord Neuberger in the light of the Attorney General of Belize decision, and other subsequent cases.

Your Lordship will see that being reviewed beginning at paragraph 21, on page 754. Your Lordship sees, at 754, paragraph 21, just below letter F, he observes:

"It could be dangerous to reformulate the principles, but I would add six comments on the summary given by Lord Simon in BP Refinery."

The first of those is to echo observations of Lord Steyn in Equitable Life v Hyman.

"The implication of a term was not critically dependent on proof of an actual intention of the parties when negotiating the contract. If one approaches the question by reference to what the parties would have agreed, one is not strictly concerned with the hypothetical answer of the actual parties, but with that of the notional reasonable person in the position of the parties at the time at which they were contracting."

So it is an objective test by reference to what the reasonable person in the position of the parties would have considered.

The second point:

"A term should not be implied into a detailed commercial contract merely because it appears fair or merely because one considers that the parties would have agreed to it if it had been suggested to them. Those are necessary but not sufficient grounds for including

the term. However, and thirdly, it is questionable whether Lord Simon's first requirement, reasonableness and equitableness, will usually, if ever, add anything. If a term satisfies the other requirements it is hard to think that it would not be reasonable and equitable."

So the first part of the traditional formulation may well simply be superfluous.

"Fourthly, as Lord Hoffmann I think suggested in Attorney General of Belize, although Lord Simon's requirements are otherwise (inaudible), I would accept that business necessity and obviousness, his second third requirements, can be alternatives in the sense that one of them needs to be satisfied, although I expect that in practice it would be a rare case in which only one of those requirements would be satisfied."

So necessity and for business efficacy, and obviousness, are potentially alternatives.

"Fifthly, if one approaches the issue by reference to the efficacious bystander it is vital the formula (?) of the question be posed to him with the utmost care.

"And sixthly, necessity for business efficacy involves ...(reading to the words)... the test is not one of absolute necessity, not least because the necessity is judged by reference to business efficacy.

It may well be that a more helpful way of putting Lord Simon's second requirement is, as suggested by Lord Sumption, that a term can be implied if without the term the contract would lack commercial or practical coherence."

And just dropping down to paragraph 23, he is there considering some observations by Lord Hoffmann about the process of implying terms into a contract being part of the exercise of construction. He makes the observation at paragraph 23 that:

"The notion that a term will be implied of a reasonable reader of the contract, knowing all of its provisions and the surrounding circumstances we would understand it to be applied, is quite acceptable provided that the reasonable reader is treated as reading the contract at the time it was made and he would consider the term to be so obvious as to go without saying or to be necessary for business efficacy."

And he also goes on, I think, just below letter F to say:

"The second proviso is important because otherwise Lord Hoffmann's formulation may be interpreted as suggesting that reasonableness is a sufficient ground for implying a term."

Now, just applying the relevant test with those qualifications, we respectfully submit that the reasonable reader would have taken account of the other provisions of the subordinated loan agreement and in particular clauses 6F and 7F that Your Lordship has seen and would take account of all of the surrounding circumstances that we have been through, specifically the contents of the FSA handbook in terms of what type of capital was intended to be preserved. And we would submit the particular circumstances leading to these subordinated loan agreements under which a UK group position was intended to be protected, with creditors of the group as a whole intended to receive that protection.

With that background we respectfully submit any reasonable reader would have treated it as an obvious conclusion that recourse was to be had to the assets of LBIE itself without recourse to those of its members for the repayment of the LBHI2 subordinated loan. And that only becomes even more obvious when one sees that LBHI2 is by far and away the most significant member and that the other member holding a minority interest has a right of recourse as against LBHI2 concerning its own liability if a call was made under section 74.

My Lord, the points that are made against us in

terms of implication of a term are firstly that the court has some sort of strong presumption against implication of a term when one is dealing with a detailed standard form contract. That is based on the judgment of Mrs Justice Gloster as she then was in the case of Great Ship India, which I think Your Lordship has in bundle 3 of the authorities at tab 92. If I can just show you that very quickly. This was a case concerning a standard form charterparty.

(Pause).

Your Lordship will see from the report at page 360, in the right-hand column, paragraph 2 it was an appeal from arbitrators and it raised a short point of construction in relation to a clause of the amended BIMCO supply time 1989 form of charterparty. And the relevant part that is relied upon, I think, is at page 366 of the report on the right-hand column at paragraph 41 and it is I think the last sentence of paragraph 41, where her Ladyship made this statement:

"Moreover, there is a real difficulty in seeking to imply a term into a detailed standard form contract such as the supply time 1989 form where the strong presumption is likely to be the detailed terms of the contract are complete."

And Your Lordship sees that there is then

a reference to Attorney General of Belize and in particular the speech of Lord Hoffmann at paragraphs 17 to 27, and then to the Mediterranean Salvage case and the speech of Lord Clarke at paragraphs 10 and 15 to 18.

My Lord, with respect we submit unfortunately the analysis here seems to be incorrect, because in fact the two cases referred to don't support any suggestion that there is in fact a strong presumption rule of that kind. But in any event the contract Your Lordship is concerned with here, certainly on one view, is not a detailed standard form contract. It is actually quite a brief document. In terms of loan agreements, one knows from experience they certainly can be a great deal more comprehensive and detailed than the one that we have to consider in this particular instance.

If one goes to Attorney General of Belize, which is the first authority referred to to support what Mrs Justice Gloster has there referred to, that is at bundle 3-tab 79 and the passages that were relied on were 17 to 27. That is in the report at tab 79-page 1993 through to 1995. It is actually quite a lengthy passage in which His Lordship was dealing with the correct principles for implication of a term generally. And among other things, Your Lordship sees on page 1994 at paragraphs 23 to 25, there is reference

to Lord Steyn's observations in Equitable Life that Lord Neuberger had referred to and he then refers to the Moorecock, and paragraph 25:

"The requirement that the implied term must go without saying is no more than another way of saying that although the instrument does not expressly say so, that is what a reasonable person would have understood it to mean."

Then, just above letter C on page 1995, he then said this:

"Likewise, it is not necessary that the need for the implied term should be obvious in the sense of being immediately apparent, even upon a superficial consideration of the terms of the contract and the relevant background. The need for an implied term not infrequently arises when the draftsman of a complicated instrument has omitted to make express provision for some event because he has not fully thought through the contingencies which might arise even though it is obvious after a careful consideration of the express terms and the background that only one answer would be consistent with the rest of the instrument. In such circumstances, the fact that the actual parties might have said to the efficacious bystander could you please explain that again does not matter."

observations made by Sir Thomas Bingham in the case, I think, of Socimer Bank v Standard Bank Limited. There is a quotation, which Your Lordship will see in paragraph 18, from Sir Thomas Bingham, where he says:

"The difficulties increase the further one moves away from these paradigm examples."

MR JUSTICE HILDYARD: I think this is in Philips Electronique, is it not?

MR MARSHALL: Yes, I am so sorry. I may have the wrong one. Your Lordship is right, yes:

"It is much more difficult to infer with confidence what the parties must have intended when they have entered into a lengthy and carefully drafted contract but have omitted to make provision for the matter in issue. Given the rules which restrict evidence of the parties' intention when negotiating the contract, it may well be doubtful whether the omission was the result of the parties' oversight or of their deliberate decision if the parties appreciate that they were unlikely to agree on what is to happen a certain, not impossible, eventuality. They may well choose to leave the matter uncovered in their contract in the hope that the eventuality will not occur."

The judgment then moves on to other aspects.

So, my Lord, that is pretty much the only bit of the

So my Lord, from what we can see there doesn't seem to be any support for this suggestion that there is some sort of strong presumption when one is dealing with complicated agreements, or complicated standard form agreements. But rather, an indication that when one is dealing with a complicated instrument there may well be a basis for implication of a term, having regard to the factors that Lord Hoffmann refers to at 1995, C to D. So if anything, the authority is actually contrary to such an approach.

If one goes to the Mediterranean Salvage case, which I think has been inserted into Your Lordship's bundle at tab 79A. This is the speech of Lord Clarke. Paragraph 10, which was the first of the passages referred to by Mrs Justice Gloster, is really a passage referring back to Lord Hoffmann's speech in Belize. It is also noting that it can be the inference that something is not provided for that nothing is intended to happen.

Paragraphs 15 to 18, which is the other passage that was referred to by Mrs Justice Gloster, sets out the general approach to implication of terms. The relevant bit, which then refers to what might be the approach, or the special issue that arises when one is dealing with a lengthy or complicated contract, is with reference to

two judgments referred to that could possibly provide any kind of support for the proposition: well, it is more difficult to imply a term in a complex standard form agreement.

But none of them go as far as to say there is any form of strong presumption. Lord Hoffmann rather suggests that in a complicated instrument it may well still be appropriate to imply a term, and Sir Thomas Bingham is simply indicating that it can be more difficult in a lengthy and carefully drafted contract because it might have been something that had been left in the air because the parties couldn't agree about it and they left it out for that reason. But we aren't, in our submission, dealing with a lengthy and complex agreement here. It is a relatively short standard form document that one is concerned with. And --

MR JUSTICE HILDYARD: It is a very difficult test for the (inaudible) though, isn't it? I mean, at what stage of a contract? Does it have to be more than ten pages?

MR MARSHALL: Well --

MR JUSTICE HILDYARD: It can't be the length. Surely what they are getting at is along the lines of: where lots of people have worked hard to reach a standard form, which will be considered appropriate across a wide variety of

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

under section 74 at all, and that maybe because they wanted to keep them out of the equation, in terms of what sources could be called upon for repayment; another option would be to conclude that they just didn't have unlimited companies in mind, at all, for this type of document. That wouldn't be at all surprising, because unlimited companies are such a rare thing. Very rare thing.

Not to focus on provisions that are going to cover them perhaps wouldn't be that surprising. It wouldn't be any criticism of the FSA in relation to that. Particularly where what the FSA is doing is very much based on the European background directives, which certainly wouldn't have had English unlimited companies as the focus.

So while accepting what Your Lordship has said, we would respectfully submit this could well properly come into the category of case where it is simply an area which wasn't focused upon and for understandable reasons.

For that reason, there is a gap in terms of what is covered, and there needs to be appropriate implication of a term to cover it, to make the document work coherently, having regard to what its objective was. Your Lordship has already heard from me as to the

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

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

one you take, and this is the last of it -- that the obvious focus --
MR JUSTICE HILDYARD: The most difficult --
MR MARSHALL: -- was on the assets of the borrowing entity and not with recourse to other persons within the group via section 75, or indeed by other routes, like indemnities and suretyships.
MR JUSTICE HILDYARD: Yes. The most difficult is the Aberdeen City, isn't it, because a gap is one thing, but curing (inaudible) bargains is another.
MR MARSHALL: Your Lordship has to, for that approach to apply, Your Lordship is looking at the other provision to see what the objective was. If one can see it clearly enough Your Lordship can fill that gap, which is what they did in that case.
My Lord, just a couple of other very short points before we break, if I may. There was reference, I think, in Mr Trower's skeleton argument to Dairy Containers, which is a case to do with negotiable contracts. This was relied upon to support the proposition that you don't apply terms very readily. We respectfully submit that is of no relevance. We are not dealing with a negotiable contract. It is not some sort of bond that was going to be traded around. Reliance was also placed on the case of Mannai, and the

observation of Lord Hoffmann that you can have some agreements where certainty in terms of the meaning is critical. Certainty is paramount. But the type of case which is being considered there is where, for example, you have a documentary credit which is going to be presented to a third party, a bank, who then has to know straight away with a high degree of clarity what has to be done for payment to be made. We aren't in that category either. There is no question of some third party involvement, who doesn't know about the context of the agreement, who has to look simply at the terms of the document to work out what they have to do. It is not that category of case. We respectfully submit neither Dairy Containers nor Mannai provide Your Lordship with any assistance.
The right approach is simply to apply the Marks and Spencer principles, which have been set out by Lord Neuberger. There is no reason to depart from the approach that he has described as the correct approach in this case.
My Lord, if that is a convenient moment, that is, I think, the largely concluded issue 1. So I can move on and I should certainly finish during the course of this afternoon.
MR JUSTICE HILDYARD: 2.05.

(1.03pm)
(The luncheon adjournment)
(2.05pm)
MR MARSHALL: My Lord, over the short adjournment those behind me have been working industriously and have found annex 5 to the council directive from 1993, which I think is the one referred to by Mr Justice David Richards, which then cross refers to an earlier council directive of April 1989, which has various definitions of what comprises own funds for the purposes of the institutions that are regulated. Could I hand up a copy of the relevant EU provisions.
(Handed)
MR JUSTICE HILDYARD: Thank you.
MR MARSHALL: I think Your Lordship will find the 1993 directive, annexe 5, is, I think, the penultimate annexure and it cross refers, as Your Lordship will see, in paragraph 2, sub-paragraph A, to:
"Own funds as defined in directive 89.299, excluding certain items."
Then there is also reference to net trading book profits, subordinated loan capital and liquid assets, which are then defined, I think, on the following page.
(Pause)
MR JUSTICE HILDYARD: Yes.

MR MARSHALL: My Lord, the other council directive of April 1989 has the definition of own funds in Article 2.
MR JUSTICE HILDYARD: Yes.
MR MARSHALL: Then that has, in addition, on its list something called:
"Other items within the meaning of Article 3."
Those are then set out on the following page. So:
"Items covering normal banking risks, whose existence is disclosed on internal accounting records and amount is determined by management of the credit institution verified by auditors and made known to the competent authorities."
Then there is also provision for securities of indeterminate duration, which fulfil various criteria.
MR JUSTICE HILDYARD: Mm-hm.
MR MARSHALL: I think Your Lordship now has the relevant EU materials.
My Lord, I wasn't proposing to say anything further on the question of construction under issue 1.
In connection with the other issues which are contentious, on issue 3, I adopt the submissions that Your Lordship has had already from Mr Arden and Mr Atherton, if the issue arises, which if we are correct on issue 1 it doesn't, and if we are correct on

the rectification issue it doesn't as far as we are concerned. We would simply note that if those submissions are accepted on valuation, then any claim under the subordinated loan agreements would be extinguished by set-off as regards LBHI2, and there would not be anything left to claim over as against LBL.

My Lord, as regards issue 7, which is the next one, we view that really as being in two parts, with parts of items (i) and (v) being considered together. (i) Was whether the obligations to contribute to the assets of LBIE were joint or several or otherwise, and (v) was whether the LBL administrators directed to assert less than 100 per cent of the contribution claim as against LBL or LBHI2 and, if so, what should the reduction be and what factors should be taken into account.

My Lord, if we take that category first of all, our position on reflection is that whilst we accept that the jurisdiction exists to call for the full amount of the debt as against any member, irrespective of the size of shareholding, when it comes to actually making the decision to do that, to make a call under section 150, the court has a discretion and that discretion is not limited to just having regard to whether or not the relevant shareholder can pay or not, which is the particular factor averted to in decision 150.2.

My Lord, the rationale behind the reference to the ability to pay must be a practical consideration. There is no point in going through the process of seeking to call in money when it is, as a practical matter, not possible; one is simply going to waste time and effort by seeking to do so.

If that is the rationale behind it, then one can foresee that there will be a number of other factors which may come into the court's consideration, which would have potentially the same effect. For example, why bother where both contributories are in funds but have very different sizes of shareholding and go through the process of making a call for the full amount as against each contributory, and then go through a further process of adjustment? One can simply save time and effort by making this a one stage process rather than a two stage process by basing the calls on the size of shareholding.

Similarly, if one shareholder is simply holding that shareholder as a nominee on behalf of another, and that other is in funds, again, it in our submission makes more sense for the matters to be resolved in one court and in one process rather than two. Rather than having a call made on the shareholder who is holding as nominee and then them seeking to be indemnified, one can cut it

down, again, to a single process.

Now, looking at the authorities, there is no case, we submit, that is inconsistent with that approach. In the skeleton argument for Mr Trower, at paragraph 210, there is reference to a number of authorities beginning with re: Barnard's Banking Company, and then also to re: Cordova Union, and Helbert v Banner. They all, of course, emphasise that the process is for the benefit of creditors and that the court has to get on and see that creditors are paid. But, subject to that, if the process of calling in is going to achieve that objective, one can then take into account further factors which will make the process smoother, quicker and easier, which will include, where appropriate, to have regard to the size of shareholdings held and other factors, such as the nominee arrangements.

If I could just go to the Helbert v Banner case, which I think is in bundle 1 of the authorities, at tab 22, what Your Lordship can see from the decision, particularly the passage that begins just about half way down, with reference to that part of the case. The emphasis is on the fact that the court is exercising a reasonable discretion and, in that particular case, the question is whether or not the court should make the call where there was a question over whether or not

it was in fact necessary that there might in fact be other sources of payment. The observation is, from Lord Hatherley, the Lord Chancellor:

"The court would in no case direct calls to be made if it was clear that there were assets actually in the possession of the liquidator which were sufficient for the payment of the debts."

Then there was a question, really, of what level of proof was required for the court to be satisfied that it was appropriate for a call to be made given the question over whether or not the company would have funds available, itself, to meet the outstanding indebtedness. If it is a reasonable discretion of that kind, in our submission that sort of discretion is entirely consistent with the type of approach which I have indicated to Your Lordship can be properly taken. It is not surprising that Helbert v Banner and the other cases that have been referred to, like re: Cordova and Barnard's, have not referred to factors beyond the lack of assets to meet the relevant indebtedness, because most of these cases -- in fact I think in each one of these cases, the court was concerned with limited companies where the calls were tied only to the amount outstanding on the relevant debt, which certainly seems have been the case in Helbert v Banner, as one sees from

pages 29 to 30, where the shortfall on what had been paid up is set out.

Here, one is of course dealing with an unlimited company, and the sorts of factors that will come into play, potentially, are more wide ranging, including those which I have just indicated could potentially be taken into account.

My Lord, we respectfully submit, although in theory there is jurisdiction to make a call for the full amount, a number of factors would come into play at the point of the exercise of the discretion under section 150. Not simply linked to the number of shares held, but possibly also nominee arrangements and the like. My Lord, as far as --

MR JUSTICE HILDYARD: What proposition do I get from Helbert v Banner, really? That was a case on, wasn't it, as to whether the office holders had made sufficient inquiries to bolster the affidavit which they had made as to whether there was a deficiency.

MR MARSHALL: Yes.

MR JUSTICE HILDYARD: Beyond that, what do I get from it?

MR MARSHALL: Not much more than the fact that the court clearly has -- well, as the expression is put: a reasonable discretion.

MR JUSTICE HILDYARD: A reasonable discretion to accept or

not the liquidator's say so?

MR MARSHALL: Well, I think it is expressed as being a reasonable discretion under the provision as to whether or not to make a call. It is page 34:

"As part of the exercise, reasonable discretion would in no case direct the calls to be made if it was clear that there were assets actually in the possession of the liquidator."

If it has a reasonable discretion, in our submission, it is not limited to just working out whether the relevant member can pay or not. There is no reason why one shouldn't take account of further factors, which will mean that the whole process of administration or winding up is carried out in a more efficient manner, and having regard to the arrangements between the various contributories.

My Lord, as regards the second aspect of issue number 7, which is parts 2, 3 and 4, which is really about entitlement to contribution or indemnity between shareholders, and the extent to which any right or contribution will be affected by other claims which LBHI2 and LBL have against one and other, or against other parties. We respectfully submit the right approach to this is that, of course, the court has the power of adjustment. That can properly be invoked to

adjust the position between the contributories where the contribution, or adjustment, is required simply based on the size of shareholdings. So taking account of rateability. But where there is some independent right between the members -- for example, a right to indemnity because one is holding as nominee for another, so indemnification on agency or trusteeship principles -- it may be that is not capable of being dealt with by way of the adjustment process, but that doesn't mean that that right suddenly disappears. It still persists and the right can still be asserted, and if the relevant member, against whom the right exists, is in insolvency, then it would be asserted, no doubt, as part of the proofing process and appropriate set-off arrangements as may be the case.

My Lord, two authorities, I think, are referred to by Mr Trower to suggest that it is all really going to be dealt with as part of an adjustment process and there isn't any separate claim at that will be capable of being advanced.

One of the main ones, I think, is the Alexandra Palace case. We would respectfully submit that one of the other authorities that has been referred to, I think Overend & Gurney, clearly anticipated that there could be separate proceedings for an indemnity,

independently of the call and adjustment process. There is also nothing inconsistent with the existence of a potentially independent process in the Alexandra Palace case.

Overend & Gurney, I think, is in the authorities bundle, number 1, volume 1, at tab 19. If I can just go first to that.

My Lord, this was a case in which there was a contention that there ought to be a rectification of the register on the basis that one of the shareholders had in fact transferred shares away to another person. Then there is a question of whether or not that transfer had been completed, and could be the subject of some form of order for specific performance.

Your Lordship will see one of the issues that arose is described on page 202 of the report, in the fourth paragraph down from the top of the page, where it is recorded in the judgment of the Vice Chancellor that:

"It was contended by the counsel for Mr Hart there was no contract between Messrs Musgrave and Mr Hart, but Mr Hart intended to buy 30 shares in this company. It was perfectly unimportant to him from whom he bought them and the acceptance of the transfer from Messrs Musgrave is in my opinion a conclusive permission it was from them that the purchase was made and the

difference between that point is thus removed. The subsequent diminution in the value of the shares from a clause which both parties were in perfect ignorance at the time of the contract ...(reading to the words)... There was, therefore, I think, a binding contract between Messrs Musgrave and Mr Hart which I should have been bound to decrease specific performance if the case had been brought before me by a bill to enforce the contract."

The court concluded there was a contract and could have been specifically performed had there been appropriate proceedings do it. What then happens is that the Vice Chancellor then goes on to consider whether all of this can be dealt with in the proceedings before him under one of the provisions of the 1862 Companies Act.

At page 204, he goes on to note that there were previous binding decisions in which there were opposing opinions. In particular, at the bottom of page 204, opposing opinions in the case of Ward v Henry's case.

But then, at page 205, four lines down, he then says:

"However, there is a later case of the greatest important which was not reported at the time of argument. I refer to Marino's case."

And then he notes in that case:

"Marino was registered shareholder of company and another party ...(reading to the words)... accepted the shares bought by the company and acted as agents on his behalf."

He then goes on to describe further details of that case. At about ten lines up from the foot of page 205, he then notes:

"There was therefore this defect, that while the transfer was executed by the seller and sent to the company for registration, it had not been executed by the purchaser."

The case then came before the Court of Appeal. The conclusion of Lord Justice Turner was:

"The respondent has to make out that the company was guilty of default in not taking his name off the register, although according to their ordinary practice, the name could not be taken off ...(reading to the words)... to deviate from the practice which they had always pursued."

The conclusion, which appears about ten lines down from the top of the page, on page 206, is that Mr Marino had to continue upon the register and seek his remedy, if remedy he had, against Mr Issaverdens."

The conclusion, after all that, at the bottom of

page 206, is that the Vice Chancellor, although finding it rather difficult to reconcile all of the decisions, comes to the conclusion that he is bound by the outcome in that case and he cannot order rectification of the register in the case before him, notwithstanding having concluded that there was a contract and in normal circumstances he would have ordered specific performance. So he concludes, I think, at the top of page 207, four lines down from the top:

"Under these circumstances, I must reluctantly leave Messrs Musgrave to assert what remedies they have against Mr Hart by bill for a specific performance and indemnity or, as they may be advised, the present application must therefore be refused but considering the conduct of Mr Hart, it certainly must be so without costs."

So that is the position that is arrived at in Overend & Gurney, where the company had gone into liquidation and the question was rectification of register to alter the list of contributories. The conclusion is: can't alter the register, can't avoid you having a call made upon you, as a contributory, but you are still going to have your remedy for some form of contractual relief, whether for specific performance or damages in lieu, or compensation in lieu, as against the

other party.

We would respectfully submit that is entirely consistent with what you would expect. You still have your right. It may not be dealt with as part of the call process. It may not be dealt with as part of the adjustment process. It may not be capable of being dealt with as part of rectification of the register, but you still have a right which is then capable of being pressed. In the context of an insolvent respondent to the proceedings, would be dealt with, no doubt, by way of proof.

My Lord, the Alexandra Palace decision, which I think is the one referred to in Mr Trower's skeleton argument, is also in bundle 1, at tab 40.

The question that arose -- as one sees from the headnote -- is whether or not under the particular provision of the Companies Act, section 109, the 1862 Companies Act, there was a possibility of adjusting rights which included equities between tortfeasors. There were some rights between the -- potentially rights between the contributories for contributions as joint tortfeasors. It is therefore focused simply upon the question of whether or not the adjustment process under the Act can take account of that sort of claim for contribution as a tortfeasor, a joint tortfeasor.

The conclusion is that it can't. There is no jurisdiction under the Act to deal with it as part of the adjustment process. That is from Mr Justice Fry's judgment, at page 300. Your Lordship sees what was trying to be asserted in, I think, the second paragraph down:

"I do not find that I have any authority to make such an order for the purposes of working out such inequity between a tortfeasor to the company and creditors or contributories of the company."

Then he addresses the question as to whether section 109 gave him the jurisdiction for the adjustment process. He concludes that it doesn't.

At page 301, Your Lordship sees that he was purely focusing on whether he had the statutory jurisdiction and concluded that the statutory jurisdiction, among other things, wouldn't be appropriate because equities, of the sort that were raised, would need to be worked out by, potentially, other forms of proceedings. They wouldn't be convenient to be dealt with as part of the adjustment process in the winding up.

That does not mean, however, that the right to contribution that existed then suddenly disappeared. It could still be asserted. It would just have to be dealt with by a more convenient and appropriate process. Of

course, if the respondent had been, itself, insolvent, by a proof in their bankruptcy, or whatever insolvency process was being undertaken.

So, my Lord, that we submit is also the position here, in the sense that if there is a right of indemnity, for example, on the part of LBL, against other estates, irrespective of whether that can be dealt with as part of the adjustment process, the claim can still be made and it can still be proved for. If there is a right of set-off, or an appropriate set-off to be made in connection with it, then it will be dealt with as part of the set-off procedure. But, my Lord, the right to indemnity just doesn't disappear, it persists.

My Lord, linked to issue 7 is issue 8, where it is said: well, if there is a right to claim contribution or indemnity against other contributories, then potentially the rule against double proof would come into play. That is the way it is put in paragraph 232 of Mr Trower's skeleton argument. Two rival claims are postulated as against LBHI2, for in substance the same debt. Their concern is raised, I think, in paragraph 222.1, that there would then be potential competition with the right to contribution made, or call for contribution made, by LBIE.

My Lord, what we say in connection with that is

this: in relation to an unlimited company, it is not clear how this would actually work prejudicially certainly as far as LBIE is concerned. Because if LBL was to make a claim as against LBHI2, and received any funds as a result of that, there could be a further call from LBIE, if necessary, as against LBL, assuming we are wrong in all of our other arguments about our defence to such a call, and any difficulty arising over double proof could be dealt with by the making of that further call.

It is a similar explanation to the one that applies when considering the contributory rule in connection with an unlimited company. It is a point that is considered in the judgment of one of the members of the Court of Appeal in Black's case, which I think Your Lordship was taken to, which is in bundle 1 of the authorities, at tab 26.

It is the judgment of Lord Justice Mellish, at page 265. He was really considering, specifically, the contributory rule here, but similar considerations, we submit, apply in connection with double proof as well.

At 265, about eight lines down, there is a sentence beginning "although that section", and he is referring to section 101 of the 1862 Act:

"Although that section does not in terms say that

there is to be no set-off, it shows the legislature in framing that section the thought had already been enacted. There should be no set-off, because in the 101st section they proceed to say: where there is unlimited liability in the case of any independent contract, there may be a set-off. The reasonable distinction between a company with unlimited and limited liability is obvious. In the case of ...(reading to the words)... is that it doesn't at all prejudice the rights of the other creditors, because all of the shareholders are liable to the fullest amount of everything they possess. Therefore, if that call does not pay the creditors all their debts, in the case of an unlimited company, then another call may be made on the shareholders, including this particular shareholder, and so on, until the shareholders have been made to pay everything they can pay and the debt has been satisfied."

So issues over set-off, and what would normally be classified as the contributory rule, don't apply, in our submission, in quite the same way when dealing with an unlimited company. We would respectfully submit that the same goes for double proof considerations, because if there is a proof which ends up being a competing one from LBL, any money recovered from that proof, if there

is still a shortfall at LBIE, they can make a further call as against LBL to recover.

When one looks at the authorities that have been cited in connection with issue 8, in the LBIE skeleton argument, they all appear to be cases where the double proof doctrine has been applied in connection with a limited liability company, not an unlimited company.

My Lord, that then leads on to the last, well, one of the last, of the contentious issues involving our side, which is issue 9A, the preliminary issue to issue 9, which concerns whether you can have an agreement between a member and the company which enables the member to avoid liability under section 74.

In this context, it would seem the only agreement we are really concerned with is in fact the recharge agreement, which we are contending existed and which had been in place for some time prior to LBL's involvement with LBIE, and in particular prior to it having a share. That recharge agreement, we contend, had a much wider potential area of coverage. It is covering a number of different services being provided for the Lehman Group, and which was never entered into, of course, for the purposes of avoiding the effect of section 74.

Now, we contend that such an agreement, if it does have the effect of negating a call by virtue of the

right to then seek indemnification from LBIE and creating a defence of circuity of action, or set-off, doesn't offend public policy and that is essentially for three reasons. Whilst it is correct that there is a general principle that you can't contract out of the insolvency legislation, it is not the case that principle is applied in precisely the same way in all of the circumstances covered by it, and one can see that from the Belmont Park Investments decision, which Your Lordship was, I think, taken to last week, which is in bundle 3 of the authorities, at tab 85. If one takes it up in the judgment of Lord Collins, which is at page 396, Your Lordship, I think, was taken to this passage previously.

Your Lordship will have seen that the anti-deprivation rule, and the rule that it is contrary to public policy to contract out of pari passu distribution are two sub-rules of the general principle: you can't contract out of the insolvency legislation.

It is noted that there is some overlap, but they are directed fundamentally at different situations; anti-deprivation being aimed at attempts to withdraw assets from bankruptcy liquidation; the pari passu rule reflecting the principle that statutory principles for pro rata distribution may not be extended by a contract,

which gives one creditor more than its proper share.

My Lord, it is also then noted that, I think at paragraph 9 of Lord Collins' judgment, at page 398, that the distinction between the two sub-rules is by no means clear cut. He gives, as an example, the case of ex parte McKay.

Then notes, at page 400, paragraph 14, that it doesn't follow from the fact that it is difficult in some cases to draw the line between the two categories, that there aren't relevant differences. He goes on to describe:

"The anti-deprivation rule applies only if the deprivation is triggered by bankruptcy and has the effect of depriving the debtor of property which would otherwise be available to creditors, the pari passu rule applies irrespective of whether bankruptcy or liquidation is the trigger. There is a question of whether the bone fides of the parties are equally relevant to the application of the two principles."

He then goes on to consider that. Your Lordship will see that then dealt with, at page 413, paragraph 75 where he considers the limits of the anti-deprivation rule. At paragraph 75, just beside letter G, on page 413, he explains that the anti-deprivation rule had been based on the notion of fraud or a direct fraud on

the bankruptcy laws. At letter H, he then says:

"The overall effect of the authorities is that where the anti-deprivation rule has applied, it has been an almost invariably expressed element that the party seeking to take advantage of the deprivation was intending to evade the bankruptcy rules. But where it is not applied, the good faith or the commercial sense of the transaction has been a substantial factor. By contrast, the leading pari passu principle case, British Eagle, it didn't matter whether there was a sensible commercial arrangement not intended to circumvent the pari passu principle."

My Lord, there is then a conclusory section, at page 421, where, firstly, in paragraph 102, the anti-deprivation rule is treated as too well established to discard. Then, at paragraph 103, he goes on to say this:

"As has been seen, commercial sense and absence of intention to evade insolvency laws have been highly relevant factors in the application of the anti-deprivation rule, despite statutory inroads party autonomy is at the heart of English commercial law. Plainly, there are limits to party autonomy in the field with which this field is concerned, not least because the interests of third party creditors will be involved.

But, as Lord Neuberger stressed, it is desirable that insofar as possible the courts give effect to contractual terms which parties have agreed and there is a particularly strong case for autonomy in cases of complex financial instruments, such as those involved in this appeal. No doubt that is why, except in the case of a blatant attempt to deprive a party of property in the event of liquidation, the modern tendency has been to uphold commercially justifiable contractual provisions which have been said to offend the anti-deprivation rule."

He then goes on to explain the policy behind the anti-deprivation rule being clear, and:

"It is possible to give that policy a commonsense application which prevents its application to bone fide commercial transactions which do not have as their predominant purpose, or one of their main purposes, the deprivation of the property of one of the parties to the bankruptcy."

My Lord, in the present case, we respectfully submit we are not concerned with the pari passu rule. We are concerned with a statutory provision for a call which, on one analysis, that of Lord Justice Briggs, is an asset of the company.

On another analysis, that of Lord Justice Lewison,

although not an asset, is certainly a resource from which debts can be paid. Whichever way one categorises it, a contract, such as the recharge agreement, is one which deprives LBIE of the ability to exercise the right to call and, in our submission, is very closely analogous to, or indeed may properly be categorised as falling within, the anti-deprivation rule or something very close to it. Its effect is either to deprive LBIE of the asset, adopting Lord Justice Briggs' approach, or negates the ability to revert to that form of resource if one approaches it from Lord Justice Lewison's perspective.

Looked at in that way, and if that is the right way to analyse it, what one is looking for is, first of all, a lack of good faith that, if you like, a nefarious intent in terms of the agreement. Was it designed to deprive LBIE of that ability? Was that the intention behind it when it was set-up?

Secondly, also, if it is within the anti-deprivation rule, it has to be a right which is only triggered upon insolvency and doesn't apply outside of insolvency.

In our submission, one can categorise the recharge agreement as falling within either of those two conditions for the application of that rule or anything analogous to it.

My Lord, we would respectfully submit that the conclusory comments of Lord Collins in Belmont ought to be applied and ought to be the approach which the court adopts in connection with the recharge agreement. The commercial arrangement should be respected, given the absence of any objective other than a perfectly appropriate commercial objective, which does not have any connection with an attempt to undermine the effect of the insolvency legislation. Its effect insofar as it has deprived LBIE of an asset or a right of recourse is purely incidental to the overall arrangement which was entered into at a much earlier stage between the relevant parties. Perhaps that could be said to be reinforced by the fact that the effect of the arrangement is to bring about a result that could have been achieved directly by making appropriate provision in the contracts that LBIE issued, in which case section 72.4(e) could have been used directly, but the effect is one which has been able to be achieved indirectly.

Now, my Lord, I think a number of points were made about the fact that there are older authorities suggesting that any attempts to issue shares at a discount is inconsistent with the insolvency legislation and can't be allowed, is not possible. In

particular, I think reliance is also placed upon Welton v Saffery for the proposition that it doesn't matter whether there was any form of nefarious intent when setting up such arrangements. It is enough that they are simply inconsistent with the statutory provisions for shares to be fully paid up.

My Lord, we contend that in those cases, in particular Welton v Saffery, are focusing, really, upon the power, the authority, to issue shares granted by the memorandum articles which are the ones that then have to comply with the statutory requirements. There wasn't authority in Welton v Saffery for shares to be issued in the form in which they were. So it ultimately ended up being a sort of ultra vires point, as opposed to a question of whether or not there was a contravention of public policy.

My Lord, if I can just take Your Lordship to the Welton v Saffery case. It is in volume 2 of the authorities, tab 50. I think the relevant passage that is relied upon is at pages 304 to 305, and the argument was whether the previous case, the Ooregum case, could apply where there was a call simply to settle the rights of shareholders interse. That is recorded in the judgment of Lord Halsbury, at page 304, in the first paragraph.

He then goes on, in the second paragraph, at the foot of page 304, to say that he thinks:

"The legislator, in permitting the existence of a company limited by shares and with limited liability, created a machinery which makes it impossible by any expedient, either by company or shareholder, to act otherwise than in pursuance of provision of the statute, whether for the purposes of settling the rights interse or for the purposes of satisfying creditors."

He then expresses a view as to what the decision in Ooregum established:

"Unable to see how this artificial feature limited within its sphere of action by the statute under which it was created can do anything contrary to the provisions of the statute is not a question for what purpose it is done, dealing with it, as I think it must be dealt with, as an artificial creation, it can only act as a company or a shareholder in either of those characters within the fetters created by the Act of Parliament."

He then goes on to say:

"It is said and I think justly said that people have been invited to take shares under the article of association which expressly provided that shares might be issued at a discount. It is I think hard for persons

who have relied upon that assurance to find out that the Article which authorised the issue of the shares at the discount was ultra vires of the company, because it is in conflict with the memorandum of association by which the statute itself that must determine the rights in that respect."

It is evident, from the way that this analysis works, that it is a question of the power of the company to issue shares at a discount. His conclusion is because of the way in which the company is set-up, as a statutory creature, the memorandum is subject to the statutory requirements, there wasn't the power to issue shares in the form in which it was done.

My Lord, many of the other cases that concern actions inconsistent with the statutory regime are ones where one can see some form of nefarious intent has been established. If one takes as an example of authorities referred to, I think, in Mr Trower's skeleton argument, at paragraph 275, this is on page 83. Your Lordship will see reference at 275.1 to Booth v Pollard, and there Your Lordship will see the focus is upon whether there is a contrivance, an evasion of the statute, and there is a discussion then about the provisions of an Act of Parliament being evaded by shift or contrivance. All indicative of an intent which is

contrary to the statutory objective.

In our submission, the cases that are referred to in this section would be consistent with an approach which categorised an attempt to evade, a deliberate attempt to evade, the effect of the insolvency provisions as being prohibited; that would be consistent with an application of something similar to the anti-deprivation rule, as opposed to a rule similar to the pari passu rule, where no nefarious intent is required.

So, my Lord, in summary, we respectfully submit that the recharge agreement is not contrary to public policy per se. It would require establishing some form of intent, on the part of those who entered into it, to act contrary to the insolvency provisions before it could be said to be unenforceable in any relevant respect. If we are correct, that it is something that has to be looked at by reference to the anti-deprivation doctrine, or something akin to it, one would need to see, also, that it was triggered by or intended to be triggered by insolvency, which it clearly is not, it is something that applied outside of that context. For those reasons, it is not defeated simply because it may incidentally result in a scenario whereby a call is made under section 74, there may be a right of recourse back again to LBIE because of its provisions.

My Lord, I think that largely dealt with the issues which were the key ones for me to address. I think there are also potentially issues raised in connection with issue 10. But, my Lord, I think our position is issue 10 was that that would not arise as a practical issue because of either our arguments under issue 1, the circuity of action defence, or alternatively the correct contractual interpretation, or as a result of the effect of the rules on set-off. But this is in connection with whether the recharge claim against LBIE in respect of the sub-debt contribution claim and LBHI2's claim in respect of the sub-debt are to be paid pari passu and, if not, in what order of priority.

I think the main points made here are in relation to the possibility, effectively, of a double proof in respect of the same obligation. Our answer to that is: if we are correct in our contentions as to how the sub-debt works, we won't get to this scenario at all. One way or another, it would be dealt with without their being proof from our side, as well as that from LBHI2. It is an entirely academic issue.

My Lord, as regards the agreed issues, I just wanted to indicate to Your Lordship which of those we saw as being potentially affected by the outcome in the Supreme Court.

I think our position was that -- I will just find my note in connection with it -- issue 1 potentially would be affected by the Supreme Court's judgment to the extent that it concerned the sub-debt and its construction.

In terms of the agreed issues, we don't consider that issues 5, 6 and 12 were likely to be affected by the Supreme Court judgment, because the court wasn't considering the position as between multiple administrations but only the position in LBIE's administration. But it does seem that the judgment would impact on issue 2, because the ranking and provability of the sub-debt are in issue, together with the question of whether it may be included in the insolvency set-off account. Similarly, those issues might impact on issue 4, which concerns the availability of the sub-debt or a sub-debt contribution claim for the purposes of set-off.

My Lord, as far as the remaining issues are concerned, issue 3 might be impacted if the Supreme Court ventured into the issue of the valuation.

MR JUSTICE HILDYARD: If what?

MR MARSHALL: Issue 7 might be affected as well. Issue 3 might be impacted if the Supreme Court enters into the issue of valuation. Issue 7 might be affected by any

determinations as to the scope of the section 74 liability and is operation. Issue 8 might be affected by the Supreme Court's determination as to the application of the contributory rule. We don't see any likely impact from the Supreme Court on issue 9A or 10.

My Lord, that might be a convenient moment to break. I can obviously just check whether there is anything else for me to add, but I think we have pretty much come to the end of our submissions.

MR JUSTICE HILDYARD: Have you all been discussing how we should carry forward matters, both as regards the agreed issues and as regard any replies?

MR MARSHALL: Briefly, but perhaps we can use the opportunity of the short break to discuss it a little further as to the right way forward. There was some discussion about whether or not a break was still needed and, if so, how much of a break. But perhaps I can discuss that further with Mr Trower.

MR JUSTICE HILDYARD: Shall we take ten minutes now and then you can report provisionally and we can work out how it goes ahead?

MR MARSHALL: Yes, indeed.

(3.14pm)

(A short break)

(3.28pm)

MR MARSHALL: My Lord, I am just going to say that subject to anything Your Lordship wanted to ask me, that does conclude our submissions.

Mr Trower and I have discussed the question of replies, and I think he is going to address Your Lordship.

MR JUSTICE HILDYARD: Can I ask you something on the circuity of action?

MR MARSHALL: Yes, of course.

MR JUSTICE HILDYARD: The facts of the cases are not easy to always to see clearly --

MR MARSHALL: Yes.

MR JUSTICE HILDYARD: -- and I must look at them. But is there any case, on which you rely, where the circuity did not depend on there being an equal and opposite contractual indemnity in respect of the same amount?

MR MARSHALL: I think the ones that I have taken Your Lordship to were ones in which there was a contractual indemnity, but there are more cases which we can consider.

I am just trying to remember. The Post Office case, my Lord, the one about the telephone line.

MR JUSTICE HILDYARD: Yes.

MR MARSHALL: That was a tortious claim for misrepresentation by the relevant telephone company to

the local authority -- the Post Office to the local authority, which would have given the right to compensation for the same amount that the local authority was liable to the Post Office for, for damaging their line. So that would be an example of a non-contractual claim going in the other direction, but they are generally cases about the same amount.

MR JUSTICE HILDYARD: I mean, they are the same claim. I am grateful to you for pointing out that the Post Office is the same claim in a different direction as regards tortious basis of liability.

MR MARSHALL: Yes.

MR JUSTICE HILDYARD: That is helpful. It is not a principle which has seen the light of day all that often, as far as I can see.

MR MARSHALL: Yes.

MR JUSTICE HILDYARD: You have to stretch fairly hard to find it. It is not the worse for that, but it does seem to be confined when the court can say, "Well, look, come on, you are simply saying on the one hand something which on the other hand is going to result in an equal and opposite amount. Therefore, we are not going to have this moot about the whole thing".

MR MARSHALL: Yes. My Lord, it is right to say that the cases have been considering claims which are directly

comparable in terms of the quantification. That is certainly true.
MR JUSTICE HILDYARD: Yes.
MR MARSHALL: But the basis on which the claim may come back need not necessarily be contractual, it would appear.
MR JUSTICE HILDYARD: No. There is either a contract or some equal and opposite fault.
MR MARSHALL: Yes.
MR JUSTICE HILDYARD: Whereas one might think that the calls on an unlimited share are simply a contractual matter. They may or may not be confined to the particular exposure. Mr Trower says they are not, you say all but a penny or two they are, but they do seem rather different in source; do you want to respond to that?
MR MARSHALL: Well, my Lord, fundamentally, if there is a call made to meet this sub-debt, then necessarily its quantification is based on the subordinated debt agreement and, therefore, there is a right to recover for precisely the same amount, but one can't see why, in principle, that shouldn't come within the doctrine.
No one has suggested on any of the authorities, including the Supreme Court decision advanced, that it has to be a fault based claim going back for --
MR JUSTICE HILDYARD: That case was a contractual indemnity.
MR MARSHALL: That was for contractual indemnity.

MR JUSTICE HILDYARD: That was a moot, on analysis.
MR MARSHALL: Yes.
MR JUSTICE HILDYARD: Yes. Well, if anyone knows of a case which is not an equal and opposite claim, that would be helpful.
MR MARSHALL: Of course, we will look for that, check that.
HOUSEKEEPING
MR TROWER: My Lord, we will also do a bit more work on that as well.
MR JUSTICE HILDYARD: Yes.
MR TROWER: My Lord, just so I can tell Your Lordship where we are we all are, first, so far as the Supreme Court is concerned. First of all, we did make a further inquiry this morning. We have been regularly inquiring and they are probably bored of us asking, and I am afraid the answer remains: they simply don't know and won't tell us. Can't tell us, perhaps, but that is the position.
MR JUSTICE HILDYARD: Yes.
MR TROWER: The second point is: so far as the issues are concerned, we agree with Mr Marshall that it is possible that issues 1, 2, 3 and 4 may be impacted, although it is very difficult to know to what extent. There are any number of different ways of analysing the issues leading to a conclusion that they might be impacted, and they may well not be, whatever the result in the Supreme

Court. But they may, we accept that.
We don't think, for our part, that any of the other issues will be.
I think everyone is of the same mind in relation to all of the other issues, apart from 7. I think there is a slight divergence of view between counsel as to whether there is any possibility of 7 being affected. We don't see it ourselves at the moment, but that is one of the things that we will think about before I do my reply, now I know which area there is a little bit of divergence of view in relation to the impact. I think it is only issue 7.
My Lord, that is the position as far as the Supreme Court is concerned.
My Lord, as far as replies are concerned, we have discussed it. I think where we are is this: I think we are all agreed that we should go back down the line, by which I mean in the reverse order for the way we did submissions first time round. With me finishing with the last of the replies of right. Of course we accept that if anyone raises new points, or new cases in their replies, Mr Marshall will then have a go at the end, insofar as, in accordance with normal practice. But, otherwise, that is the way we think it will work.
We would respectfully suggest that we rise for a day

and sit again on Wednesday morning to do the replies. We are all confident we can get the replies dealt with in a day. The great advantage of that is that it will give us time to give Your Lordship, I hope, a little bit more assistance in the way in which the issues actually all do inter mesh in the light of the way the arguments have gone. Subject to the court, we think that it will make our replies crisper and more effective, if we can do it that way.
So, unless there was anything else, I think that was where we all were as to how we should take matters forward, but we should invite Your Lordship to adjourn now until 10.30 on Wednesday, when we will do the replies in that way. It may also assist Your Lordship in identifying those areas which you want to cross-examine us a bit harder on.
MR JUSTICE HILDYARD: Are you each proposing to have merely -- I don't mean that rudely -- oral replies, or are you envisaging that there will be any written replies?
MR TROWER: My Lord, I think there will be one or two aids that Your Lordship will get.
MR JUSTICE HILDYARD: Yes.
MR TROWER: We weren't envisaging a full speaking note in writing.

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

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

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

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

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