1 Wednesday, 1 February 2017
2 (10.30 am)
3 HOUSEKEEPING
4 MR TROWER: May it please, your Lordship. This is the trial
5 of Waterfall Part III A in which, as my Lord knows, some
6 but not all, in fact most but not all, of the issues are
7 set out in the administrator's application notice for
8 trial.
9 Shall I just give your Lordship the appearances so
10 far as the speaking parts are concerned for the record?
11 MR JUSTICE HILDYARD: Yes.
12 MR TROWER: I appear for LBIE, with Mr Bayfield and
13 Ms Robins.
14 Ms Toube, with Ms Peters, appears for LBEL.
15 Mr Marshall and Ms den Besten appears for LBL, or the
16 administrators of LBL.
17 Mr Arden, Ms Hutton, Ms Foskett appear for LBHI2,
18 the administrators.
19 Mr Atherton and Mr Beswetherick appear for the
20 administrators of LBH.
21 Your Lordship has had skeleton arguments from all
22 the parties in relation to the issues which are for
23 determination during the course of the trial over the
24 course of the next few days.
25 Our skeleton argument is -- I think is probably fair

1 to say -- fuller than the others. It was done
2 deliberately that way, as more in the light of a written
3 submission than a skeleton. I hope your Lordship will
4 find it helpful rather than onerous .
5 My Lord, the skeleton arguments, given the nature of
6 the issues which the court is being asked to determine,
7 are amongst the most important documents for the court
8 to consider; there is other material which we included
9 in a reading list to the court, which is also essential.
10 So far as the first few categories on the reading list
11 are central, so far as all the parties are concerned.
12 There were then some additional documents that LBL was
13 particularly keen your Lordship should have a look at
14 before the trial commenced. I think it is fair to say
15 that other parties were not convinced that was
16 necessary, but it was appropriate, obviously, in the
17 light of LBL's position that your Lordship should see
18 them if your Lordship had time to do so.
19 So far as the issues which are live and in respect
20 of which there is going to be substantive argument
21 before the court are concerned, as my Lord knows, those
22 are issues 1, 3, 7, 8, 9A and 10. When I say 9A, I mean
23 the preliminary issue on 9.
24 The other issues are, I think, broadly agreed,
25 although I will have to take your Lordship, at some

1 stage, to exactly the extent of the agreement and take
2 your Lordship through why it is the parties are
3 satisfied that it is appropriate for the court to grant
4 the declarations that are sought. I was not going to do
5 that straight away as my Lord will have seen from
6 pre-reading what they are, so I hope will have mind --
7 we will come to one or two of them as we go through the
8 other issues -- what the issues are that are agreed.
9 MR JUSTICE HILDYARD: In that connection I will I think
10 need, as I indicated previously, to be satisfied that it
11 is right and appropriate to grant a declaration.
12 MR TROWER: Yes.
13 MR JUSTICE HILDYARD: Where there has been full argument and
14 it will assist, and will direct others who may not be
15 immediately involve, I quite see the point of
16 declarations and they have been granted in previous
17 Waterfall proceedings.
18 The mere fact this arises at the instance,
19 technically, of the administrators and arises in the
20 context of liquidation or administration proceedings
21 does not, to my mind, in anyway remove from the court's
22 obligation the usual rules that it is not to grant
23 a declaration unless satisfied after argument.
24 MR TROWER: Yes, indeed, my Lord.
25 The way we have dealt with it at the moment is we

1 have dealt with each of the agreed declarations
2 relatively shortly towards the end of our skeleton
3 argument. I will take my Lord through that part of the
4 skeleton argument and explain one or two of the points
5 that may require explanation .
6 My Lord, so far as I think it is fair to say that in
7 respect of one or two aspects of each of the agreed
8 issues, we will touch on points that bear on them during
9 the course of the argument on the other issues,
10 obviously. So I hope my Lord will begin to see the
11 shape of it.
12 MR JUSTICE HILDYARD: Yes.
13 MR TROWER: The very fact they are agreed means that of
14 course my Lord will not have adversarial argument in
15 relation to any of them. We are all officers of
16 the court, or representing officers of the court, and to
17 the extent that there are questions which arise, we are
18 conscious of the need to draw those to the court's
19 attention.
20 I think it's fair to say that in relation to some of
21 them they have become increasingly obvious, we would
22 submit, so far as the answer is concerned in light of
23 the preparation of the application over time.
24 MR JUSTICE HILDYARD: Yes, well, you quite rightly identify
25 my concern.

1 MR TROWER: Indeed.
2 MR JUSTICE HILDYARD: Which is there is not an adversarial
3 argument.
4 MR TROWER: Yes.
5 MR JUSTICE HILDYARD: That may be remedied by your point
6 that, as officers of the court, you are bound to draw to
7 my attention other contrary arguments.
8 MR TROWER: Yes.
9 MR JUSTICE HILDYARD: But I make the point now in case it
10 affects the timetable, and just to put down a little
11 warning that I would have to feel that I was in
12 a position to give a declaration notwithstanding not
13 having the full advantage of adversarial argument.
14 MR TROWER: Yes. No, I understand that, my Lord.
15 I wasn't going to address the substance of the
16 question -- what I can describe as the agreed issues at
17 this stage. I was going to leave that until the end.
18 MR JUSTICE HILDYARD: As you say, there will be certain
19 issues, including set-off for example, where you will
20 necessarily touch on it in the course of your other
21 submission.
22 Opening submissions by MR TROWER
23 MR TROWER: Indeed, my Lord.
24 So, my Lord, with that very brief introduction I was
25 going to turn straight to the first issue, and my Lord

1 knows where the issues are to be found. They are still
2 in the application notice and my Lord has seen them
3 recited in a number of the skeleton arguments, and so on
4 and so forth.
5 While I am, while I am going through my submissions,
6 my Lord may find it helpful just to have to hand our
7 skeleton argument, because the order in which I am going
8 to address them is reflected in the skeleton argument,
9 broadly speaking. There are one or two occasions on
10 which I stray.
11 The first issue is whether the obligation to
12 contribute to the assets of LBIE, pursuant to
13 section 74, include an obligation to contribute to the
14 assets of LBIE to the extent necessary to enable LBIE to
15 pay the sub-debt.
16 Now, before I address the substance of that issue,
17 can I say something in the light of what is said in
18 a number of places in LBL's skeleton argument about why
19 issue one matters.
20 Now, it is said against us that issue one is of
21 limited affect because everyone is agreed that any
22 sub-debt contribution claim is to be dealt with in
23 LBIE's administration by way of set-off as against as
24 LBHI2 as lender of the sub-debt. The effect is to
25 extinguish, to the extent of any set-off, any sub-debt

1 contribution claim that LBIE might otherwise have had
2 against LBL.
3 Now, we agree that any claim against LBHI2 and LBL
4 under section 74, including in respect of the sub-debt,
5 is included in the insolvency set-off account in LBIE's
6 administration, as against the provable claims, whatever
7 they may be, of LBH12 and LBL; that is the answer to
8 issue 2. We deal with it in our skeleton at paragraphs
9 300 and 303.
10 We also agree that any set-off in LBIE's
11 administration between LBHI2's claim in respect of the
12 sub-debt, and LBIE's sub-debt contribution claim against
13 LBHI2, has the effect of extinguishing LBIE's sub-debt
14 contribution claim against LBL to the extent of the
15 set-off. That is the answer to issue 4.
16 But that doesn't mean that it is not necessary to
17 identify what goes into either side of the account, it
18 is.
19 Before explaining why, it is important to bear in
20 mind that issues 1 and 3 -- 1 being whether you include,
21 as I have indicated, within the obligation to contribute
22 anything attributable to the sub-debt, and, 3, how you
23 value it. Those are concerned with identifying two core
24 aspects of LBIE's out bound section 74 claim.
25 So, as I intimated, 1 is concerned with whether, in

1 principle, the obligation to contribute extends to what
2 is required to pay the sub-debt. In essence: is the
3 sub-debt one of the debts or liabilities which is to be
4 taken into account when determining the insufficiency of
5 LBIE's assets for the purpose of the section 74. 3 is
6 concerned with the value, which is attributed to the
7 element of the section 74 claim which derives from
8 non-payment of the sub-debt. It is doing it for two
9 purposes: one, for the purpose of proof in the members
10 insolvencies and, two, for the purpose of taking the
11 set-off account in LBIE's insolvency.
12 The reason that issue 1 matters is that by reason of
13 the answer we give to issue 3, there are many
14 circumstances in which the provable amount of the
15 inbound claim against LBIE is different to the value of
16 the out bound section 74 claim which LBIE is able to
17 prove against it --
18 MR JUSTICE HILDYARD: On your case.
19 MR TROWER: On our case. That is why we have to answer
20 section 1.
21 Just so my Lord has a bit of factual context in
22 which to place this: Mr Downs's 9th witness statement,
23 I don't think we need turn it up, paragraph 926.3.
24 He gives some figures which help put this in context.
25 The inbound side of the account, that is the amounts

1 provable by LBHI2 in LBIE's administration, LBHI2 has an
2 ordinary secured claim for 38 million in LBIE's
3 administration. It has a claim for 1.254 billion in
4 LBIE's administration arising under the sub-debt
5 agreement. Until such time as the contingencies are
6 satisfied -- and this is a point we will come back to at
7 a number of stages -- the sub-debt is provable for zero
8 according to Lord Justice Lewison. For the purposes of
9 this part of the description, you assume that the
10 contingencies are not satisfied because interest and
11 currency conversion claims are not paid in full. The
12 contingencies are not satisfied.
13 The consequence of that is that the provable claims,
14 until the contingencies are satisfied, are 38 million,
15 so far as LBHI2 is concerned and the amount that goes on
16 one side of the set-off account.
17 So far as the out bound side of the account is
18 concerned, the amount provable by LBIE in LBHI2's
19 administration, which we say is the deficiency in our
20 administration, you include for this purpose a figure of
21 1.254 billion in respect of the sub-debt. You can
22 immediately see there is a difference in the inbound and
23 the outbound.
24 Then posit what is a perfectly possible scenario,
25 which is assume a deficiency of 1 billion as regards

1 statutory interests and currency conversion claims
2 within LBIE's estate. What you then do is you add, on
3 our case, the sub-debt amount of 1.254 billion to the
4 deficiency of 1 billion, and you then have a total
5 outbound provable claim of 2.254 billion. So what
6 you have is you have the total deficiency as respects
7 (inaudible) and you then have the claim in respect of
8 the sub-debt.
9 Now, if that leads, in those circumstances, to
10 a dividend of materially less than a billion from LBHI2
11 and LBL, the sub-debt contingencies will never have been
12 satisfied and the decision of the Court of Appeal means
13 that the set-off available in the LBIE estate will still
14 only be 38 million, because that is the only figure of
15 the inbound claim.
16 Now, I will come back, when dealing with issue 3, to
17 what happens if the effect of the dividends from the
18 members as a result of the recoveries made pursuant to
19 section 74 is that LBIE's other liabilities are actually
20 paid in full. There is a point that is raised in
21 particular by Mr Arden, we will need to just address it.
22 I do not want to get distracted on that at the moment.
23 I am simply addressing the question of why it is that
24 issue 1 is necessary, notwithstanding our acceptance in
25 relation to set-off which is the answer to issue 2 and

1 issue 4.
2 So, against that background, issue 1, the substance
3 of it. The starting point is section 74 of the
4 Insolvency Act. My Lord, I know has seen it. It is in
5 the bundles, bundle 5, at tab 132 and 133.
6 MR JUSTICE HILDYARD: In the authorities bundle?
7 MR TROWER: In the authorities bundle, yes. Just so my Lord
8 is aware of the position. I do not think that it
9 affects anything so far as my Lord is concerned on this
10 application. But section 74 was amended on
11 1 October 2009. You have the amended version and the
12 present version.
13 Now, I do not think anything turns on that, but that
14 is why you have two versions in the bundles. LBIE went
15 into administration in 2008, but is not obviously yet in
16 winding-up.
17 I have marked up the version behind tab 132.
18 I do not think there is anything very much in
19 dispute between the parties on this. The first question
20 is: as a matter of construction is the contingent
21 obligation under the sub-debt agreement a debt or
22 liability within the meaning of the section?
23 Now, we do not understand any of the parties to
24 contend that sub-debt does not fall within the language
25 of section 74.1, i.e. that so far as section 74 is

1 concerned the language does not fit the obligation
2 created by the sub-debt agreement.
3 Indeed, it is difficult to see how such an argument
4 could survive in the light of what was said in
5 Waterfall I by both Lord Justice Lewison, at
6 paragraph 121, and Lord Justice Briggs, at paragraphs
7 201 to 203. I think, given this is the first time I
8 have mentioned it, it is probably just worth turning
9 those passages and their judgments up now.
10 We have the Waterfall I and II judgments. They are
11 in the bundles, volume 1 of the trial bundle. I think
12 they are also in the authorities bundle too, behind
13 tab 8 is Mr Justice David Richards and 9 is --
14 MR JUSTICE HILDYARD: You want me to go to volume 1 of?
15 MR TROWER: Of the trial bundle, tab 9.
16 The two parts of the judgments that are relevant are
17 paragraph 121, on page 35, and then Lord Justice Briggs
18 at paragraphs 201 to 203.
19 The point there is that the debts and liabilities in
20 both those -- they are the conclusions that both judges
21 reach as to the extent of the ambit of section 74 and
22 the concept of debts or liabilities. The explanation is
23 they cover all the items in the Waterfall, right down to
24 the contributories adjustments, so it inevitably follows
25 that they must cover also the sub-debt; that is not

1 seriously in contention.
2 There are three arguments, as we understand it, that
3 are put against us. The first is one based on circuity
4 of action, which is raised by LBL, in paragraph 30 of
5 their skeleton argument.
6 The second argument is that, as a matter of
7 construction of the sub-debt agreement, the obligations
8 which arise under it are not just subordinated but are
9 also, in effect, limited in recourse. They are limited
10 recourse obligations. The limitation in the recourse is
11 said to be to LBIE's own funds, and it is said:
12 "A limitation of this sort is both contemplated and
13 authorised by section 74.2E."
14 My Lord still has section 74 open. This is the
15 subsection. As my Lord knows, the limitations in
16 relation to the obligations and the contributories are
17 all set out in section 2. 2E is the relevant one on
18 which reliance was placed.
19 We come back to this, not just in the context of the
20 application of or the construction of the agreement, we
21 come back to it also when looking at issue 9A, the
22 preliminary issue, it is also relied on in that context
23 too.
24 The third argument, which is primarily run before
25 your Lordship by Mr Atherton on behalf of LBH is that it

1 is in effect an argument the sub-debt is not payable at
2 all, unless all of the other debts and liabilities of
3 LBIE are payable from its own resources without
4 reference to any contribution from the contributories.
5 MR JUSTICE HILDYARD: This is the solvency argument?
6 MR TROWER: Yes, based on clause 5.2 of the sub-debt
7 agreement.
8 Now, so far as the circuity of action argument is
9 concerned, as I indicated, it was raised in paragraph 30
10 of LBL's skeleton argument. It is worth just turning
11 that up briefly, so my Lord can see it.
12 It is not an argument that we address head on in our
13 skeleton, so I just need to explain what our position is
14 in relation to it. Paragraph 30, page 15 of
15 Mr Marshall. The argument appears to be that LBIE has
16 a defence to the claim under the sub-debt agreement
17 based on circuity of action. The circuity is said to be
18 the claim under section 74. Now, we say this is wrong.
19 Circuity of action is a legal defence to a claim. It is
20 most crisply described in one of the cases on which
21 Mr Marshall relies, the Post Office v Hampshire case.
22 If we could just turn that up. It is in bundle 2 in the
23 authorities bundles, at tab 64.
24 MR JUSTICE HILDYARD: Shall I just mention this: I have
25 tried to read through and understand the skeleton

1 arguments, and I have looked at the position papers
2 which they reflect.
3 MR TROWER: Yes.
4 MR JUSTICE HILDYARD: I have had a look at the section and
5 dipped into the Waterfall cases which have preceded
6 this. I have not, on the whole, looked at the
7 authorities which were referred to.
8 MR TROWER: I am very grateful for that indication, my Lord.
9 I will bear that in mind.
10 Now, it is actually a convenient place to find what
11 was said in a case called Ginty. If we go to page 134
12 of the judgment, what is happening here is
13 Lord Justice Geoffrey Lane is relying on what was said
14 in Ginty about circuity of action. If my Lord would
15 simply read from E to G, on page 134, which is
16 a quotation from Ginty, it explains crisply what
17 circuity of action is all about.
18 (Pause).
19 MR JUSTICE HILDYARD: Yes.
20 MR TROWER: The important point is it requires an action to
21 which the claim can then be advanced as a defence.
22 Obviously, one is in a rather different world when
23 we are dealing with insolvency of this sort. There are
24 two hypothetical situations one has to posit and bear in
25 mind. One either has to think of it in the context of

1 the winding up of LBIE, where the cross claim said to
2 give rise to the circuity arises under section 74
3 directly; or one has to think of it in the context of an
4 administration of LBIE, where the cross claim is
5 a contingent claim based on section 74, which is
6 provable in the insolvency of the members, which was one
7 of the points decided in Waterfall I. So that is the
8 context in which one is thinking about the claims.
9 Now, in administration, there is a mandatory set-off
10 which takes place under rule 2.85 at the relevant
11 insolvency date, which includes prospective and
12 contingent claims. That is the answer to issue two.
13 The consequence of that is there isn't room for the
14 operation of a defence of circuity. The set-off has
15 already taken place. The analysis is: what is the
16 effect of the set-off? Not: is there a defence of
17 circuity?
18 In the case of winding-up the analysis is actually
19 a little bit different, because in the case of
20 winding-up, if one is thinking about what is said here
21 by Mr Marshall, actually the contributory rule would
22 apply.
23 Now, this was a rule that was examined in some
24 detail, by Mr Justice David Richards and the Court of
25 Appeal in the Waterfall I. We argued that the

1 contributory rule should be extended from windings up to
2 administrations. We were unsuccessful in that argument,
3 both before Mr Justice David Richards and before
4 the Court of Appeal. That was what the argument was all
5 about before Mr Justice David Richards, in the Court of
6 Appeal: should you apply the contributory rule in the
7 context of an administration? They said, "No".
8 In the context of a winding-up the contributory rule
9 would apply so as to prevent LBHI2 from making any claim
10 as an unsecured or subordinated creditor until it had
11 discharged its liability as a contributory. That is the
12 way it works.
13 Can I give my Lord probably the best description of
14 what is going on in the contributory rule? It is in
15 Mr Justice David Richards judgment in Waterfall I,
16 paragraphs 179 to 184, more particularly paragraph 184.
17 That is behind tab 8 and page 48 is the conclusion,
18 paragraph 184. There is a very crisp analysis of what
19 the rule is, in paragraphs 179 to 183. Then, in 184, if
20 my Lord would just read that. 184. Because it was
21 actually common ground, in Waterfall I, that the
22 contributory rule would apply so as to prevent any form
23 of proof in respect of the sub-debt until the court had
24 actually been discharged were LBIE to be in liquidation.
25 I don't know how familiar my Lord is with the

1 contributory rule and how it actually works, but it
2 might be convenient just to cast your eye down 179 to
3 183.
4 MR JUSTICE HILDYARD: Yes, do you mind.
5 MR TROWER: It is not the kind of rule one comes across
6 every day. (Pause).
7 MR JUSTICE HILDYARD: Yes? There is a sort of mandatory
8 deferment to the right of claim.
9 MR TROWER: Indeed. If you have an obligation to contribute
10 to this particular fund, in this particular capacity,
11 you have to do it. Only then can you participate.
12 We say that circuity of action simply is not the
13 right way of looking at this; you either have set-off in
14 the context of administration or you have the
15 contributory rule were LBIE to go into liquidation and
16 make a call. So that is our answer to paragraph 30 of
17 LBL's skeleton argument.
18 The second argument that arises on issue 1 is what
19 I might call the construction argument.
20 The way it is put by LBL is that it there is either
21 an express term or an implied term in the agreement --
22 and by "the agreement" I mean the sub-debt -- that is
23 based on, effectively, the principles that underpin
24 section 74(ii)(e) and which means that the sub-debt is
25 only capable of being paid out of LBIE's own funds.

1 I think the first task is just to look at the
2 sub-debt agreement itself. I think it is fair to submit
3 that our task in relation to the express term is
4 somewhat circumscribed by the fact that it is quite
5 difficult to identify what it is that is said to be the
6 express term that has the meaning for which Mr Marshall
7 contends. What I am saying is slightly without
8 prejudice to us getting something more precise on this
9 during the course of his submissions which I can then
10 deal with by way of reply.
11 If we look at the sub-debt agreement, which my Lord
12 finds in volume 4, behind tab 1, the short submission is
13 that while there is much in the sub-debt agreement which
14 deals with subordination, there is nothing that we could
15 find in the sub-debt agreement that constitutes an
16 express term that is even capable of meaning. There is
17 a limitation on the right of recourse as against the
18 debtor. By that I mean that there is a limitation in
19 the assets from which the lender is entitled to say that
20 it is to be paid.
21 This is the first time we have looked at the
22 sub-debt agreement, so it might be a good idea just to
23 show you how it works. On page 2, which is the front
24 page of the standard form, it identifies who it is
25 between. Would my Lord notice the recital:

1 "Whereas the borrower wishes to use the loan or
2 reach advance under...(Reading to the words)... and has
3 fully disclosed to the FSA the circumstances giving rise
4 to the loan facility and the effective subordination of
5 the loan and each advance."
6 Now, we have INPRU in 1063 in the bundles, at
7 volume 5, tab 172 -- and when I say volume 5, I mean the
8 authorities bundles volume 5. If my Lord would just
9 turn that up. The very last tab. An important point
10 for present purposes. What 10.63 does is, by sub 1,
11 it permits a firm to take into account subordinated loan
12 capital in its financial resources in accordance with
13 the table. Just pausing, the only firm in this case is
14 LBIE, so we are talking simply about LBIE, which is
15 a point that is of some relevance on the implied terms
16 we will come on to in a moment.
17 Then in sub 2:
18 "A firm may include a subordinated loan in its
19 financial resources only if it is drawn up in accordance
20 with the standard forms obtained from the FSA."
21 So, you have to use the standard form if you want to
22 get the benefit. So that is the first point.
23 Then, if we go on, if we go back to the agreement,
24 page 3, the way this agreement is structured is that
25 there are variable terms in schedule 1 and standard

1 terms in schedule 2. You can put in the variations in
2 schedule 1, but the standard terms are what they are in
3 schedule 2.
4 If my Lord turns on, just on the interrelationship
5 between the two, to clause 11, on page 13 of the bundle:
6 "Where there is inconsistency between the variable
7 terms and the standard terms, the standard terms shall
8 prevail."
9 So you have quite a strict concept of standard form
10 here. You have to have the standard terms. Both
11 because of INPRU and because --
12 MR JUSTICE HILDYARD: Where is that?
13 MR TROWER: I'm so sorry, clause 11, page 13. Clause 11 of
14 the standard terms is what I didn't say. There is
15 a standard term prevailing clause. You have two things
16 there that sort of focus on the importance of the
17 standard. One is the INPRU context the other is
18 clause 11. Then, just going back to the shape of this
19 agreement, going to the variable terms, you have all the
20 variations on things like dates on, dates and lenders
21 and borrowers, on page 3.
22 There is a description of the facility in clause 7.
23 The interest is obviously something that is capable of
24 being varied in clause 8. Then, 9, repayment. You will
25 see, in the box underneath, there are restrictions in

1 the standard form as to what you can put in box 9 by way
2 of repayment. Those restrictions, themselves, being
3 provisions which are designed to ensure that the
4 obligations under the sub-debt agreement are suitable
5 for subordinated loan capital.
6 Then you have additional terms with reference to
7 paragraph 11.
8 I perhaps should have pointed this out when we
9 looked at paragraph 11, but you can see the
10 interrelationship between 10 of the variable terms and
11 11 of the standard terms; the additional terms in the
12 variables refer forward to 11 of the standard terms. So
13 the concept is obviously that you do not put anything in
14 the variable terms which are of inconsistent with the
15 standard terms.
16 If you go to the standard terms, there is
17 a definition provision. I think the one definition one
18 probably just needs to pause on for a short while, on
19 page 8, is the definition of liabilities:
20 "Not present and future sums liabilities and
21 obligations payable or owned by the borrower."
22 It is identifying the borrower as obligor in respect
23 of it. Then there is a description of the facility and
24 the interest provisions. Then, the repayment, the way
25 this works is the repayment obligation is subject by 4.1

1 in all respects to the provisions of 5. The 5 is the
2 subordination provision.
3 There are then a number of restrictions as to what
4 it is that the lender can do, in 4. There is
5 substantive subordination provision in 5:
6 "Notwithstanding the provisions of paragraph 4, the
7 rights of the lender in respect of the subordinated
8 liabilities is subordinated to the senior liabilities."
9 That is everything except the sub-debt and certain
10 excluded liabilities, which do not matter for present
11 purposes:
12 "Accordingly payment of any amount of the
13 subordinated liabilities is conditional upon ..."
14 Then there is a condition. The first condition we
15 do not need to worry about for present purposes. The
16 second condition is:
17 "The borrower being solvent at the time of and
18 immediately after the payment by the borrower and
19 accordingly no such amount which would otherwise fall
20 due for payment shall be payable except to the extent
21 that the borrower could make such a payment and still be
22 solvent."
23 Then the provision is:
24 "For the purposes of subparagraph 1B above the
25 borrower shall be solvent if he is able to pay its

1 liabilities ...(Reading to the words)... in the
2 insolvency of the borrower and the excluded
3 liabilities."
4 There was a lot of argument about the true meaning
5 of this clause in the context of Waterfall I, but the
6 important point for present purposes is what this
7 agreement does is subordinate the obligation under the
8 agreement by the introduction of a conditional payment
9 mechanism. That is what it does. The condition that
10 has to be satisfied is that, at the time of and
11 immediately after payment of the sub-debt, the borrower
12 must be solvent within the meaning of the clause.
13 What it does not do is say anything about limiting
14 the recourse of the lender to any particular category of
15 assets, or any particular source.
16 Just continuing in the structure of the agreement,
17 there are then representations and undertaking by the
18 borrower provision. There are then representations and
19 undertakings by the lender which are designed to
20 facilitate and assist in the enforceability of the
21 subordination. If my Lord would just read 7B, because
22 we will come back to that during the course of -- well,
23 7A and B, actually, both of which will feature in the
24 submissions. 7A.
25 MR JUSTICE HILDYARD: This is your approach to construction

1 point?
2 MR TROWER: That is right. 7A is an assignment clause and
3 7B is the set-off prohibition that comes into the mix
4 when looking at one of the arguments on issue 3.
5 MR JUSTICE HILDYARD: Yes.
6 MR TROWER: So Mr Marshall's argument in relation to express
7 terms picks up on the language of section 74(ii)(e), but
8 we respectively ask: what is the provision contained in
9 the sub-debt agreement whereby the funds of LBIE are
10 alone made liable in respect of the sub-debt?
11 We have not been able to identify it. Simply saying
12 that refers to the true interpretation as a whole does
13 not help on express terms anyway. I quite appreciate
14 the analysis is quite different in relation to an
15 implied term.
16 There are any number of different cases that one can
17 look at, at the Supreme Court and the House of Lords
18 level, as to the exercise of construction my Lord is
19 being asked to carry out. Whether one is thinking of it
20 in terms of Lord Clark's approach, which is that
21 construction is a unitary exercise or whether one adopts
22 in Rainy Sky or whether one adopts any other approach.
23 You have to identify the language which may have more
24 than one potential meaning and ask yourself whether or
25 not it has the meaning for which the parties contend.

1 So for that reason alone we say that this situation
2 is quite different from the cases on which LBL appears
3 to rely in support of their argument on limited
4 recourse, which are section 74(ii)(e) cases.
5 All of those cases fall into the category of case in
6 which the form of provision with which section 74(ii)(e)
7 is concerned was spelt out in explicit terms. I will
8 just briefly show my Lord one or two of those cases, so
9 one can put it in context. Can I just give you two
10 minutes on the background section 74.2E because I think
11 it is important given the way in which the argument is
12 being advanced against us.
13 Section 74(ii)(e) is the statutory successor of
14 section 38(6) of the 1862 Act. So it has been around
15 for a long time. We have now, my Lord, put in
16 the bundles, just because it was convenient, the whole
17 of the 1862 Act, just so you have it. It is behind
18 tab 127A. The reason we have done it is because there
19 are quite a few of the old authorities one may have to
20 look at which refer to sections in the Act. It is
21 easier just to have it in one place. It is behind 127A
22 I hope you have a new -- it only went in this morning.
23 MR JUSTICE HILDYARD: Yes.
24 MR TROWER: If we look at 38.6, which is on page 804 of the
25 print.

1 MR JUSTICE HILDYARD: Yes.
2 MR TROWER: Section 38 is the statutory predecessor to
3 section 74. It is in exactly the same form. I say,
4 "Exactly", that is probably not quite accurate. It is
5 almost exactly the same form, the structure is the same.
6 6 is the one that is relevant for these purposes:
7 "Nothing this Act contains shall invalidate any
8 provision contained in any policy of insurance or
9 contract ...(Reading to the words)... funds of the
10 company are alone made liable in respect of such policy
11 or contract."
12 That form of words, if you turn on in the bundle to
13 section 74, is almost identical to section 74.2E, behind
14 tab 132.
15 MR JUSTICE HILDYARD: Yes.
16 MR TROWER: Now, at the time the 1862 Act was passed, it was
17 relatively common for mutual insurance companies to
18 issue policies to their members which contained
19 provisions in the form contemplated by what is now
20 section 74.2E, so the company's members were also
21 contingent creditors under the relevant policy. That is
22 the background.
23 In a series of pre-1862 cases, where such companies
24 were wound up, the remedy which was then available to
25 a creditor or policy holder creditor to proceed to

1 execution against shareholders was held to be capable of
2 limitation or exclusion in the contract entered into
3 between the policy holder and the company.
4 The contract was either in the form of a policy
5 between the policy holder and the mutual company -- that
6 is what it normally was. It was that sort of policy --
7 and the authority to enter into the contract, so far as
8 the company was concerned, was granted by the deed of
9 settlement or other instrument by which everybody was
10 bound. That was the context pre-1862 and the
11 introduction of the statute in which one finds this kind
12 of arrangement.
13 The position is explained in a case that is referred
14 to in both of our skeletons called the Athenaeum case
15 which is at bundle 1, tab 8.
16 MR JUSTICE HILDYARD: Under the original pre-1862
17 position -- my understanding was and you will correct
18 it -- that there were direct rights of action by
19 contracting parties against the contributories.
20 MR TROWER: Yes.
21 MR JUSTICE HILDYARD: There was no need to go via the
22 company, you just had a direct right of action and their
23 liability was not to restore the company but was to pay
24 direct against the claimant.
25 MR TROWER: Yes.

1 MR JUSTICE HILDYARD: Then in 1862 everything was channelled
2 through the corporation and has been ever since.
3 MR TROWER: Has been ever since. We have what we describe
4 in some places in our skeleton as a centralised process,
5 my Lord is absolutely right.
6 What we say section 74(ii)(e) does -- or section
7 38(6) as it was originally enacted -- it provides within
8 that context that which was previously done by way of
9 contract between the policy holders and the company to
10 ensure that, on the winding-up or insolvency of the
11 mutual, you did not find that everybody who was a member
12 policy holder in all those capacities was liable for all
13 those obligation of all the other policy holders in
14 relation to a shortfall. The way you achieved that was
15 by limiting the right of recourse. So the right of
16 recourse was limited to the collective, you excluded the
17 entitlement that you otherwise would have had to go
18 against the other members. One can see why that was
19 appropriate in that kind of context, because one can see
20 that you have a large number of members of the public
21 really entering into contracts of insurance, is what it
22 was all about. One gets that, as I say, most clearly
23 from the Athenaeum case, at least I thought it was made
24 clear from that, which is volume 1, tab 8.
25 MR JUSTICE HILDYARD: So although expressed as a general

1 provision, in fact this only applies to unlimited
2 companies who were then in force; is that right?
3 MR TROWER: Well, no, that is not entirely right, because if
4 you have partly paid shares, it would also be relevant.
5 MR JUSTICE HILDYARD: Really? I know that in at least one
6 of their Lordships in Waterfall I reckons that a
7 section 74 claim is an asset of the company.
8 MR TROWER: Yes.
9 MR JUSTICE HILDYARD: Lord Justice Briggs,
10 Lord Justice Lewison didn't think so. One can see it
11 may be an asset, one can see even more clearly that
12 a right to call on unpaid shares is plainly an asset to
13 the company.
14 MR TROWER: No, I think that is right. I think I am going
15 to step back from my answer. I think my Lord is right.
16 It is only to the extent that there is -- that must be
17 right because the wording that -- and one gets this from
18 the Athenaeum company case.
19 MR JUSTICE HILDYARD: Where is that?
20 MR TROWER: Behind 1.8, yes. (Pause). It is, if one looks
21 at page 216, and the Athenaeum company case was
22 a winding-up under the 1857 Act, so it was pre-1862. It
23 is just to illustrate how it worked at that stage.
24 If you see, on page 216, what the proviso in the
25 relevant policy was, in that instance it made clear that

1 you were liable up to but not beyond the amount unpaid
2 on your shares.
3 MR JUSTICE HILDYARD: Yes.
4 MR TROWER: You then get, on page 218 --
5 MR JUSTICE HILDYARD: The same thing. The Court of Chancery
6 could require the common law judges to come an explain
7 themselves.
8 MR TROWER: Yes. Yes.
9 MR JUSTICE HILDYARD: I am so sorry.
10 MR TROWER: No, much more interesting than listening to me.
11 My Lord, one then goes on to page 218.
12 MR JUSTICE HILDYARD: Yes.
13 MR TROWER: It is really again a description of the proviso.
14 MR JUSTICE HILDYARD: This is as regards the first part.
15 MR TROWER: So there are then three paragraphs.
16 MR JUSTICE HILDYARD: "The surety is precluded from any
17 remedy at law against individual shareholders."
18 MR TROWER: Yes.
19 MR JUSTICE HILDYARD: Yes.
20 MR TROWER: Now, what we have in the cases, and we do not
21 need to look at them apart from to note where they are,
22 I think, is -- or in the bundle -- a number of other
23 cases in which the form of a particular form of contract
24 was used for this purpose. Just leafing through, the
25 first one is Lethbridge, at tab 25. You can just keep

1 the bundle that you presently have in front of you.
2 Lethbridge, at tab 25.
3 This was a case of an unregistered company that had
4 been formed by a deed of settlement, but it was
5 registered as an unlimited company under the 1862 Act,
6 so that is the context. You see the relevant provision
7 starting on page 548, finishing halfway down 549.
8 MR JUSTICE HILDYARD: Yes. Of course, one can quite see why
9 that is so necessary in the context of life assurance.
10 MR TROWER: Indeed, my Lord, particularly necessary, yes.
11 Then, just in the judgment of the vice chancellor,
12 starting at page 552, and it is really the paragraph
13 starting:
14 "Now the assets of the society consist ..."
15 So he is there referring in one respect to the
16 controversy that my Lord alluded to in
17 the Court of Appeal in Waterfall I. Although one
18 sometimes finds that it is difficult to work out from
19 some of these old cases whether the cause of action for
20 recovery of the call or whether the actual receipt was
21 the asset when judges are talking about it.
22 MR JUSTICE HILDYARD: Yes, so where there is a contract of
23 limited liability will the court enforce unlimited
24 liable?
25 The answer to that, on the authorities, was: no, if

1 they had so contracted.
2 MR TROWER: Indeed. It is an interesting precursor to what
3 ended up as the concept of limited liability within
4 74(ii)(e).
5 MR JUSTICE HILDYARD: I can't remember when Salomon was
6 decided, whether it was pre-or post Lethbridge.
7 MR TROWER: It would have been post.
8 MR JUSTICE HILDYARD: There was still some unease as to
9 whether the company was for all purposes a separate
10 company, a separate party.
11 MR TROWER: Yes, the way my Lord has put it is very clearly
12 expressed at the top of page 554.
13 MR JUSTICE HILDYARD: Yes.
14 MR TROWER: Then one has the like situation, I will just
15 give you the references, behind tab 33, a case called
16 Accidental Death. Again, a case where the company
17 started life before 1862 but was re-registered as an
18 unlimited company under the 1862 Act.
19 Great Britain Mutual behind tab 38. The only point
20 about Great Britain Mutual really is the form of words,
21 which you find on pages 347 and 348, rather than what is
22 said in the judgment about the issue between the
23 parties.
24 The principles that we say that can be established
25 from these cases is --

1 MR JUSTICE HILDYARD: Do you mean 247 or 248?
2 MR TROWER: Did I say?
3 MR JUSTICE HILDYARD: Maybe I misheard.
4 MR TROWER: No, I may have given you the wrong reference.
5 MR JUSTICE HILDYARD: 247. Sorry, Mr Trower.
6 MR TROWER: No, I am sorry. As my Lord asked me, so my file
7 fell apart, so Mr Bayfield is putting it back together
8 again, which is very kind of him.
9 MR JUSTICE HILDYARD: Never has a question been so
10 withering.
11 MR TROWER: Staggering effect, yes.
12 MR JUSTICE HILDYARD: No, thank you. Yes.
13 MR TROWER: Can I summarise the principles to be drawn from
14 these cases?
15 The first is that it is, and has been, for many
16 years lawful for a company to agree with a creditor that
17 the creditor's recourse for the relevant debt is to be
18 limited to a particular asset or category of assets. As
19 my Lord indicated this principle is established when
20 there were direct rights against the great creditors
21 pre-1862.
22 Point 2, the concept of making the funds of the
23 company, a loan liable in respect of a contract, was a
24 reflection we submit is fairly evident of this principle
25 in the context of the 1862 Act, and amounted to a form

1 of limited recourse arrangement, and has become codified
2 in section 74(ii)(e).
3 The third point is that in all the cases we have
4 been able to find, where section 38(6) of the 1862 Act
5 were considered, the wording was quite explicit. The
6 limitations in recourse were clearly spelt out and the
7 intention behind them was easy to discern. We
8 respectfully suggest that that is very far removed from
9 this particular case.
10 Moving on, if I may, to the implied term aspect of
11 this. The essence of the case is that a term is to be
12 implied as permitted by section 74.2E. I make the
13 point, perhaps in passing but nonetheless significant we
14 suggest, that nowhere does LBL actually identify the
15 precise form of words that they say should be implied
16 into the agreement. That is a useful and important test
17 when you are talking about an implied term, because you
18 have to work out where it is that the words need to be
19 included, and see how it is that they might affect what
20 is elsewise provided for by the express terms of the
21 agreement.
22 MR JUSTICE HILDYARD: In telling me that in the
23 Great Britain case the wording was slightly different
24 are you implying it had a slightly different effect?
25 MR TROWER: No, I am not. No.

1 Of course I accept that one, in this day and age, at
2 the beginning of the 21st century, the wording which is
3 capable of being used to achieve the affect that is
4 contemplated by section 74.2E could take a number of
5 different of forms. I am not pretending it could not,
6 of course it could. One does, at least, have to
7 identify the form that it takes, or is intended in the
8 present case. We simply point out that we do not really
9 have a form of words anywhere, nor do we know exactly
10 how it is that the implication is to be included.
11 MR JUSTICE HILDYARD: I assume you could have a term, right
12 back to 1862 and continuing, which actually more greatly
13 limited the recourse. It might, for example, have
14 limited it in the case of temperance members to the
15 temperance book, or something like that. So you would
16 always have to ask what extent of the recourse or
17 limitation on the recourse, was. Is your point any more
18 than that; that you have to be sure what the extent of
19 the limitation on recourse is before you can imply
20 a term?
21 MR TROWER: I do not think that my point is any more than
22 that, for this reason: the reason it matters is to know
23 what it is that the term of the agreement provides
24 cannot be done by the party who is undertaking the
25 relevant obligation.

1 For these purposes, what matters, on my learned
2 friend's case, is how it is that the rights which the
3 sub-debt holder would otherwise have, have been limited.
4 MR JUSTICE HILDYARD: So put another way: your point is it
5 is not binary. It is not: you either have the
6 limitation or you don't.
7 MR TROWER: No.
8 MR JUSTICE HILDYARD: You can have varying sorts of
9 limitation. For example, you might want to let between
10 your view of Lord Justice Briggs or
11 Lord Justice Lewison, not personally but as to their
12 views.
13 MR TROWER: Yes.
14 MR JUSTICE HILDYARD: You might say: actually, for the
15 purpose of recourse, it is not part of the recourse
16 available that you should include section 74.
17 You might say it is, or whatever it is. Is that
18 what you are --
19 MR TROWER: That is the root of the point I am trying to get
20 at. Bear in mind that the way 74(ii)(e) is formulated,
21 the first point is whereby the liability of individual
22 members on the policy or contract is restricted. The
23 second point talks about whereby the funds of the
24 company are a loan made liable in respect of the
25 contract.

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1 MR JUSTICE HILDYARD: I think my point is: do you submit
2 that enables a limitation which restricts the recourse
3 more severely than the funds of the company alone?
4 MR TROWER: Well, 74(ii)(e) clearly doesn't touch on the
5 point in those terms, because what 74.2E is doing is it
6 is close to "for an avoidance of doubt" provision. It
7 is saying: nothing that is included can stop you doing
8 that.
9 This is why we need to -- against the background of
10 why it is that we need to include it.
11 Now, if a restriction were to be entered into
12 between the company and a creditor which went wider than
13 the wording of 74(ii)(e), the question is whether or not
14 that restriction works. It is very difficult to see why
15 it wouldn't work, in principle, because all that is
16 being done is that the creditor, who would otherwise
17 have rights against the company, is waiving or
18 contracting out of his entitlement to pursue those
19 rights. That does not mean to say -- and does not bear
20 at all on the later question, which is whether the
21 company can enter into a contract with the members,
22 which has a similar effect. That is a completely
23 different issue, and arises on issue 9.
24 But, on this point, in the same way that you can
25 contract out of the pari passu rule in order to have

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1 a sub-debt agreement in the first place, which was
2 relatively controversial I think, until
3 Lord Justice Vinelott decided that you could in MCC.
4 You can contract in a manner which limits your rights,
5 so long as it does not interfere with anybody else's
6 rights who is a stake holder in the insolvent estate,
7 whether it be a creditor or the shareholder.
8 I think that is the way I would approach it. Where
9 this applies, it enables a contract to be enforceable
10 whatever the consequence. Although it is a bit
11 difficult to see how it could prejudice other people.
12 But there is a provision which permits it as a matter of
13 statutory construction.
14 Where this does not apply, the normal principle
15 would apply, we would say.
16 We started this discussion in the context of why it
17 is that we say that one needs to be quite precise about
18 what it is that one is asserting constitutes the applied
19 term. That remains the underlying submission that
20 I make.
21 Now, the correct approach, of course, for
22 implication of terms is that once you formulated the
23 term, my Lord can imply it into the contract, either if
24 it is necessary to give it business efficacy or if it is
25 so obvious it goes without saying. I don't know whether

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1 my Lord has seen the most recent --
2 MR JUSTICE HILDYARD: Lord Sumption's re-statement.
3 MR TROWER: Indeed, in Marks and Spencer. If my Lord is --
4 MR JUSTICE HILDYARD: That is what necessary means.
5 MR TROWER: Yes, indeed. Because what it is really all
6 about is: does it lack commercial or practical
7 coherence? Is the way he puts it. We put
8 Marks and Spencer in the bundle, if I can just turn it
9 up so my Lord can see where the passages are, you are
10 probably familiar with it anyway. It is in bundle 4,
11 tab 103, paragraph 21, I think it is where one needs to
12 start.
13 The start of Lord Neuberger's judgment, at page 16,
14 is where he goes through the cases my Lord will be very
15 familiar with. Really the guts of it start at
16 paragraph 21. It is at the end of paragraph 21 that the
17 re-statement of commercial practical coherence is made.
18 The other point that comes out of this is what he says
19 about Belize Telecom, in paragraphs 26 and 27, and
20 really concludes his discussion in paragraph 31.
21 MR JUSTICE HILDYARD: Reasonableness is not the test.
22 MR TROWER: Indeed, it is not.
23 I think paragraph 31 is a warning about using
24 Belize Telecom. Just in saying:
25 "The right course for us to take is to say these

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1 observations should henceforth be treated as
2 a characteristically inspired discussion, rather than
3 authoritative to guidance on the law of implied terms."
4 So careful about Belize Telecom is the very clear
5 message that comes across from Lord Neuberger's
6 judgment.
7 My Lord, I am conscious that we have shorthand
8 writers and I wonder whether now would be a convenient
9 moment?
10 MR JUSTICE HILDYARD: Yes, indeed five to 10 minutes.
11 (11.45 am)
12 (A short adjournment)
13 (11.55 am)
14 MR TROWER: So, my Lord, the upshot of the Marks and Spencer
15 approach is that a term can only be implied if, without
16 the term, the contract would lack commercial and
17 practical coherence. It is simply not enough to say
18 that the parties would have considered the term would
19 have been a good idea if they thought about it at the
20 time which, in any event, we don't accept. We submit
21 that the contract works perfectly well without any
22 implied term. It is a loan which is repayable when
23 certain contingencies are satisfied and there is nothing
24 incoherent, either practically or legally, about
25 a contract which subordinates the debt but does not

1 contain the limited recourse provisions for which LBL
2 argues.
3 As we understand the way the case is put against us
4 on this, I think there are two principal points. The
5 first is it is said to make no sense that LBHI2 might
6 have to contribute towards payment of the subordinated
7 debt when LBHI2, itself, is the creditor in respect of
8 the subordinated debit.
9 MR JUSTICE HILDYARD: Could you say that again? I am so
10 sorry.
11 MR TROWER: It is said to make no sense that LBHI2 might
12 have to contribute towards payment of the subordinated
13 debt when LBHI2, itself, is the creditor in respect of
14 the subordinated debt, on both sides of the fence.
15 Now, we actually do not agree with that, with
16 respect, at a general level. We do not see why there is
17 a problem with it but there are some more specific
18 answers.
19 MR JUSTICE HILDYARD: This is not the circuity argument?
20 MR TROWER: No.
21 MR JUSTICE HILDYARD: This is a constructional argument on
22 the basis that because of that oddness it is unlikely to
23 have been intended as between those parties.
24 MR TROWER: Yes.
25 MR JUSTICE HILDYARD: Your point is: yes, but it might not

1 be between those parties.
2 MR TROWER: That is the fundamental point. It is assignable
3 list debt, admittedly with the consent of the FSA.
4 We saw that point.
5 Just as far as the shares themselves are concerned,
6 because there are two aspects to this: the debt
7 assignable and what is the position in relation to the
8 shares?
9 The shares in LBIE are transferable, albeit with
10 consent. Ordinary shares with the consent of the other
11 members and the preference shares without restriction,
12 so long as the transfer is made to other members of the
13 LBHI group.
14 My Lord has the articles in bundle 2, tab 1,
15 page 11. It is article 7. Article 7. The important
16 point is that those were the articles that were in force
17 at the time the subordinated debt agreement was entered
18 into. What you are being asked to do is imply terms
19 into the subordinated debt agreement. So page 11,
20 article 7.
21 MR JUSTICE HILDYARD: Yes.
22 MR TROWER: Just so my Lord knows, just so there is no
23 concern about this, on page 9, it says:
24 "This print is the amended up to and including the
25 29 February 2008. I have taken instructions, it has

1 been in the same form since 2002.
2 MR JUSTICE HILDYARD: I cannot find that. Sorry, where is
3 that?
4 MR TROWER: See, on page 9:
5 "Articles of association of Lehman Brothers
6 International Europe up to and including
7 29 February 2008."
8 It was actually in the same form from --
9 MR JUSTICE HILDYARD: No change to article 7?
10 MR TROWER: 7, from 2002, yes. Indeed, it may have been
11 earlier than that, but we know it was from 2002.
12 Objectively speaking, there is nothing to show and
13 nor could there be a clear intention that both the
14 member and lender were to continue to be the same
15 person. The submission is as simple as that.
16 The upshot, and the legal consequence of that, is
17 there could be no basis for anybody to have assumed that
18 the creditor under the sub-debt agreement and the
19 potential debtor in respect of the section 74 liability
20 would continue to be the same.
21 Now, what has developed, I think, in the skeleton
22 argument a little bit more, as the second main point,
23 and I think it may be reflected, although it may be
24 necessary for us to hear exactly how it is that it is
25 put by LBL, but it may be reflected in some of the

1 documents that my Lord was asked to pre-read.
2 It appears to be the argument that, at the time of
3 the sub-debt agreements, regardless had not just to the
4 regulatory position of LBIE, but also to the regulatory
5 position of the UK Lehman Group as a whole.
6 The essence of the argument seems to be contained in
7 paragraphs 37C and E of the LBL skeleton.
8 It is E, really, which seeks to draw the threads
9 together. The concept that is put forward is an intent
10 or appears to be an intent, that the sub-debt would not
11 result in prejudice to third party creditors of the
12 group. It is therefore said that it must have been
13 intended that because of the reference to the group as
14 a whole, that they rely on in some of the documents, the
15 sub-debt agreement should be construed in a manner which
16 ensures that the third parties creditors of the group as
17 a whole were not to be prejudiced.
18 It is then said that because LBL has creditors who
19 were providing services to the group as a whole, it
20 would have been inimical to the regulatory capital
21 requirements of the group as a whole for LBHI2 to be
22 able to receive payments at the expense of those
23 external creditors.
24 The first point to make is that there is no material
25 whatsoever to justify this conclusion from the face of

1 the subordinated debt agreements, themselves. So this
2 all depends on looking at a selection of extraneous
3 documents.
4 There is also no basis for thinking that the nature
5 of the agreement was one in which the interests of
6 creditors of entities other than the borrower were
7 a concern of the parties. Indeed, quite the contrary.
8 The protection which third parties receive from the
9 terms of the subordinated debt agreement is the
10 conditionality to which LBIE's payment obligation is
11 subject and that conditionality, which is spelt out in
12 the clause we have already looked at, in clause 5, is
13 that for the payment obligation to arise, the borrower
14 must be solvent at and immediately after payment. For
15 the purposes of assessing solvency, what is taken into
16 account as one would expect is the borrower's
17 liabilities, not the liabilities of any other companies
18 in the Lehman Group. There is nothing on the face of
19 the subordinated debt agreement and it would be
20 inconsistent with the structure of the subordinated debt
21 agreement to have regard to creditors other than
22 creditors of the borrower.
23 What is sought to be advanced is a case built on the
24 back of some extraneous material. There is a limit to
25 how much in the way of submission I can make on this

1 until Mr Marshall has made his submissions. But the
2 evidence is thin, because what LBL has been table to
3 point to is a few emails in which, shortly before the
4 subordinated debtor agreements were entered into,
5 certain individuals referred to the regulatory
6 requirements of the UK Lehman Group.
7 Now, the important point is that they do not bear
8 the weight or significance which LBL attributes to them
9 for one quite simple reason, which is that the
10 regulatory requirements on which LBL rely in their
11 skeleton are the regulatory requirements of LBIE as
12 a bank, or other financial institution. That is
13 something that is explained by Mr Justice David Richards
14 in Waterfall I, at paragraphs 33 and following:
15 "LBL has not identified any regulatory requirements
16 which refer to, or protect, the creditors of group
17 entities which are not themselves banks or financial
18 institutions."
19 We know that the regulatory requirements which are
20 referred to in the sub-debt agreements, themselves, are
21 those which applies to banks. As I indicated to my
22 Lord, it is never any part of LBL's case that it was
23 a firm within the meaning of INPRU.
24 It is then said: well, whether or not that is the
25 case, that is what it appears individuals thought was

1 the case.
2 Now, we do not say that the factual matrix hook is
3 anything like substantial enough to hang an implied term
4 argument in any event. But, that brings me on to
5 a submission based on implying terms based on factual
6 matrix in the context of a standard form agreement of
7 this sort.
8 MR JUSTICE HILDYARD: Are the matters sought to be relied on
9 in 37D, for example, admissible as a tool of
10 construction?
11 MR TROWER: Well, they are --
12 MR JUSTICE HILDYARD: I mean, ordinarily, subject to the
13 article, I think Lord Nicholls reflected that in the
14 title "My Kingdom for a Horse".
15 My understanding is that what parties say after the
16 event as to their intention is not generally admissible
17 in English law. Partly because they may be
18 self-serving. They may utter things in order to control
19 the construction were it admissible.
20 MR TROWER: Yes. So my Lord is referring to D in
21 particular.
22 MR JUSTICE HILDYARD: Yes.
23 MR TROWER: I think that must be inadmissible. I would
24 certainly agree with that. To be fair to Mr Marshall,
25 not everything he relies on is --

1 MR JUSTICE HILDYARD: I said 37D.
2 MR TROWER: I think that must be inadmissible.
3 MR JUSTICE HILDYARD: We will hear what he says but I think
4 I would want persuading that after utterances as to the
5 intention of the parties are admissible, (a) because the
6 subjective intention of the parties is not generally
7 admissible, (b) particularly so when after the event.
8 MR TROWER: Yes. We don't resile from submission that one
9 has to be very careful about this form of "factual
10 matrix" evidence in the context of a case such as this.
11 We have a selection of emails, to think that this gives
12 a complete picture of the way everyone approached this
13 is a much more substantial step to take than we would
14 suggest the court is able to take.
15 I was just going to make a submission based on the
16 significance of the fact this is a standard form
17 agreement, because we do say this is significant when
18 the court is considering the weight to be attached and
19 the extent to which it can attach any weight to
20 so-called factual matrix material of this sort.
21 My Lord actually applied the one of the better known
22 statements of principle, which is Lord Millett's
23 statement of principle in AIB in your decision in
24 Waterfall II Part C. The AIB case is in volume 3,
25 behind tab 74. It is the very first paragraph of

1 Lord Millett's speech, at paragraph 7.
2 The last sentence is of some significance, we say.
3 This is plainly not a case which shows there is any
4 indication the standard form was being employed in
5 circumstances for which it was not designed. Indeed,
6 quite to the contrary.
7 MR JUSTICE HILDYARD: I suppose slightly different rules may
8 apply where the parties have been given the liberty,
9 which they have taken, of including specific or special
10 terms.
11 MR TROWER: Yes, I can see that. I can absolutely see that.
12 That was one of the reasons I showed your Lordship the
13 structure of the special terms structure within this
14 agreed --
15 MR JUSTICE HILDYARD: As to the standard terms, if they are
16 to have utility, they must mean the same thing to all
17 potential users.
18 MR TROWER: Indeed. It is important to remember that this
19 was being produced in a regulatory context. I will come
20 back to a submission on that point in a moment.
21 Just before I do so, my Lord may or may not find
22 helpful a short explanation that we actually cite in our
23 skeleton from Mr Justice Andrew Smith in the
24 Swiss Marine case, where he said that the point about
25 standard forms is:

1 "The parties usually evince an intention thereby
2 that the wording should be given its usual meaning."
3 That is the whole point that underpins it. That we
4 don't need to turn it up. It is in the bundles at
5 volume 4, tab 102.
6 We do say that the use of the standard form is --
7 and not implying terms into it on the back of factual
8 matrix evidence is particularly important in
9 a regulatory context.
10 What has happened here is that the form has been
11 prescribed by regulations. For that reason, the court
12 should be particularly reluctant to imply a standard
13 form, to imply any term, unless it can clearly see that
14 it is what the parties must have intended from the
15 context.
16 Two more references, just because my Lordship may
17 find them helpful. In the Great Ship case, in
18 paragraph 41 of her judgment, which we refer to at
19 paragraph 39.3 of our skeleton, Mrs Justice Gloster drew
20 the threads together in a manner that my Lord might find
21 helpful. It is bundle 3, tab 92. It is paragraph 41.
22 MR JUSTICE HILDYARD: Paragraph 41.
23 MR TROWER: Paragraph 41. This was a charter party case in
24 a slightly different context.
25 MR JUSTICE HILDYARD: A separate case, is it different?

1 MR TROWER: No, I don't think that. Sorry, is what
2 different, my Lord?
3 MR JUSTICE HILDYARD: 92 and 93, are they the same?
4 MR TROWER: I think they are the same case, but different
5 reports.
6 MR JUSTICE HILDYARD: Right. Anyway it is paragraph 41 in
7 either, is it?
8 MR TROWER: It is paragraph 41.
9 The only other reference, the second reference I was
10 just going to give to my Lord is that
11 Lord Justice Lewison in his judgment, in Waterfall I, at
12 paragraph 31, behind tab 9.
13 MR JUSTICE HILDYARD: This is tab 9, paragraph 31.
14 MR TROWER: Paragraph 31.
15 MR JUSTICE HILDYARD: Is it tab 9?
16 MR TROWER: Yes. I am sorry, I am not sure this is
17 a particularly significant point. I should have drawn
18 it to your attention a little bit earlier in the
19 analysis. The trial bundle file 1, it is behind tab 9,
20 is where it is included, unless my Lord has taken it
21 out.
22 MR JUSTICE HILDYARD: No.
23 MR TROWER: I don't think it adds very much to be honest
24 with you. It is Lord Justice Lewison explaining that
25 the rule required a sub-loan agreement to be drawn up in

1 accordance with the standard forms obtained from the FSA
2 and this was the form used in our case.
3 MR JUSTICE HILDYARD: Mr Marshall will address these points
4 but, I mean, there is a further a fortiori which is in
5 the INPRU context. The issue as to recourse is right at
6 the centre of the INPRU --
7 MR TROWER: Indeed.
8 MR JUSTICE HILDYARD: -- universe. So if you are going to
9 change that, in a particular case, you may have
10 differences.
11 MR TROWER: Yes. So, my Lord, I did not really think it was
12 appropriate to do more than give the shape of where we
13 are on that because it is a bit difficult to preempt
14 precisely how it is going to be put. I have obviously
15 seen what he has put in his skeleton. I have sought to
16 show your Lordship how it is that we say, in broad
17 terms, we respond to it. I am conscious I will probably
18 have to deal in reply with some more specific points
19 which will be developed.
20 MR JUSTICE HILDYARD: Yes, by way of forearming Mr Marshall,
21 I think I need to understand whether his point
22 ultimately is the solvency point or some point separate
23 from the solvency point, especially as regards the
24 alleged express term. I just put that as a marker for
25 his thought.

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1 MR TROWER: When your Lordship says, "The solvency point",
2 do you mean clause 5.2?
3 MR JUSTICE HILDYARD: Yes.
4 MR TROWER: I was actually just going to make one or two
5 submissions in relation to 5.2. In fact, 5.2 itself is
6 dealt with by Mr Atherton, not Mr Marshall. Shall
7 I deal with that separately now? Would that be
8 convenient?
9 MR JUSTICE HILDYARD: You take your course.
10 MR TROWER: What I thought I would do is just simply say
11 this about 5.2: as we understand the argument --
12 MR JUSTICE HILDYARD: Where are we? Let us have a look at
13 it in 5.
14 MR TROWER: 5.2.
15 MR JUSTICE HILDYARD: 4/1.
16 MR TROWER: That is right. It is bundle 4, tab 1.
17 MR JUSTICE HILDYARD: Yes. Yes, I mean, put another way --
18 and you are going to address it -- I wondered whether
19 this was the closest to an implied express term or
20 expressed implied term, or some such, but there may be
21 other points in Mr Marshall's armoury.
22 MR TROWER: As we understand the point, as developed by
23 Mr Atherton, is that clause 5.2 of the subordinated debt
24 agreement is to be construed as providing that the
25 condition to payment, in clause 5.1 is only satisfied

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1 where LBIE is solvent at the time of and immediately
2 after payment of the sub-debt, in the sense that it is
3 able to pay all of its debts other than sub-debts out of
4 its own funds.
5 The way the argument, as we understand it, is put --
6 it is put in paragraph 18.2 of the LBH skeleton
7 argument. Then developed at paragraphs 28 and
8 following, but 18.2 is a summary of it. Page 6 of the
9 LBH skeleton.
10 MR JUSTICE HILDYARD: Yes?
11 MR TROWER: Now, what is said is that the word "it" in the
12 phrase "it is able to pay", means "it" without recourse
13 to its contributories. That is what is said.
14 Now, the point to note about this argument before
15 I address why -- well, it is one of the reasons why it
16 does not work is it does have a rather extraordinary
17 consequence. If it were to be correct, the consequence
18 would be that the subordinated debt was never payable at
19 all if the only means of paying the anterior liabilities
20 in full was from LBIE's own funds without any recourse
21 to its contributories. Because what the argument leads
22 to is a situation in which you cannot use a claim
23 against contributories to pay any of the anterior
24 liabilities. That is where you get to on this argument.
25 Now, we disagree as a matter of construction,

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1 actually, just plain looking at the language. The
2 natural, ordinary meaning of the words is that the
3 source from which LBIE is able to pay its liabilities is
4 not identified on the face of the clause. If you look
5 at the clause, there is nothing in the clause that
6 identifies the source. So, the natural meaning of the
7 phrase "it is able to pay" is it is able to pay using
8 such entitlements as it has to generate the funds from
9 which payment can be made. It is nothing more
10 complicated than that. There is nothing in there, as
11 a matter of ordinary language, which limits it to its
12 own funds.
13 A person's ability to do something depends on the
14 extent to which it has the ability to generate the state
15 of affairs from which it can be done. So an ability to
16 make a call or to prove in the distributing insolvency
17 of a member is just as capable of giving rise to funds
18 from which a payment can be made as is the realisation
19 of any other asset of LBIEs.
20 Now, all LBH does do is draw a distinction between
21 the right to make a call or prove in respect of a call
22 and any other asset of LBIE's. So, it does make that
23 distinction. We respectively submit that is not
24 warranted.
25 I have obviously said that even if there were such

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1 a distinction, it would not be relevant because the
2 clause is not concerned with the source from which the
3 payment is to be made. It is simply concerned with the
4 ability to do so.
5 But, just on the distinction, this obviously was an
6 area that the Court of Appeal considered in Waterfall I,
7 as my Lord has already alluded to.
8 Can I characterise slightly differently from the way
9 my Lord characterised it, where their Lordships ended up
10 on this point in Waterfall I?
11 The first point, and the context in which we need to
12 remember this, is that Lord Justice Briggs decided in
13 terms that contributions made following a call on
14 members become part of the assets of the company. Once
15 you have them in, there is no doubt they are assets of
16 the company. Lord Justice Lewison did not disagree with
17 that. What Lord Justice Briggs also decided was that
18 the membership liability to contribute is an asset of
19 the company before the stage at which the contribution
20 is actually received. He regarded that as an essential
21 building block in the bootstraps argument, as to how you
22 got in the call.
23 We do respectfully suggest that, given the analysis
24 that Lord Justice Moore-Bick seems to have agreed with
25 this conclusion, because he does so, at the beginning of

1 paragraph 246 of his judgment, in the sense that he
2 agrees with everything that was said.
3 Now, the problem is -- and I quite accept this -- is
4 that Lord Justice Lewison clearly had reservations on
5 the point, at paragraph 113 and following, and explained
6 in some detail what his reservations were. Somewhat
7 unfortunately, the way Lord Justice Moore-Bick expressed
8 himself indicated he agreed with those reservations too.
9 It is very difficult to see how he can have agreed with
10 both, because Lord Justice Briggs' explanation was
11 inconsistent, in the sense that he clearly had no
12 reservations at all.
13 We do respectfully suggest, for this reason, that
14 Lord Justice Lewison's reservations probably do not go
15 very much further than reservations. The reason for
16 this -- anyway so far as concerns the point that is made
17 by LBH -- is that it was part of the ratio of the
18 decision of the Court of Appeal in Waterfall I, not just
19 that the contributory already has a contingent liability
20 to LBIE for its liabilities under section 74 but, also,
21 that it is entitled to prove in the administration its
22 members for that contingent liability under section 74.
23 In those circumstances, it is a bit difficult to see
24 why that right of proof should not be treated as an
25 asset for the purposes of the argument that we are

1 engaged in with LBH. That entitlement is something
2 which, on any view, LBIE has been entitled to exercise
3 from the time that the members entered distributing
4 administration.
5 It follows, really, from this that whatever the
6 argument might be in relation to the uncrystallised
7 section 74 claim, so far as a call is concerned, which
8 is where the reservations of Lord Justice Lewison came
9 in, it follows that from the right of proof, and both
10 the right of proof itself and the funds which derive
11 from that right to prove, can be properly regarded as an
12 asset. But, perhaps more importantly for the purposes
13 of this argument, it is very difficult to see why that
14 is not something that is plainly available to it as the
15 source from which it can discharge its liabilities
16 within the meaning of the sub-debt agreement. That is
17 what we are concerned with here: has there been
18 a cutting down, by reason of what was said by
19 Lord Justice Lewison, in the concept of what it might
20 have available?
21 So, for those reasons, we say that although the
22 debate between Lord Justice Briggs and
23 Lord Justice Lewison on this point is obviously quite
24 difficult for my Lord to resolve, because
25 Lord Justice Moore-Bick does not really help,

1 ultimately, we say it does not lead to the conclusion
2 that Mr Atherton reaches, both because there is still,
3 come what may, a right of proof, and because we are
4 simply looking at the construction point as to what the
5 word "it" means, and that right of proof is sufficient.
6 The other argument that I ought just briefly to
7 address, which is an argument that we deal with in
8 paragraph 76 of our skeleton --
9 MR JUSTICE HILDYARD: I am so sorry, Mr Trower ...
10 (Pause).
11 Yes, well, I shall are to read what
12 Lord Justice Lewison says, possibly after being guided
13 by Mr Marshall.
14 MR TROWER: Yes.
15 MR JUSTICE HILDYARD: His reservation seem to be centred on
16 uncalled capital, rather than a section 74 claim.
17 MR TROWER: I think that is right. I mean, I think one of
18 the problems in this area is that in some of the old
19 cases, the judges were drawing distinctions between
20 assets and capital; sometimes the distinction between
21 the two, that undoubtedly exists, was not properly kept
22 in mind, which is why we say that, interesting though
23 this debate is, it is not likely, ultimately, to be that
24 illuminating on the point that we are concerned with for
25 the purposes of identifying the implied term. What my

1 Lord has to consider is whether or not there is
2 a cutting down of the ability of LBIE to pay something
3 by reference to the source of payment as a matter of
4 construction of the agreement, and to reach a conclusion
5 on that, based on what one might see as quite a sort of
6 technical approach to exactly what it is that is being
7 referred to in some of the old cases -- is it assets or
8 is it capital? -- may be a rather dangerous approach to
9 take.
10 MR JUSTICE HILDYARD: Speaking instinctively, but possibly
11 irrelevantly, for which I apologise, one finds it hard
12 to think that amounts uncalled on issued shares are not
13 assets of the company.
14 MR TROWER: Quite.
15 MR JUSTICE HILDYARD: As a matter of fact, one finds it
16 difficult to suppose they are not capital of the company
17 as well. That is different and one might be more
18 equivocal about whether a particular right under
19 section 74, in a particular context at this state
20 liquidation, to call upon contributories is an asset of
21 the company. I can understand the equivocation in that
22 context.
23 MR TROWER: Yes.
24 MR JUSTICE HILDYARD: I do know not know whether
25 Lord Justice Briggs expressed himself firmly by

1 reference to the former context i.e. unpaid capital, or
2 the latter context.
3 MR TROWER: If we turn up his judgment, it is at
4 paragraph 197.
5 MR JUSTICE HILDYARD: Yes. I mean, that is not for me to
6 say but, nevertheless, I suppose, technically, some
7 people might think that a call on issued shares is
8 a right for different nature than a provision -- he
9 equates the two, is the point.
10 MR TROWER: He does. There is no doubt there was a quite
11 a lot of debate about this in Waterfall I, that you have
12 the right to call that exists before liquidation in
13 relation to unpaid amounts on shares. You then have the
14 statutory right in relation to unpaid calls under
15 section 74; one of the points that
16 Mr Justice David Richards made in his judgment, at first
17 instance, was that you have a new statutory right that
18 comes into existence under section 74 but, itself,
19 relates back to, and is fed by, the contract of
20 membership which existed prior thereto.
21 Then you have the right to make unlimited calls, but
22 so far as those latter two rights are concerned, the
23 cause of action derives from section 74.
24 MR JUSTICE HILDYARD: I see.
25 MR TROWER: Although they are based, in the second instance,

1 on the underlying contract of membership. Both are
2 actually, yes.
3 MR JUSTICE HILDYARD: Both are incidents of the share.
4 MR TROWER: Yes. The second one, there was an antecedent
5 entitlement under the contract --
6 MR JUSTICE HILDYARD: Yes.
7 MR TROWER: -- which there wasn't, obviously, in relation to
8 the furthest.
9 MR JUSTICE HILDYARD: Yes. Yes, I see thank you.
10 MR TROWER: Yes, I was just moving on to the final point on
11 this bit of the argument, which is picked up, I think,
12 by us, in paragraph 76 to 80 of our skeleton argument.
13 This is the argument by the LBH administrators that
14 the members liability under section 74 is:
15 "Allowable to contribute to some which is sufficient
16 to pay the company's debts and liabilities and expenses
17 in winding-up ..."
18 They say that -- well, if my Lord would just read
19 the way we describe it in 76 and 77, which I think is
20 fair.
21 MR JUSTICE HILDYARD: Hmm. (Pause)
22 MR TROWER: The argument appears to be that the consequence
23 of what they say is that the condition precedent to the
24 payment of the section 74 liability by the members and
25 the sub-debt liability of LBIE cannot both be satisfied

1 at the same time. That seems to be the argument.
2 But the short reason why this is wrong is that the
3 liabilities with which the condition precedent and the
4 sub-debt agreement is concerned exclude the sub-debt
5 itself, but the liabilities with which section 74 is
6 concerned do not exclude the sub-debt. That is the
7 simple reason why the circularity argument does not
8 work.
9 My Lord, that was all I was proposing to say on
10 issue 1.
11 I was proposing then to move on to issue 3, which is
12 whether the value of the sub-debt contribution claim for
13 the purposes of proof in set-off is for the full amount,
14 limited to the estimated value that is applied to
15 LBHI2's claim for the sub-debt for the purposes of proof
16 or some other real.
17 Now, the claim with which issue 3 is concerned is
18 obviously the claim for proof in the administration of
19 the contributories. It is also the claim which has to
20 go into the set-off account in LBIE's administration.
21 So it is the value of the member's liability under
22 section 74 discounted, if necessary, for any contingency
23 by reason of the fact that LBIE is not in liquidation
24 yet. Although we say there shouldn't be a discount,
25 there is a dispute between the parties as to whether

1 there should. That is not an issue that is before your
2 Lordship. You are certainly not asked to decide that
3 point. We are asking your Lordship to decide this as
4 a point of principle not as point of detail.
5 But with a conceptual discount as for any amount, if
6 any, as is appropriate to reflect the prospects of LBIE
7 going into liquidation.
8 The first thing to do is to look at the statute of
9 the liability. Just thinking about this for proof of
10 purposes in the members insolvency, the debt must fall
11 within the concept of what is provable, which it
12 obviously does.
13 Indeed, one of the conclusions of Waterfall I was
14 that claims based on section 74 are, in principle,
15 provable. So that is that out of the way.
16 If one then goes on and looks at the wording of
17 section 74, itself -- if my Lord turns it up, if you
18 have it open.
19 Our submission is that as a matter of plain language
20 of the statute, the value of the member's liability,
21 under section 74, is such amount as may be required to
22 render LBIE's assets sufficient for payment of the
23 debts, liabilities and expenses of the winding-up and
24 adjusting.
25 Our position is that in working out that amount one

1 of the liabilities is the sub-debt, so the amount of the
2 proof must reflect the amount required to pay the
3 sub-debt.
4 Put another way, if the realisations in LBIE's
5 estate are insufficient to discharge the sub-debt in
6 full, LBIE's contributories are liable to contribute for
7 the payment of that part which cannot otherwise be paid.
8 Now, the argument on the other side is that if the
9 realisations in LBIE's estate are insufficient to pay
10 any part of the sub-debt, the sub-debt is to be given
11 a value of nil for the purposes of the contribution
12 claim. They base this argument on the fact that
13 Lord Justice Lewison said that the sub-debt was to be
14 given a value of nil for the purpose of proof in LBIE's
15 administration.
16 The core of our argument is that we say that this
17 contention gets two things wrong; it misunderstands the
18 way in which the Waterfall works in insolvency and it
19 misapplies what Lord Justice Lewison said about the
20 provability of the sub-debt when he talked about it in
21 paragraph 41 of the Court of Appeal judgment. Those are
22 two separate aspects of this: misunderstanding the
23 Waterfall and misapplying what Lord Justice Lewison
24 said.
25 So far as the Waterfall is concerned, my Lord is

1 very familiar with it. I am not going to turn it up at
2 all, but it is in the Nortel judgment, which is in
3 the bundles at bundle 4, tab 98, page 230. We set it
4 out on page 26 of our skeleton argument. It governs the
5 order of priority of distributions and liquidations in
6 administrations.
7 Lord Justice Briggs in Waterfall I -- and for this
8 bit of what I am going to say my Lord may find it
9 helpful just to look at our skeleton, as I go through
10 it. He explained the effect of the Waterfall at the
11 passage we cite, at paragraph 86. We submit that it
12 follows from this description of the position that once
13 insolvency proceedings have commenced, the question of
14 whether the liability would have been immediately
15 payable without insolvency proceedings isn't a question
16 any more. What matters is whether there is a liability
17 which falls within the Waterfall and, if so, when it is
18 payable.
19 So to give the example: the mere fact that debt is
20 due and payable immediately before the commencement of
21 the winding-up is not the determining factor. The
22 reason for that is obvious: you cannot compel payment,
23 you cannot compel execution, you can't do anything like
24 that.
25 What matters is the creditor has an entitlement to

1 payment only to the extent that prior liabilities have
2 been achieved. That is the approach that
3 Lord Justice Briggs takes. So you get your right to
4 payment only if there is a surplus after the payment of
5 the liabilities which fall within the proceeding levels,
6 is the way we put it in the skeleton.
7 The next stage in the analysis is that the
8 contributories liability to an insufficiency arises at
9 every level of the Waterfall. It is said as much by
10 Lord Justice Lewison and Lord Justice Briggs in the
11 passages we have identified.
12 Just to illustrate that, you could have a situation
13 in which there is only enough to pay the preferential
14 creditors right at the top. It does not mean to say
15 that the contributories are not liable in respect of the
16 unsecured creditors, of course they are. One way of
17 looking at that is the way we put it, in paragraph 91 of
18 our skeleton: it is self-evident from the structure that
19 the company's office holder pays the item in the
20 Waterfall, to the extent the net realisations made by
21 him are sufficient to meet them, but the contributories
22 obligations arise when there is an insufficiency, is one
23 way of looking at this.
24 There is a twofold consequence of that: while the
25 members are not liable to contribute to the extent of

1 the items in the Waterfall which the company is able to
2 pay, they are liable to the extent of the items which
3 the company is otherwise unable to pay, so that is the
4 way it works. With a consequence that we say that the
5 liabilities of the contributories cannot be reduced by
6 insufficiency of realisations in the estate. So the
7 contributors cannot rely on the fact that the company
8 itself is not yet making payments at a particular level
9 in the Waterfall as a basis for restricting or
10 eliminating their own liability in respect of the items
11 falling within that level, or any level below it.
12 There is a passage that is probably helpful to look
13 at on this point, in paragraphs 196 to 198 of
14 Lord Justice Briggs's judgment in Waterfall I. Yes, it
15 is actually the bit that we have already looked at, in
16 fact.
17 MR JUSTICE HILDYARD: Give me those paragraphs again.
18 MR TROWER: 196 to 198, which we have actually looked at
19 already.
20 MR JUSTICE HILDYARD: Yes.
21 MR TROWER: We are looking at it for a slightly different
22 reason because it is confirmation this. The fact, for
23 example, in this case, that statutory interest is not
24 yet payable by the company, provides no basis for
25 suggesting the contributories have no liability in

1 respect of statutory interest.
2 It is the same point as the point I made to my Lord
3 just now in relation to preferential debts. The company
4 still has the liability, even if the trigger for it
5 becoming payable is, in effect, the company being able
6 to pay it.
7 The consequence of this is that the contingency to
8 payment, at any given level in the Waterfall, which is
9 the sufficiency of realisations in the estate to
10 discharge the prior ranking level, doesn't affect the
11 liability of the contributories. That is the short
12 consequence of this.
13 How does that then fit with what the Court of Appeal
14 decided in Waterfall I?
15 The essence of the conclusion was that the sub-debt
16 is payable after the statutory interest, at level 6, and
17 the non-provable liabilities at level 7, but ranks ahead
18 of any claims at level 8. Just so my Lord can see how
19 this works, you need, I think, just to have a quick look
20 at the Court of Appeal order, as to what they actually
21 ordered, which is behind tab 12 of bundle 1. It is
22 paragraph 2.
23 Because Mr Justice David Richards had previously
24 declared that it was not provable. They said it was,
25 but you stick it in a different place.

1 We say the effect of the subordination is to take
2 the sub-debt out of the place it would normally sit,
3 which is an unsecured claim, and stick it down to
4 Waterfall. Nothing is payable in the insolvency, and
5 unless and until the prior ranking levels have been paid
6 in full. Or the way they put it is: payment of the
7 sub-debt is contingent on the payment in full of the
8 prior ranking levels.
9 What you have is a situation where unsecured
10 provable debts are contingent on payment in full of the
11 higher level, statutory interest is contingent on
12 payment of everything, including unsecured debts,
13 non-provable claims are contingent on everything being
14 paid above them. The payment of the sub-debt is
15 contingent on the payment in full of the non-provable
16 liabilities at level number 7.
17 The only difference between the subordinated debt
18 and the other levels in the Waterfall, is that whereas
19 the ranking of the other levels is the result of the
20 insolvency legislation, the introduction of the sub-debt
21 below level 7 is a direct consequence of the terms of
22 the sub-debt agreement as construed by
23 the Court of Appeal.
24 There is not any conceptual distinction between
25 those two situations. It has no effect on the basic

1 principle that the liability to contribute is for the
2 full amount of each liability. So, against that
3 background, if we just look at what Lord Justice Lewison
4 actually said in Waterfall I, paragraph 38 is where he
5 starts. Can I invite my Lord, just to read 38 to 41
6 inclusive. (Pause).
7 MR JUSTICE HILDYARD: Yes, I am going to have to read that
8 again, but, yes.
9 MR TROWER: Yes. Indeed, my Lord, and I should say straight
10 away, and this is one of the issues that I mentioned at
11 the CMC. The Court of Appeal's conclusion on this
12 particular point is subject to consideration in the
13 Supreme Court. We have to proceed on the basis of what
14 Lord Justice Lewison says at the moment.
15 The effect of what he says, we submit, is that since
16 the contributors are allowable to contribute in respect
17 of any insufficiency at every level in the Waterfall,
18 1 to 8, it must follow that they are liable in relation
19 to the sub-debt as well. It must follow that they are
20 liable to such matters as required to render the
21 company's assets sufficient to pay it, which is the
22 extent to which there is an insufficiency.
23 Now, perhaps one can test it this way: if the
24 sub-debt had not been subordinated, the contributories
25 would have been liable to contribute to the company's

1 full extent as an item within level five. That is
2 undoubtedly the case, whether or not anything before had
3 been paid.
4 There is no reason why the fact that it sits below
5 7, rather than at 5, means the contributories do not
6 have to contribute to the deficiency sufficient to pay
7 it.
8 Indeed, it is precisely that insufficiency which
9 gives rise to the liability in respect of it.
10 Another way of thinking about it is that the
11 contingency which applies to the payment of the sub-debt
12 by LBIE, which is the ability to pay the liabilities, as
13 referred to in the subordinated debt agreement, in full
14 is different from the contingency which applies to the
15 liability of the contributories in respect of the
16 subordinated debt. Merely because the realisations in
17 LBIE's estate are insufficient to enable payment of any
18 of the sub-debt, does not mean that the contributories,
19 themselves, have no liability to make a contribution
20 sufficient to meet those liabilities.
21 MR JUSTICE HILDYARD: Subject to the prior argument.
22 MR TROWER: Yes.
23 MR JUSTICE HILDYARD: Is this right: on your case, if there
24 are no express or implied terms, bowling out any
25 recourse to the contributories, if there are none --

1 MR TROWER: Yes.
2 MR JUSTICE HILDYARD: -- the contributories are in effect
3 guarantors without condition of the final tranche of
4 creditor claims.
5 MR TROWER: Yes. That is my case. We say that is not
6 particularly surprising.
7 MR JUSTICE HILDYARD: You say that is an incident of
8 unlimited liability.
9 MR TROWER: Indeed.
10 MR JUSTICE HILDYARD: Just as it would have been the
11 consequence before everything was channelled through the
12 corporation.
13 MR TROWER: Indeed. Once you are in a situation in which
14 the concept of the liability for which the contribution
15 has to be made is capable of extending to a liability of
16 this sort that is an inevitable consequence.
17 It is important to understand what we say
18 Lord Justice Lewison must have meant when he referred to
19 the sub-debt as a contingent provable debt in the
20 insolvency, because it is plain, on any view, that it is
21 a contingent provable that debt of a rather unusual
22 kind -- there are two possibly three factors which
23 render it particularly unusual.
24 First of all, the relevant contingency is the
25 occurrence of an event within the insolvency

1 proceedings. Namely, the payment of the prior ranking
2 levels of the Waterfall within the insolvency
3 proceedings, themselves, which is why it feels much more
4 like a ranging question, as between preface and
5 unsecureds, for example, as it does for what one would
6 traditionally regard as a contingency.
7 The second aspect of it that is unusual is that
8 the court of appeal has concluded that the provable
9 value of the sub-debt is binary, or seems to have done,
10 moving from nil to 100 per cent of the satisfaction of
11 the relevant provisions.
12 What Lord Justice Lewison said, at the end of
13 paragraph 41, is one would expect the office holder to
14 value it at nil, and then to re-value it once it becomes
15 clear that the contingencies have been satisfied.
16 Now, this is actually quite different from any other
17 normal form of provable debt, where you value by
18 reference to the percentage chance of the contingency
19 occurring. He obviously had in mind something a bit
20 different.
21 The third aspect of it is: we do say that the
22 treatment of the debt in this way is the mechanism by
23 which the subordination has been held to take effect
24 within the statutory insolvency code. That is what is
25 going on here. What Lord Justice Lewison is doing is

1 finding a way of rendering the debt capable of being
2 treated in accordance with the insolvency code in
3 a manner that is consistent with the underlying
4 subordinated debt agreement.
5 What I mean by that is this: that if any value were
6 to have been given to it above zero, there would have
7 been a breach of the subordination provisions in the
8 sub-debt agreement to the extent that any recovery was
9 made. That is what would have happened. One of the
10 reasons it was valued at zero was so there was no breach
11 of the subordination provision. If it had been valued
12 at any more than zero, there would have been a breach of
13 the subordination provision.
14 It has to be said that those kind of considerations
15 are considerations which featured in the appeal to the
16 Supreme Court on the analysis of this, because the
17 argument in the Supreme Court is whether it would or
18 would not have been right, in those circumstances, to
19 have concluded that the debt could not be proved at all.
20 Not conceptually be a provable debt with a zero value.
21 What this all demonstrates is that
22 Lord Justice Lewison must have been thinking about
23 ranking when he said what he did, otherwise he would not
24 have given the debt a value of zero. That must have
25 been what he was thinking about. What is important is

1 that it is only valued at nil for the purpose of proof,
2 and therefore the figure at which it goes into the
3 set-off account, which is a different question to the
4 question of: what is required to pay once it has been
5 re-valued?
6 So what is the consequence of this?
7 If the realisations in LBIE's estate are
8 insufficient to pay any part of the sub-debt, the
9 sub-debt is to be valued in full for the purposes of the
10 sub-debt contribution claim. That is what we say.
11 The members remain liable in respect of it precisely
12 because the realisations coming down the Waterfall are
13 insufficient to reach that level. The contribution
14 claim takes it into account at full value.
15 If the realisations are sufficient to pay part of
16 the sub-debt, but not all of it, the members remain
17 liable for the unpaid part.
18 It is only if the realisations are sufficient to pay
19 the sub-debt in full that the members will have no
20 liability in respect of it, because there will have no
21 liability in respect of it because there will then be no
22 deficiency for them to contribute towards paying.
23 Now, the argument on the other side is: for as long
24 as the prior ranking liabilities remain unpaid, the
25 sub-debt shall be valued at nil for the purposes of the

1 sub-debt contribution claim. They say the same amount
2 on both sides of the equation. The reason for this is
3 said to be the contingency which applies to payment of
4 the sub-debt by LBIE, namely the sufficiency of
5 realisations in its estate, is also a contingency to the
6 liability of the contributories to ensure there is
7 sufficient to pay the sub-debt.
8 We suggest that argument is wrong. If it were
9 correct, they would be able to say that in any case
10 where the realisations were insufficient to pay the
11 expenses, for example, item 2, so that the contingency
12 to the payment of the provable debts for the company
13 hadn't occurred, the contributories themselves would
14 have no liability in respect of the provable debts,
15 which cannot be right.
16 The flaw, we suggest, in the argument is that merely
17 because there is a contractual restriction which has the
18 effect of preventing LBHI2 from proving for a figure of
19 more than zero, that means that a contribution of zero
20 is sufficient to ensure that the liability is paid.
21 What that approach does is confuse what
22 the Court of Appeal has said is the amount for which the
23 proof can be made and admitted, with the amount that is
24 required to be contributed to ensure that the liability
25 is paid. They are two quite different points.

1 There are parts in the position papers where we say
2 that that confusion is manifest. We do pray in aid the
3 fact that the approach is wrong because it could equally
4 be said that the contingency to the payment of ordinary
5 unsecured debts is also a contingency to the liability
6 of the contributories for the provable debts. But the
7 contention would be misconceived because there is not
8 any logical basis for contending that the insufficiency
9 of realisations to pay anything at a particular level
10 will operate so as to relieve the contributories from
11 liability.
12 It appears to be the case that underpinning all of
13 the submissions on the other side is the point that it
14 cannot be correct that a contribution claim can be made
15 for an amount which is greater than the value which is
16 given in the insolvency for the incoming claim; that
17 seems to be the source of the underlying concern.
18 My Lord, we say that is not correct. To the extent
19 the realisations are insufficient the contributories
20 remain liable, to the extent they are sufficient, but
21 only to that extent, the liability is reduced. It makes
22 absolutely no sense to say: to the extent that the
23 realisations are insufficient, the contributories have
24 no liability.
25 MR JUSTICE HILDYARD: The premise is that the proof must be

1 revalued for your case.
2 MR TROWER: For my --
3 MR JUSTICE HILDYARD: It has to be revalued and, in fact,
4 for your full case at 100 per cent, otherwise the call
5 on the contributories will be to, in effect, fund level
6 8, which is themselves.
7 MR TROWER: Indeed, my Lord. But we say there is no
8 objection to that. I do not resile from that being the
9 consequence of the call on the contributors. I accept
10 that that is the case. Put it this way: one can have
11 a situation in which you make a call in respect of the
12 particular liability --
13 MR JUSTICE HILDYARD: Yes.
14 MR TROWER: -- in circumstances in which having made that
15 call, based on that liability, you know that the money
16 is not actually going to flow down to the person in
17 respect of whom the call is played. The reason for that
18 is the insolvency of the contributory. If the
19 contributory was not insolvent, the issue would not
20 arise because the full amount would be paid and everyone
21 would be paid.
22 The reason the issue arises is because the
23 contributory is insolvent. So if you make a call for
24 £100 in order to deal with all the contributions, or all
25 the liabilities in the estate, you are still entitled to

1 make a call for £100 even if you know that the dividend
2 you are going to get is not going to be sufficient to
3 enable some element of that £100 to trickle down to the
4 person in respect of whom that element was quantified.
5 That is a necessary consequence of the centralized
6 process of making calls where you have an insolvent
7 contributory.
8 MR JUSTICE HILDYARD: To whom will the benefit of the call
9 inure in those circumstances, unless you revalue?
10 MR TROWER: In a very simple case, where you just have
11 preface and unsecureds, there is no reason why you
12 cannot make a call -- indeed, this is what you do. You
13 would quantify the full extent of the liabilities even
14 though, in the light of the insolvency of the
15 contributory, the money only gets as far as the
16 (inaudible). You do not reduce the amount of the call
17 simply because you know that the trickle down will not
18 reach the unsecureds. You still take into account the
19 value of the unsecured claims for the purposes of
20 quantifying the call, you must do.
21 The mischief with which one is concerned in this
22 case flows from the fact that the contributories are
23 insolvent, so that we are only ever getting a dividend
24 in their insolvency. We say that is not a particularly
25 surprising result. I am conscious that it is now

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1 1.05 pm, but I have one or two submissions to explain
2 why that is not a very surprising result, which I will
3 come back to after the short adjournment.
4 The critical point here is that the problem here
5 arises because of the contributories own insolvency.
6 MR JUSTICE HILDYARD: 2.05 pm.
7 (1.05 pm)
8 (The luncheon adjournment)
9 (2.05 pm)
10 MR TROWER: We say it is distracting to think about the
11 inbound and outlying claim as being mirror images of
12 each other.
13 MR JUSTICE HILDYARD: Say that again.
14 MR TROWER: We submit it is distracting to think about the
15 inbound and the outbound claim as pure mirror images of
16 each other.
17 Perhaps it is a little bit distracting to have used
18 the concept of the subordinated debt contribution claim
19 which we did in the application notice.
20 It is designed for a particular purpose, but the
21 outbound claim is one unitary claim for a contribution
22 in respect of the liabilities necessary to make up the
23 shortfall. What can be proved is not the same as what
24 can be recovered from the contributory. The
25 counterbalance to that is: what is recovered from the

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1 contributory does not necessarily flow down to the level
2 of the waterfall in respect of which any element of the
3 recovery was made.
4 That is a necessary consequence of the insolvency of
5 the members in a case such as this.
6 At the risk of using an inappropriate illustration.
7 Waterfall is not a series of buckets which are filled up
8 with a proportionate share of the recovery. It is
9 a smooth flowing stream which fills each bucket up and
10 then moves on to the next one.
11 Now, one of the consequences of this is that
12 although the contribution claim goes into the set-off
13 account, which is issue 2, it will not necessarily be
14 extinguished, or reduced to zero, by the inbound claim,
15 which has been taken into account as a liability under
16 section 74, because the inbound claim only goes into the
17 account at its provable value.
18 MR JUSTICE HILDYARD: What then happens to the surplus?
19 MR TROWER: What then happens is you wouldn't have
20 a set-off. This is only obviously relevant in
21 circumstances where there is an insolvency.
22 MR JUSTICE HILDYARD: Yes.
23 MR TROWER: Let me give your Lordship an illustration as to
24 why -- there is one very clear case in which one can see
25 this wouldn't happen, which is in the case of statutory

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1 interests and non-provable debts.
2 We know, from the decision of the Court of Appeal,
3 that the contributories are liable to contribute in
4 respect of them but, by their very nature, statutory
5 interests are non-provable liabilities aren't provable
6 debts, and so cannot go into the set-off account in
7 LBIE's administration. That is the very nature of them.
8 So they have no value in the insolvency, if looked
9 at through Lord Justice Lewison's perspective, until the
10 time there is sufficient money in the estate to pay
11 them. So you don't have a set-off issue that arises in
12 relation to them.
13 None of this means that you do not give them their
14 full value for the purposes of working out how much you
15 have to contribute. So you contribute, you make the
16 contribution claim based on the full value of the
17 liability -- in this case statutory interest and
18 non-provable debts -- that amount is entitled to be
19 recovered from the contributory notwithstanding the fact
20 that, in his capacity as a creditor, he has no provable
21 claim in respect of statutory interest or to the extent
22 that it is a non-provable liability. So what I am
23 positing is a situation where the contributor, instead
24 of a claimant creditor, under the subordinated debt
25 agreement he is a claimant creditor in his capacity as a

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1 person entitled to recover statutory interest or
2 non-provable debts. That is a very good example of a
3 case where you can get the full amount in, you have no
4 entitlement to set-off and you have to pay your full
5 amount until such time as everybody has been paid in
6 full in respect of the non-provable liabilities in the
7 statutory interest.
8 That result is entirely consistent with what would
9 happen if LBIE were to be in liquidation rather than
10 administration because of the operation of the
11 contributory rule which we looked at before. It is
12 entirely consistent with the whole idea that what you
13 get in is the amount necessary to fill up the pot, even
14 though you are not going to get out that which you
15 ultimately may be entitled to until a later stage in the
16 process. Because, of course, we know, in the situation
17 of the sub-debt, that there will come a moment in time
18 at which the sub-debt is payable in full, and in respect
19 of which they will be entitled to prove for full amount,
20 but that is only the moment in time at which everybody
21 else has been paid in full and the waterfall has reached
22 that stage in the structure.
23 Both those set-off examples are good examples, we
24 suggest, as to why it is that what might be at first
25 blush a slightly surprising result that you look at the

1 value of the inbound claim differently from the
2 valuation of the outbound element which it is founded
3 on. There is a good example of why it is that you
4 cannot simply say that they are the precise mirror image
5 of each other.
6 MR JUSTICE HILDYARD: Just looking at it, as it were, in
7 accounting terms --
8 MR TROWER: Yes.
9 MR JUSTICE HILDYARD: -- here there is a curiosity, which is
10 that of course the contributory and the creditor are the
11 same, and they have a deficiency in both capacities --
12 MR TROWER: Yes.
13 MR JUSTICE HILDYARD: -- but that might not always be the
14 case.
15 What would happen as to the mismatch between the
16 inbound claim and the outbound claim?
17 The outbound claim is, let us say, worth 10, and the
18 inbound 1, or none.
19 MR TROWER: Yes. Let us assume.
20 MR JUSTICE HILDYARD: Where do you post that? If I can put
21 it that way. What happens?
22 MR TROWER: What, to the inbound claim?
23 MR JUSTICE HILDYARD: No, to the outbound, the receipts.
24 Looking at it --
25 MR TROWER: It comes into a fund. So it comes into a fund

1 and out of the fund you then pay the prior receipts
2 because, of course, when you are quantifying the amount
3 of the outbound claim, it won't just be on this
4 hypothesis, it won't just be the element that relates to
5 the subordinated debt.
6 MR JUSTICE HILDYARD: No, you have explained that.
7 I appreciate that. It will go down --
8 MR TROWER: Yes.
9 MR JUSTICE HILDYARD: -- the waterfall, through the sluices
10 and not the buckets. I understand that. It then
11 arrives and you have paid up to level 6 or 7.
12 MR TROWER: Level 7, yes.
13 MR JUSTICE HILDYARD: You then have 7A to deal with, you
14 have the subordinated debt. It is the last sluice
15 before the shareholders.
16 MR TROWER: Yes, it is the only thing that is left. Is your
17 Lordship positing a situation which there is some money
18 to go on down?
19 MR JUSTICE HILDYARD: Yes.
20 MR TROWER: Well, in that situation what we say happens --
21 and this is a point that is actually raised in one of
22 the paragraphs of, I think, Mr Arden's skeleton
23 argument, paragraph 63.
24 MR JUSTICE HILDYARD: Yes.
25 MR TROWER: In those circumstances the condition precedent

1 to payment of the obligation under the sub-debt
2 agreement will have been satisfied because everybody
3 else will have been paid in full. So that means that
4 the subordinated debt becomes payable at that stage.
5 MR JUSTICE HILDYARD: Right.
6 MR TROWER: At that stage, they will be able to recover in
7 respect of the full amount of the subordinated debt.
8 One thing that is said against me, in that
9 situation, is that you could then have a problem arising
10 because the subordinated debt, having been re-valued for
11 the full amount, you would end up in a situation where
12 that re-valuation needs to be taken into account for the
13 set-off purpose, which will have knock-on consequences
14 on the ability to have paid everybody else in the first
15 place, is essentially the argument that is made.
16 The short answer to that is that they cannot
17 exercise the set-off right under clause 7B of the
18 subordinated debt agreement in a manner which adversely
19 affects the interests of the other unsecured creditors.
20 I was actually going to come on and explain --
21 I will take your Lordship through that point, but so far
22 as the narrow point is concerned, the narrow point is
23 that moment in time at which there is enough -- it
24 follows as night follows day that the condition
25 precedent is satisfied and so they can prove that their

1 claim becomes worth the full amount.
2 MR JUSTICE HILDYARD: Correct me if I'm wrong because I am
3 floundering a little bit here, to be honest. Two things
4 have to happen, don't they, you sort of abandon the
5 notion that you value everything at the liquidation or
6 the administration date --
7 MR TROWER: Well, you are not abandoning, well --
8 MR JUSTICE HILDYARD: -- and are you abandoning, also,
9 the -- or alternatively -- hindsight principle with
10 regard to the valuation of the set-off?
11 MR TROWER: No, you are not doing that. I mean, I quite
12 accept, so far as the first point is concerned, a bit of
13 an issue arises in the relation to way in which
14 the Court of Appeal characterised what was going on.
15 There isn't an abandonment. All that is happening
16 is that it can now be seen, at a later stage in the
17 process, that there has been a recovery which is
18 sufficient to discharge everybody else in full so that
19 the debt becomes payable. So to that extent there is
20 a re-valuation. I don't think it interferes with the
21 fact that the valuation is notionally treated as having
22 taken place at the commencement date for proving
23 purposes. All that is happening is that you can see
24 that the condition precedent has been satisfied so that
25 the debt has been re-valued. It does not --

1 MR JUSTICE HILDYARD: Put another way, the justification for
2 the mismatch between the inbound and the outbound, is
3 the valuation of the inbound as zero.
4 MR TROWER: Yes, I would not put it as a justification for
5 the mismatch.
6 MR JUSTICE HILDYARD: No.
7 MR TROWER: I would simply say the amount to which I am
8 entitled to recover --
9 MR JUSTICE HILDYARD: The source of the mismatch is that you
10 value the inbound at zero --
11 MR TROWER: Yes.
12 MR JUSTICE HILDYARD: -- and you are entitled on your case
13 to take the entire indebtedness as the marker for the
14 value of the outbound claim.
15 MR TROWER: Yes.
16 MR JUSTICE HILDYARD: You know that the justification for
17 that is because at some time in the future, therefore,
18 you are going to have to re-set up the set-off at the
19 same value.
20 MR TROWER: You don't know that at all.
21 MR JUSTICE HILDYARD: Don't you?
22 MR TROWER: No, because you have no idea whether or not the
23 recovery you actually make is going to be enough to
24 render the condition precedent satisfied.
25 MR JUSTICE HILDYARD: Right, I see.

1 MR TROWER: You simply do not know the answer to that, at
2 the moment.
3 MR JUSTICE HILDYARD: Because you do not know whether
4 solvency will be achieved or not.
5 MR TROWER: One thing you do know is that you have some
6 contributories out there who may not be able contribute.
7 First of all, you do not know whether your own
8 estate is going to be solvent and, if so, how solvent it
9 is going be. At the moment, one of the big issues is
10 whether a currency conversion claim would survive in the
11 Supreme Court. That will be have a big impact.
12 There is that question within the LBIE estate.
13 Probably more importantly for present purposes, you
14 don't know the impact of your own contributories'
15 insolvency, on how much you are going to recover from
16 them; to the extent you need to make a recovery from
17 them in respect of the deficiency.
18 So, yes, there may be circumstances, and we do not
19 deny that. There may well be circumstances in which you
20 have to go through the re-valuation exercise. Indeed,
21 Lord Justice Lewison expressed it in the way he did, but
22 that may or may not happen, and what we are seeking to
23 do is find a way of identifying what it is, at
24 a particular moment in time, gives rise to the
25 inbound -- or how it is that you value the inbound and,

1 more importantly, the outbound liabilities for the
2 purposes of both proof in the contributories'
3 insolvencies and set-off in our own.
4 We can only do what we can do on the basis of the
5 present position.
6 That does not mean to say that there may not, at
7 some stage in the future, have to be a re-valuing of the
8 liability if the condition precedent is otherwise
9 satisfied. That is the only circumstance which, on the
10 present state of the law, the inbound claim is actually
11 re-valued.
12 Now, we do not shrink from the fact that the
13 analysis the Court of Appeal has adopted in relation to
14 valuing this liability is difficult. It does give rise
15 to problems because, as we say, normally, one would
16 value a contingent liability in a rather different way.
17 I mean, we say the short answer to this actually
18 should have been that the inbound claim simply was not
19 provable at all. In which case, it falls into exactly
20 the same bucket as statutory interest and non-provable
21 claims; that it only became provable and entitled to
22 participate on satisfaction of the condition precedent.
23 We do respectfully suggest that thinking about it in
24 a way that is similar to non-provable claims and
25 statutory interest is helpful because it is, in effect,

1 the contractual equivalent of the statutory
2 subordination that is given in respect of those two
3 categories of liability.
4 Can I just turn to a point that is made by Mr Arden,
5 because it does link in with what I have just been
6 submitting, which arises on paragraph 63 of his
7 skeleton; which he says illustrates the difficulties
8 with our position and just explain what our answer is.
9 MR JUSTICE HILDYARD: This is in Mr Arden's?
10 MR TROWER: Mr Arden's skeleton argument, paragraph 63.
11 Could I invite your Lordship just to read paragraph 63.
12 It is as always eloquently written but probably quite
13 dense, so it may require --
14 MR JUSTICE HILDYARD: Beyond me, in other words.
15 MR TROWER: No, my Lord, I was not saying that.
16 MR JUSTICE HILDYARD: You can watch my lips move deal.
17 (Pause).
18 Yes, I mean, it is condensed. That is right.
19 I will have to read it again, but it is broadly what
20 I was fishing towards.
21 MR TROWER: I see that, my Lord, which is why I thought that
22 was right.
23 In fact, I can summarise the problem that is
24 asserted in this way: the effect of the receipt from the
25 contributories will be that because all of the other

1 liabilities will be payable in full, the condition
2 precedent for payment of the sub-debt will have been
3 satisfied which will mean that the sub-debt becomes more
4 than zero and will have to go into a revalued set-off
5 account at full value which will then mean contribution
6 should never have been made because it will have been
7 extinguished by set-off.
8 MR JUSTICE HILDYARD: Yes.
9 MR TROWER: That is basically what it boils down to.
10 Now, what we say what that doesn't take into account
11 is the effect of the subordinated debt agreement itself
12 which, at clause 7B of it, which is bundle 4, tab 1,
13 page 12. If my Lord would just read 7B:
14 "This is what the lender cannot do ..."
15 (Pause).
16 MR JUSTICE HILDYARD: Golly, yes.
17 MR TROWER: Now, it too is quite complex in language, but
18 what we submit clause 7B does is it restricts, LBHI2
19 from setting off any amounts which it owes to LBIE, the
20 contribution claim, then, against the sub-debt, save to
21 the extent that payment of the sub-debt would then be
22 permitted by the sub-debt agreement. That is what it
23 provides for.
24 Now, the effect of this is the set-off is only
25 permitted to the extent consistent with the prior

1 payment in full of LBIE's senior liabilities. So the
2 set-off cannot reduce LBIE's net claim against LBHI2 to
3 a point at which the distribution payable by LBHI2 to
4 LBIE would be insufficient to discharge the prior
5 ranking senior liabilities in full.
6 MR JUSTICE HILDYARD: One to 6 to 7.
7 MR TROWER: Yes, that is what we say the effect of 7B is and
8 we respectfully suggest it is an answer to the conundrum
9 posed by Mr Arden in paragraph 63. It is a restriction
10 on the extent of the set-off entitlement:
11 "Except to the extent that ..."
12 That means that the conundrum identified by
13 Mr Arden, in paragraph 63 of his skeleton argument, does
14 not actually arise. So --
15 MR JUSTICE HILDYARD: Are other reasons for 7B suggested?
16 MR TROWER: Well, the underlying purpose of 7B is to ensure
17 that the subordinated creditor doesn't acquire payment
18 by set-off in circumstances where that would affect the
19 subordination of the claim. Because the basic
20 subordination right is in 5, and then you have a series
21 of things, in 7, which are designed to preserve and
22 bolster the subordination. So that is the way we say
23 the problem arose by Mr Arden and his broker, or is not
24 the problem it might at first blush appear to be.
25 So, my Lord, that was all I was going to say on

1 issue 3 at the moment. I hope I have covered the points
2 that we raised in our skeleton. We do not pretend that
3 the answer to this is among the more straightforward
4 issues on this application. It plainly is not, but we
5 do respectfully suggest that our solution is a principal
6 solution that is consistent with the correct approach to
7 the Waterfall and, on a proper analysis, the correct
8 explanation of what Lord Justice Lewison was intending
9 to achieve by his judgment at paragraphs 38 to 41.
10 My Lord, I was going to turn next to issue 7 if that
11 is convenient. It starts in our skeleton at
12 paragraph 37.
13 MR JUSTICE HILDYARD: 124?
14 MR TROWER: Sorry?
15 MR JUSTICE HILDYARD: Paragraph 124?
16 MR TROWER: Paragraph 124, that is right.
17 We deal with two of them together, but we deal with
18 the subparagraphs separately.
19 The first one is whether the obligation to
20 contribute pursuant to section 74 is joint and several
21 or otherwise. It is the first bit we deal with.
22 The main difference which arises as between us and
23 LBL on this issue is that LBL says that the liability is
24 rateable and we disagree.
25 There was a little bit of correspondence. Your

1 Lordship might have seen things in the papers, can
2 I make this clear: our understanding is that LBHI2 and
3 LBH are in the same boat as us on this particular issue.
4 I am sorry, in some of our paperwork we slightly
5 misdescribe the position.
6 Now, our first submission is a simple matter of
7 statutory construction and is that both members are
8 liable to LBIE for the full amount of the shortfall.
9 What section 74 does, my Lord is more than familiar with
10 it, is impose a separate statutory liability on each
11 member to the extent of the deficiency. What is needed
12 to pay all of the debts, liabilities and expenses.
13 That liability is limited by section 74.2, but none
14 of the limitations refer to a rateable proportion of the
15 losses. By section 152, which I don't think we have
16 looked at yet, but maybe we have, which is in the same
17 volume, volume 5 of the trial bundle, at tab 143. We
18 will come back, obviously, to this section later. By
19 section 150(2):
20 "It is striking that in enforcing the liability by
21 making a call the court is explicitly entitled to take
22 into consideration the probability that one or other
23 contributory may fail to pay the court."
24 Which we submit shows that the liability which
25 underpins the call may be enforced by reference to

1 inability to pay which is inconsistent with the idea
2 that the basic liability of each is limited to
3 a rateable amount.
4 MR JUSTICE HILDYARD: I was wondering how you test it in the
5 context of a limited company?
6 MR TROWER: What, in unpaid calls?
7 MR JUSTICE HILDYARD: Yes. I suppose, there, the exposure
8 of the limited shareholder is the less.
9 MR TROWER: Yes. The principle I think is the same.
10 MR JUSTICE HILDYARD: The call would only be on that
11 person's shares, wouldn't it?
12 MR TROWER: Yes, but still, I mean, you could have shares
13 that are only part paid to a fairly limited amount and
14 in some, say, 10P in the pound.
15 MR JUSTICE HILDYARD: I am being stupid about this, but in
16 the context of a limited company --
17 MR TROWER: Yes.
18 MR JUSTICE HILDYARD: -- which is the more usual --
19 MR TROWER: Yes.
20 MR JUSTICE HILDYARD: -- the exposure of the member, the
21 contributory, is capped at the amounts outstanding on
22 his shares.
23 MR TROWER: Yes.
24 MR JUSTICE HILDYARD: Which is rateable in that sense, and
25 there is obviously going to be no other liability

1 because of the cap.
2 MR TROWER: Yes, but it is not a genuine rateability in this
3 sense: let us assume that you, there is unpaid capital
4 in aggregate of £100.
5 MR JUSTICE HILDYARD: Yes.
6 MR TROWER: You actually only need £50 in order to satisfy
7 the requirements of section 74.
8 MR JUSTICE HILDYARD: I see, then the question is: can you
9 just pick on one of the members?
10 MR TROWER: You could pick on half of them if you wanted to.
11 MR JUSTICE HILDYARD: Yes.
12 MR TROWER: Now, we have a section in our skeleton, I am not
13 going to do anything other than --
14 MR JUSTICE HILDYARD: Slightly different matter, isn't it,
15 because no-one is being asked to pay somebody else's
16 debt, if you see what I mean?
17 MR TROWER: Well, I would respectfully not characterise it
18 in quite that way for anyone, actually.
19 At the end of the day, the starting point is the
20 members are liable for everything, you then limit or you
21 do not limit it, as the case may be. All that has
22 happened in relation to limited liability is that they
23 are limited to the extent of the unpaid calls. It does
24 not affect the underlying starting concept in
25 section 74.1, which provides the answer in a lot of

1 these cases, we respectfully submit. When thinking
2 about how to deal with this kind of problem, the
3 starting point always is -- although of course we know
4 it is terribly unusual -- everyone is liable and you
5 then cut that down.
6 My Lord, that in some ways leads neatly into the
7 next point that I was going to make, which is just to
8 draw your Lordship's attention to -- there is
9 an historical section in our skeleton which your
10 Lordship may or may not find helpful, but which simply
11 goes through the transition from partnership to the
12 1862 Act and explains how it all works. What we draw
13 from that is three points in the stages that are sort of
14 core: the starting point is that partners are, as they
15 always have been, liable for the full amount of the
16 partnership debts and not merely for a proportionate
17 part. That is the starting point. That is clear as
18 night follows day.
19 MR JUSTICE HILDYARD: To the last farthing.
20 MR TROWER: The last farthing.
21 The 1844 legislation did not alter the liability of
22 shareholders. Creditors had to sue the company first,
23 but apart from that you could then proceed direct
24 against the shareholders. At that stage, the extent of
25 the liability which they would have had as partners

1 would have remained entirely unaffected. There was no
2 impact on the extent of the liability. The 1862 Act
3 prevented creditors from proceeding against shareholders
4 direct and enabled shareholders to limit their
5 liability. They first had to obtain a winding-up order,
6 but subject to the limitations contained in what was
7 then section 38, and is now section 74, the extent of
8 the shareholders liability remained unaffected; which is
9 why I said that one always has to think in terms of
10 section 74 as the starting point.
11 The most detailed description, I think, in the old
12 cases of the history of it all is in Oakes v Turquand
13 which is in the bundles at tab 18 of bundle 1, and
14 particularly pages 362 to 364.
15 MR JUSTICE HILDYARD: What was that reference?
16 MR TROWER: Oakes v Turquand, bundle 1, tab 18, particularly
17 at pages 362 to 364 which is where Lord Cranworth
18 explains the position in some detail. So bundle 1,
19 tab 18. It is the passage starting at their important
20 differences and it is really just for your Lordship to
21 highlight them. The sort of core point on page 363, the
22 first question then is whether the change in the mode as
23 to reliability in our shareholders.
24 Then he describes the nature of the winding-up and
25 the passage that goes over to the end of the first

1 paragraph, 364. We have Oakes v Turquand open,
2 actually. There is also a passage in Lord Chelmsford's
3 judgment, at page 347, which is worth just referring to.
4 MR JUSTICE HILDYARD: Sorry?
5 MR TROWER: If you start it at the bottom of page 346.
6 MR JUSTICE HILDYARD: 346?
7 MR TROWER: Yes. Going over to 347 and then it is the
8 passage --
9 MR JUSTICE HILDYARD: Whose judgment is this?
10 MR TROWER: This is Lord Chelmsford, I was just wondering
11 whether I have misnoted it actually. I think I might
12 have looked at a bad reference. Can we check the
13 reference because I cannot immediately fine it? I think
14 it is the passage that is referred to in paragraph 153
15 of our skeleton argument.
16 MR JUSTICE HILDYARD: Yes.
17 MR TROWER: What we have done in the skeleton argument is
18 set out a series of passages which explains the
19 development of the legislation. I think apart from that
20 one passage, that I referred to in the judgment of
21 Lord Cranworth, I think everything that your Lordship
22 needs is actually contained in the skeleton argument
23 itself.
24 So, just moving away from the history, what is the
25 rateable argument?

1 It is articulated in paragraph 50 of the LBL
2 skeleton and is to the effect that a call which is
3 otherwise than rateable risks being oppressive. If your
4 Lordship just turns it up --
5 MR JUSTICE HILDYARD: Hmm.
6 MR TROWER: Paragraph 50.
7 MR JUSTICE HILDYARD: Yes.
8 MR TROWER: Now, we accept that the ultimate objective is to
9 ensure that losses are distributed rateably. But this
10 is not achieved by a rateable limit to the underlying
11 liability which we have submitted is inconsistent with
12 the language of the section. The cases, which are
13 relied on in paragraph 50 of Mr Marshall's skeleton
14 argument, do not really assist LBL. Hodges Distillery,
15 which is the first one, was actually a case of a solvent
16 company and there was no need for a call. The
17 adjustment was affected by making a distribution of the
18 surplus, first, to the shareholder, who had paid more on
19 his shares and only then being divided amongst those who
20 had paid less. Paterson v M'Farlane was a Scottish
21 case, again a solvent winding-up where there was a small
22 surplus. The holders of fully paid shares were entitled
23 to an adjustment call on the holders of the part paid
24 shares so as to ensure that total contributions of all
25 shareholders were equalised. So you are dealing with

1 a very different context there.
2 Neither of the cases bear at all on the question of
3 the liability of the individual shareholders to the
4 debts, liabilities and expenses of the liquidation. It
5 is also right that the passage from McPherson is also
6 dealing with a situation where equalisation in relation
7 to the surplus is the question. It is not dealing with
8 rateable liability in the context of the need to make
9 a call to pay the debts, liabilities and expenses in
10 full.
11 We submit that based on the wording of the statute,
12 and based on the history of the legislation, the
13 position is tolerably clear.
14 There are a number of other points that are made
15 though by Mr Marshall.
16 First of all, he says there is an issue that arises
17 out of the de minimis nature of his holding. We simply
18 say there is no separate argument based on the fact the
19 holding is much smaller than that of LBHI2; however
20 great the disparity, there is no such thing in the
21 context of liability under the section 74. If you have
22 the misfortune to find yourself in a position where you
23 are a shareholder for a tiny per cent, but happen to be
24 very wealthy and you have a co-shareholder, who happens
25 to be extremely poor but owns nearly all the shares,

1 that is just hard luck, that is the nature of the
2 obligation that you have undertaken as an unlimited
3 liability shareholder.
4 Of course we accept that once the debts, liabilities
5 and expenses have been paid in full, there will then be
6 an adjustment that will reflect the nominal value of the
7 shares and it is in that context, but in that context
8 alone, that the de minimis size of the holding becomes
9 relevant.
10 The next argument which is advanced against us is
11 what one describe is the nominee shareholding. It is
12 advanced in paragraph 53 of Mr Marshall's skeleton.
13 As we understand it, he relies on cases of which
14 Overend Gurney, I think is one example in support of the
15 submission that the nominee status must be taken into
16 account when assessing the liability.
17 Now, the question of whether or not his clients are
18 rightly to be characterised as nominees is not an issue
19 for now, it is an issue for part B, but we say the case
20 does not bear out the submission. Can we just quickly
21 turn it up. It is bundle 1, tab 19.
22 MR JUSTICE HILDYARD: This is Overend, is it?
23 MR TROWER: Overend Gurney, it is one of the many cases
24 arising out of the collapse. It was a case in which
25 the court refused rectification of the register to

1 replace a transferor with a transferee:
2 "... where the contract was concluded
3 pre-winding-up. Although specific performance and an
4 indemnity was left over for subsequent argument."
5 The conclusion of what was going on is expressed on
6 page 207 of the vice chancellor's judgment.
7 In essence, what he did was he refused rectification
8 but said, "You can go off and seek specific performance
9 of the entitlement to --"
10 MR JUSTICE HILDYARD: What is that page?
11 MR TROWER: Page 207.
12 MR JUSTICE HILDYARD: I see, yes.
13 MR TROWER: We actually say this case is inconsistent with
14 the idea that the transferor, even if a trustee for the
15 transferee in these circumstances, was not the person
16 primarily liable. There is a question based on this as
17 to whether or not specific performance would have been
18 granted and Mr Marshall can, I am sure, say the vice
19 chancellor thought specific performance should be
20 granted but wasn't sought.
21 It does not help him in saying that the secretary of
22 trust was the person who ought to be on the register or
23 that the nominee ought not to be.
24 So we say that the position is tolerably clear from
25 the cases that we rely on in paragraphs 161 to 169 of

1 our skeleton, which make clear that so far as the
2 company is concerned, which is what matters, it is the
3 nominee -- if that is what they are -- who is the person
4 that is liable.
5 There are only two cases I think we need just
6 briefly to look at. It is in a section of our skeleton
7 starting at paragraph 161. The first is the Imperial
8 Mercantile Credit Association case, that is to be found
9 in bundle 1, tab 15.
10 MR JUSTICE HILDYARD: Give me your paragraph reference
11 again, in your skeleton.
12 MR TROWER: Sorry, it is 166 is where this case is referred
13 to. 166.
14 MR JUSTICE HILDYARD: Yes.
15 MR TROWER: The important point about the bit in the
16 judgment that matters is pages 366 and 367, but my Lord
17 might want to read the headnote just to have the
18 context, on 361, it is a very short headnote. (Pause).
19 This was a case in which the members were there said
20 to be trustees for the company, itself, but the
21 principal of general application is dealt with at
22 pages 366 and 367, in a passage starting about a dozen
23 lines down:
24 "Now these gentlemen have been placed upon the
25 register most legitimately and properly."

1 Can I just note one point in the third or fourth
2 line of that passage that I have identified. There is
3 a reference there to section 30 of the 1862 Act which is
4 not recording the trust on the register, that situation
5 has, of course, continued to be the position in law
6 here, under section 126 of the 2006 Act.
7 MR JUSTICE HILDYARD: By and large, my understanding of
8 company law in this jurisdiction absent some statute
9 warrant, we're looking behind to the beneficial
10 interest. A company is really not bound by any notice
11 of any trust, nor concerned with the underlying
12 beneficial interest in its shares.
13 MR TROWER: Indeed.
14 MR JUSTICE HILDYARD: That carried forward, so you can very
15 rarely instigate statutory processes as a beneficial
16 owner however great your interest.
17 MR TROWER: Yes. It may be that one does not need to go any
18 further than that. It has statutory force by reason of
19 the section that I have just identified.
20 The other case that I think is worth your Lordship
21 looking at is the Muir v City of Glasgow case because
22 that was a decision of the House of Lords in which this
23 whole area was gone into in very considerable detail.
24 It is concerned with what the House of Lords described
25 as the national calamity of the collapse of the

1 City of Glasgow Bank which was an unlimited company and
2 the factual context is of some relevance.
3 MR JUSTICE HILDYARD: What was the tab?
4 MR TROWER: I am so sorry, tab 36 of bundle 1.
5 MR JUSTICE HILDYARD: Yes.
6 MR TROWER: The factual context is of some relevance because
7 the reason it was a national calamity was because of the
8 immense liabilities and a large number of contributories
9 including many acting in their capacity as trustees.
10 The law reports are full of cases arising out of the
11 collapse of the City of Glasgow Bank with people seeking
12 in their special circumstances to get out of their
13 liability as contributories. One sees running through
14 a number of these judgments a great sort of theme of
15 sympathy for the predicament in which a lot of these
16 contributories find themselves, many of whom were
17 bankrupted as a result of what happens. One picks that
18 up from a number of the cases in the reports.
19 This is a company, my Lord, which started life as
20 a joint stock partnership and was then registered as an
21 unlimited company under the 1862 Act. Your Lordship
22 gets that from page 338 of the report.
23 MR JUSTICE HILDYARD: Yes.
24 MR TROWER: So we have an unlimited company here. The
25 appellants were entered on the register of shareholders

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1 expressly as trust disponees which is something that
2 people did in Scotland. Unlike in England, the position
3 in Scotland was that notice of a trust could be entered
4 on the register and this was common place. You get that
5 from some of the speeches. The guts of the reasoning
6 was that if the liability of the shareholders were to be
7 to their capacity as trustees, this would not have
8 amounted to a limitation to which the company and the
9 directors had no power to agree. One gets that in
10 a number of the speeches. Lord Cairns at page 361 in
11 the paragraph, "my Lords, I have not up to this point
12 referred to".
13 MR JUSTICE HILDYARD: Page 361.
14 MR TROWER: Page 361. So he is thinking about the "as the
15 trustee disponee" wording as giving rise to an
16 unidentified limited liability. Sorry, an unauthorised
17 limitation of liability.
18 Then you get it from Lord Hatherley at page 365 in a
19 passage beginning, well right at the top of the page,
20 "but really whosoever at any given time". Then going
21 on --
22 MR JUSTICE HILDYARD: So simply not part of the compact
23 between the named shareholder and the company that
24 anyone else should be involved.
25 MR TROWER: Yes. Then he expresses it at page 367. Well,

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1 actually there is quite a good passage that deals with
2 the totality of the argument on page 366 as regards the
3 introduction of the names of the trustees as trustees on
4 the share list. He explains the position is different
5 in England from the position in Scotland. Then really
6 the guts of it are in the paragraph, "many reasons may
7 be assigned for it".
8 MR JUSTICE HILDYARD: Yes, the practice which are grown up
9 in Scotland was recorded at 348 I think, but in any
10 event it was a practice and it was not the law.
11 MR TROWER: That is right. Yes, it is described at page 347
12 as "the inveterate practice in Scotland" but it was held
13 that it had no legal effect. It had a practical
14 consequence but it had no legal effect.
15 Then in Lord Penzance's speech he examines the
16 position at some length between the bottom of page 367
17 and the bottom of page 369. It is quite a crisp
18 conclusion in the paragraph, "having thus become
19 shareholders" at the bottom of page 369.
20 MR JUSTICE HILDYARD: Yes.
21 MR TROWER: Then I do not think there is anything in
22 Lord O'Hagan but Lord Selborne, I think the clearest
23 statement of position and perhaps the attribution of the
24 analysis in relation to limitation of liability is at
25 page 384. He analogises very clearly in the first

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1 sentence on the second paragraph on page 384 the concept
2 of what was sought to be argued with an extension of the
3 limitation of liability.
4 Your Lordship may be familiar with the speeches
5 anyway, but as I say there is a very strong theme of
6 sympathy for the contributories in this case,
7 particularly those who had taken shares as trustees, but
8 notwithstanding that they concluded that the law was
9 clear.
10 MR JUSTICE HILDYARD: Lord Gordon agreed although he had not
11 heard the argument.
12 MR TROWER: Yes. He knew the wisdom of those who had gone
13 before.
14 My Lord, now is a convenient time just to refer to
15 it more generally. There is a useful summary of this in
16 McPherson on the law of company liquidation which
17 we have in the bundles at bundle 5, tab 121 at
18 paragraph 1005.
19 MR JUSTICE HILDYARD: 1005?
20 MR TROWER: Yes. What we have done, my Lord, I hope it is
21 useful, is we have put the whole of the McPherson
22 chapter on contributories in the bundle.
23 MR JUSTICE HILDYARD: Yes.
24 MR TROWER: It is, as far as we can see on our side, much
25 the clearest and most comprehensive description of the

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1 law in this area. There are some interesting Australian
2 cases, some of which are referred --
3 MR JUSTICE HILDYARD: Is this the Australian McPherson?
4 MR TROWER: It is the Anglicised Australian McPherson.
5 It is written by an Australian. It is on our act.
6 In fact I think it is fair to say that Professor Keay is
7 now in this country.
8 MR JUSTICE HILDYARD: Invest of leads (?).
9 MR TROWER: Yes, so he has repented, my Lord.
10 MR JUSTICE HILDYARD: Where do I look, 1005?
11 MR TROWER: 1005.
12 MR JUSTICE HILDYARD: Yes. So the point is really privity.
13 MR TROWER: Yes.
14 MR JUSTICE HILDYARD: There is no compact at all between the
15 underlying beneficial owner.
16 MR TROWER: Indeed.
17 MR JUSTICE HILDYARD: And the company.
18 MR TROWER: And the company. So, my Lord, that is all I was
19 going to say about issue 7(i). The next issue, if I can
20 take together, are issues 7(ii) and (iii) which relate
21 to the rights of contribution or indemnity from one to
22 another in respect of payments made and set-offs and, if
23 so, the nature and extent of such right of contribution.
24 There are two contexts in which the issue arises.
25 First of all, the general point and, secondly, the point

1 that arises -- sorry, perhaps I can put it this way:
2 (ii) is concerned with the question of whether or not
3 there is a right to contribution which is independent of
4 the adjustment position under the Act and (iii) is
5 concerned with questions of adjustment. In short, our
6 position is that there is no independent right of
7 contribution or indemnity between shareholders. There
8 is a centralised adjustment regime through which what
9 we accept is the ultimate objective of a rateable
10 allocation of the losses if there is a solvency is
11 achieved.
12 Now, the consequence of that, we say, is that
13 there is no room for any rights of contribution based on
14 equitable principles and, indeed, the exercise of any
15 such right would cut across the legal rights which the
16 company has against its contributories to require an
17 adjustment, and I characterise it as legal because
18 there is a legal liability there, and the legal
19 obligation which the contributory has for the adjustment
20 where such is necessary. So you have two sides of a
21 legal right and a legal obligation and the equitable
22 right to contribution would cut across that.
23 Now, we have a section in our skeleton starting at
24 page 175 which simply summarises the way the system
25 works. We then illustrate that summary with a series of

1 cases which arise in two different contexts in
2 paragraphs 181 and 183 of our skeleton. What the cases
3 show is that the achievement of the ultimate objective
4 of an equalisation in accordance with the nominal value
5 of the shareholding is done in two separate types of
6 case. The first type of case is one in which there is
7 a surplus to be distributed and equalisation is achieved
8 through the distribution of the surplus. That is the
9 first category of case. When I say "equalisation"
10 I mean a situation in which some shares have already
11 been fully paid and other shares are only part paid.
12 You have a surplus come in the liquidation and the
13 question is how is the surplus distributed?
14 In quite a lot of those cases there was no need for
15 an adjustment call to be made because the equalisation
16 and adjustment could be achieved through distribution
17 and surplus. The second case is one in which there is
18 an insufficient surplus to be distributed, the company
19 is still solvent, but there is an insufficient surplus
20 and equalisation through making calls for the purpose of
21 an adjustment. So you do not have enough in the surplus
22 to equalise, you have to make a call to do it and that
23 is the second category of case. But none of these cases
24 involve the making of a call for the purpose of
25 adjustment where the debts and liabilities have not been

1 paid in full. So one is looking at adjustment calls in
2 that context.
3 Now, the first category are dealt with in
4 paragraph 181 of our skeleton. As I say, these are all
5 cases in which there was a surplus in the winding-up and
6 an issue arose as to how the surplus after payment ought
7 to be apportioned. I do not think the relevant passages
8 are referred to and they are quite short in the first
9 four cases. I do not think we need to go to them.
10 I think your Lordship probably ought to just turn up
11 Birch v Cropper though which we refer to in
12 paragraph 181.5, it is a decision of the House of Lords
13 on this and Lord Macnaghten deals with the position in
14 his judgment. It is volume 1, tab 44. Sorry, that
15 cannot be right. Yes, it is right. I think it is
16 really his speech starts at page 542, but the passages
17 that matter are at page 543, "every person who becomes",
18 and then there is a neat little summary of what happens
19 on the winding-up as it happens at the bottom of the
20 page and going over the page. Then the bit about
21 adjustment is really on page 545.
22 MR JUSTICE HILDYARD: This is a limited share company.
23 MR TROWER: Indeed, I should have -- it is a partly paid up
24 case. I think I am right in saying that they are nearly
25 all part paid share cases these.

1 MR JUSTICE HILDYARD: So where should I look?
2 MR TROWER: 545, "amongst the rights to be adjusted", and
3 just if you like to read that down to about 6 lines up
4 from the bottom. (Pause).
5 MR JUSTICE HILDYARD: Yes.
6 MR TROWER: So what those cases are all about is ensuring
7 that the part paid shares first contributed to the
8 amount necessary to equalise the capital account and
9 then a distribution was affected and proportioned to the
10 nominal value of the share. Well, sorry, contributed
11 out of the surplus that they would otherwise have
12 received.
13 Now, what he also deals with in that passage is the
14 situation in which there are partly paid shares, but
15 there needs to be a call for the purposes of making the
16 adjustment. Those are the cases which we refer to in
17 paragraph 183 of our skeleton. I am not going to take
18 your Lordship to all of them because the passages that
19 I think we need are set out on the face of the skeleton
20 argument. The Lancashire Brick case though is an
21 important case in this sense: there is a reference on
22 the face, and it is actually in the passage that we put
23 in the skeleton, the same rule applying to an unlimited
24 company. So one gets that from Sir John Romily.
25 The Lancashire Brick case is in the volume that

1 your Lordship has had open just now behind tab 10. I do
2 not think we need very much more than the passage which
3 is actually set out in the skeleton argument but
4 it might be worth just turning it up. I think it is the
5 only one we probably need to turn up because it is
6 a very short judgment.
7 The issue in the Lancashire Brick case was whether
8 or not a winding-up order ought to be made.
9 Sir John Romily discusses the position in his judgment
10 in very clear terms. So there is an approach that is
11 taken which does not seek to distinguish between the
12 position of part paid shares in relation to a limited
13 company and the shares of an unlimited company.
14 I was not going to take your Lordship to the other
15 passages that were included in the skeleton by reference
16 to the authorities themselves because they are just
17 really cases which express the principle. We have the
18 Anglesea Colliery case in 183.2; the Crook Haven case --
19 MR JUSTICE HILDYARD: I am so sorry I am being so slow, but
20 in the London Lancashire Brick --
21 MR TROWER: Yes.
22 MR JUSTICE HILDYARD: -- where it is stated:
23 "If the petitioner has ...(Reading to the words)...
24 entitled to compel those..."
25 What is really meant is he is entitled to a process

1 which will enable a liquidator to compel at the end of
2 the day, is it? Is that what is meant?
3 MR TROWER: Yes, because there is no entitlement to compel
4 an adjustment.
5 MR JUSTICE HILDYARD: It is just the way it is put suggests
6 there is.
7 MR TROWER: Yes.
8 MR JUSTICE HILDYARD: But here the question was standing to
9 petition.
10 MR TROWER: It was standing to petition in the context of
11 why it was that you needed a winding-up order.
12 MR JUSTICE HILDYARD: Yes.
13 MR TROWER: The reason you needed a winding-up order was in
14 order to get the adjustment.
15 MR JUSTICE HILDYARD: So it was not the shareholder who was
16 going to compel. The share --
17 MR TROWER: No, your Lordship is absolutely right.
18 MR JUSTICE HILDYARD: The remedy which would enable somebody
19 else to compel at the end of the day.
20 MR TROWER: Yes.
21 MR JUSTICE HILDYARD: Yes.
22 MR TROWER: Yes. No, that is absolutely right. Because of
23 course at the end of the day, I mean at the end of the
24 day a shareholder would doubtless be able to seek
25 the court's direction that the liquidator should

1 exercise the delegated powers to make a call for an
2 adjustment in an appropriate case. There are mechanisms
3 of getting but you obviously need the process within
4 what you can do.
5 MR JUSTICE HILDYARD: He was faced with the argument that as
6 he has paid up and been a good boy, he had no standing,
7 it could go away.
8 MR TROWER: Yes.
9 MR JUSTICE HILDYARD: But he said that he would in fact be
10 able to achieve his ends by, and had standing to invoke
11 the winding-up process.
12 MR TROWER: Yes, indeed.
13 MR JUSTICE HILDYARD: Yes, I see.
14 MR TROWER: Yes, I am sorry. Now, Anglesea Colliery was
15 a -- I don't think any of them add very much to the
16 basic principle that we identified on the face of the
17 skeleton. I mean you get the point that we were
18 discussing just now in our citation from the
19 Crook Haven v Mining Company case. That was a case in
20 which the winding-up was concluded and the company was
21 dissolved before the shareholder was able to exercise
22 his remedy. Your Lordship sees the passage we cite at
23 the bottom of page 56 of our skeleton.
24 MR JUSTICE HILDYARD: Yes. I am sorry, just to talk it out
25 with you, but what you say is that, of course, if there

1 had been an individual shareholder equalisation method
2 then there wouldn't be any need for the winding-up
3 process. It is only because that is the only process
4 that he did have standing in the result.
5 MR TROWER: Yes, my Lord, that is absolutely right. That is
6 right.
7 MR JUSTICE HILDYARD: Yes.
8 MR TROWER: That is much more clearly put than I have been
9 able to express it.
10 You get a fairly similar point in the passage in
11 shields Marine, in the passage that is emboldened. You
12 there have the idea that merely because the claims
13 against the society had been disposed of, does not mean
14 to say that the society does not have claims against it
15 for the purpose of settling the rights of contributions
16 which wouldn't arise in the circumstances posited just
17 now.
18 MR JUSTICE HILDYARD: Yes.
19 MR TROWER: Again, I am not sure that anything is added to
20 the underlying principle by 183.5 or 183.6.
21 So what we submit is that what the authorities make
22 clear is that, where necessary, the position of the
23 shareholders intersay is to be adjusted through the
24 making of the cause and liquidation and distribution to
25 equalise the position.

1 If it is necessary to do so a contributory who has
2 paid more than his rateable share can either proceed to
3 introduce the remedy of winding-up or seek directions
4 through in the context of an existing winding-up for the
5 purpose of setting in motion the process of making
6 a call, and that is the process by which it is done.
7 That both renders both unnecessary and is
8 inconsistent with the need for an independent right of
9 contribution between existing shareholders. There is
10 not an equity to seek a contribution where the statute
11 provides for an alternative remedy.
12 Perhaps I can make one final short submission on
13 this before a convenient moment for a break. This
14 remains the case even if because there are insufficient
15 asset to pay the debts and liabilities, the liquidator
16 is unable to make an adjustment call.
17 In that situation, so you posit a situation in which
18 the company is insolvent, any direct claim for
19 contribution by an overpaying contributory against an
20 underpaying contributory would compete with the
21 company's primary claim under section 74 in respect of
22 the deficiency in the estate. This touches on the
23 double proof point which is raised by issue 8. For that
24 reason alone, you could not have a contribution claim
25 arising. If it were to be said: well, the adjustment

1 process does not give you a full remedy, because you
2 cannot exercise the adjustment process until the debts
3 and liabilities have been paid in full.
4 The answer is: well, you would not a contribution
5 remedy anyway on a proper application of rule against
6 double proof.
7 It is clear, we say, that section 74 is intended to
8 centralize equalisation process. It does so through
9 this statutory structure and it ensures that there is
10 a centralised process for working out how the
11 liabilities are ultimately borne, as between the
12 contributing members, when there is insolvency.
13 So, my Lord, that is all we were going to say about
14 issue 7(iii) and I was going to go on to issue 7(iv)
15 next, but it may be a convenient moment just to break
16 for the shorthand writers.
17 MR JUSTICE HILDYARD: Five or so minutes.
18 (3.20 pm)
19 (A short adjournment)
20 (3.27 pm)
21 MR TROWER: The next issue is issue 7(iv).4. This is a very
22 short issue, so far as we are concerned, anyway. We
23 deal with it on pages 60 and 61 of our skeleton.
24 The issue is to what extent a right of contribution
25 or indemnity and/or adjusted is affected by any other

1 claims which the adjusting parties may have against one
2 another or any other party.
3 We say this is all about adjustment, as my Lord has
4 already heard. So far as that is concerned, it is
5 clear, we submit, from the Alexandra Palace Company
6 case, that is referred to in the skeleton argument, that
7 you do not take into account anything in the adjustment
8 other than the rights of the members in their capacity,
9 as such. You don't take into account any rights which
10 they might have had against each other in any other
11 character.
12 The case is behind tab 40 of volume 1, it is
13 a pretty uncontroversial one with the proposition of the
14 nature of the statutory right. The passage is in the
15 middle of page 300.
16 MR JUSTICE HILDYARD: Hmm.
17 MR TROWER: It is a short judgment but it is entirely
18 consistent with the wording of the 1986 Act, as well.
19 Nowhere is the concept of adjustment used to refer
20 to a process which is other than rights of the members
21 in their capacity as such. So the adjustment of the
22 position between contributories relates solely to those
23 rights and obligations of a contributory and does not
24 address their rights or obligations in any other
25 character.

1 Now, what I do not specifically address and we don't
2 deal with in the skeleton because it is not possible to
3 know how it would be put if it were to be put, is if we
4 are wrong on the adjustment being the only mechanism for
5 adjusting the rights of contributories, what the
6 position would be so far as impact of any other claims
7 on the right of contribution which might arise in
8 equity. It may be that point is not very suitable for
9 determination in theory. We say the short answer is
10 that the right of contribution does not arise, in any
11 event.
12 My Lord, that takes me on to paragraph 7(v), or
13 issue 7(v), which is an issue which has a bit more meat
14 in it; whether the administrator should be directed to
15 assert less than 100 per cent of the contribution claim
16 against LBL and/or LBHI2 and, if so, by how much it
17 should be reduced and what factors the court should take
18 into account.
19 Now, what we have done in paragraph 196 of our
20 skeleton is seek to identify the common ground in
21 relation to this issue. It is common ground that the
22 rules provide:
23 "The powers of the court with respect to making
24 calls are ...(Reading to the words)... which would apply
25 to the court's exercise of the power."

1 Now, LBL and LBH say the court has a discretion to
2 decline to make a call on a contributory in respect of
3 the amount identified in section 7(iv). That more
4 particularly the factors which will include the relative
5 size of the shareholding, and where shares are held on
6 trust for a third party, and the nominees status of the
7 registered shareholder. We submit this is the wrong
8 approach because the power to call has to be exercised,
9 first of all, in the interests of the company and,
10 secondly, in the interests of those who are interested
11 in distributions from the estate in its capacity as
12 such, and their capacity as such, which is essentially
13 the same thing. It is a company as a collective and
14 those interested in their capacity as such.
15 Now, save for the statutory right, under
16 section 150(2), to take into account the probability
17 that a member will not be able to pay the call, LBIE
18 submits that it is wrong in principle to take into
19 account factors relating to the circumstances of the
20 contributories or the basis on which they hold shares in
21 the company.
22 One could characterise the circumstances described
23 in section 152 as a factor relating to the circumstances
24 of the contributory. The consequence of this is that
25 where there is a need for monies to pay the debts and

1 liabilities, the power should be exercised in favour of
2 the call. In that sense, it is not really very much of
3 a discretion at all that gives rise to a duty to see
4 that the relevant shareholders are paid.
5 Now, I quite appreciate there is the word "may" used
6 in section 150, I will come on to that in a moment. But
7 it is a "may" that has, that is use in a particular
8 manner, we submit.
9 Now, just looking at the statutory provisions,
10 themselves. There are a number of points about them and
11 we list those points out in paragraph 202 to 208 of our
12 skeleton. It is worth running through.
13 The first point is that section 74 gives rise to
14 a liability. The court is not given power to relieve
15 a contributory from the liability. Every member simply
16 is liable. When you are thinking about the liability
17 itself, the member is liable.
18 Section 80:
19 "Creates a debt accruing due at the time the
20 liability commenced but payable at the times when calls
21 are made for enforcing the liability."
22 Now, just pausing briefly on that, the concept of
23 the liability arising from the time at which the
24 liability commenced means that the contributory is
25 liable from the time he becomes a member. That was one

1 of the points that arose in Waterfall I. Your Lordship
2 gets that from Mr Justice David Richards judgment, at
3 paragraph 143, and from the Court of Appeal, at
4 paragraphs 210 and 216. So that is when the liability
5 commences. It is a liability with no power to relieve.
6 The third point is the liability is confirmed by
7 section 151 because the court's power to make calls on
8 the contributory is to the extent of the liability. The
9 contributories remain liable whether or not any call is
10 made. The call is simply part of the mechanism for
11 enforcing the liability. It does not create it. That
12 is part of the reason why there exists a claim in
13 respect of the liability, which is provable in the
14 insolvency:
15 "Of the members even before LBIE enters liquidation.
16 Because the liability is there notwithstanding the fact
17 the call has not yet been made."
18 The court's power to make the call under section 150
19 is plainly to be exercised in accordance with the
20 statutory framework. We say that the statutory
21 framework that identifies the need, because you get that
22 in section 74, and so to that extent there is normally
23 only one way you can actually exercise the power. It is
24 more akin to a duty, and we will come back to the
25 concept of duty when looking at the authorities.

1 Because section 150 makes clear that the court may
2 make a call, either before or after its ascertained the
3 sufficiency of the company's assets, the timing of any
4 call need not wait until the extent of the deficiency
5 has been finally determined.
6 We submit this is probably the most substantial
7 reason why the section is expressed in the terms it is,
8 in the terms of "may". In an appropriate case a call
9 can be made, notwithstanding the fact that the
10 sufficiency of the assets may not yet have been
11 ascertained. So that is what "may" is really directed
12 towards. It is not directed towards some sort general
13 amorphous discretion.
14 Section 150 makes plain that the entitlement to make
15 the call is to the extent of the amount which is needed.
16 So the amount of the call is something on which the
17 statute contemplates that there may be room for more
18 than one view.
19 In this context the focus is on the amount
20 considered necessary for the stated purpose. So, again,
21 when construing the statute and what it is that the
22 words are actually focussing on, one has to bear that in
23 mind; that which is needed is and when it is needed are
24 things in respect of which there is room for a view.
25 The wording of section 150(2), itself -- this is

1 a point that we have already touched on -- confirms the
2 objective is to maximise the amount of the contributions
3 to the extent they are required for the purpose. That
4 is what we say the wording of subsection 2 is all about.
5 You take into consideration the probability that some of
6 the contributories may partly or wholly fail to pay when
7 you are making out what call you need to make.
8 So that is the statutory framework.
9 So far as the authorities are concerned, we submit
10 it is not a particularly adventurous submission to
11 contend the court's power, in respect of the making of
12 calls, is to be exercised in the interests of the
13 company in liquidation. That is confirmed by the
14 authorities. We have set out in paragraph 210 to 212 of
15 our skeleton the authorities that bear on this point.
16 The bit in Barned's Banking Company Limited, the bit
17 that underlined and emboldened is probably the bit that
18 explains most clearly what the approach ought to be.
19 MR JUSTICE HILDYARD: As you say, the subsection 150 is
20 really a provision not to enable discriminatory recovery
21 but to empower the office holder simply to decide that
22 it is not worth proceeding because you cannot get blood
23 out of a stone.
24 MR TROWER: Yes. Well, yes, because of the concept of
25 improbability, one is looking at it from that

1 perspective, but it amounts to the same thing.
2 MR JUSTICE HILDYARD: It reinforces your argument, you would
3 say.
4 MR TROWER: Yes.
5 MR JUSTICE HILDYARD: The saving is necessary because
6 otherwise, despite the use of the word "may", the
7 process is mandatory, but it says, "Well, look, even
8 though mandatory, if it is going to be useless you
9 needn't do it".
10 MR TROWER: Needn't bother.
11 Then in the Cordova case, again, you have the
12 approach of Mr Justice Kekewich.
13 MR JUSTICE HILDYARD: So he actually tackles the word.
14 MR TROWER: He does tackle it head on in the context of what
15 it is that the court is seeking to do, or bound by the
16 statute to do.
17 I think it is worth just turning up the
18 Helbert v Banner case, which is the last one we refer to
19 and which you will find behind tab 22 of volume 1.
20 If my Lord reads the headnote on page 28.
21 (Pause)
22 The question of timing was really what was in issue
23 in this case; to what extent was it possible to
24 ascertain the extent and amount of the liability at the
25 relevant time.

1 The first passage that I think is worth reading
2 starts at page 34 in the Lord Chancellor's speech on
3 this appeal. This is actually a past members' case,
4 that is why the issue of evidence was relevant. So it
5 is really the passage starting on this appeal and
6 finishing over the page, about four lines down, on
7 page 35. What one gets out of that passage is the focus
8 on the timing aspect. Throughout the analysis
9 consideration of the position looking at it through the
10 spectacles of the company.
11 It is also just worth, my Lord, going to page 40 in
12 Lord Chelmsford's speech because he deals with the point
13 about:
14 "Calls may be made either before or after the court
15 has ascertained sufficiency of the assets of the
16 company."
17 MR JUSTICE HILDYARD: Where is that?
18 MR TROWER: Starting at the bottom of page 40:
19 "It is important to recollect the words."
20 102nd section is now 150.
21 So, the upshot of that is that we submit that there
22 are two primary points which come out of it. The
23 language of section 150 works in such a way as to give
24 the court latitude on timing to make the call at the
25 appropriate moment, whether before or after it is

1 conclusively established that the call is required at
2 the relevant statutory purpose.
3 Secondly, to enable the court to take into account
4 the improbability that one or more of the contributories
5 is able to pay.
6 When one thinks of those two factors in
7 considerations, it is not surprising that the word "may"
8 is used in section 150. It is not designed to give some
9 overarching discretion to the court as to how it is that
10 the power is to be exercised. The power must be
11 exercised, we submit, in accordance with the statutory
12 scheme. Once you are at a stage where monies are
13 required for the purposes identified in section 74(i) it
14 really can only be exercised one way, in favour of
15 making the call, unless there is no point in making the
16 call. But the reason that there is no point in making
17 the call is relevant, is because there is no point. It
18 would not be in the company's interest to make the call
19 if there is not anything there to be called upon.
20 We submit, therefore, in those circumstances,
21 relevant matters cannot extend to the interests of the
22 contributories or the basis on which they hold shares in
23 the company. Any such consideration will not, for that
24 reason, be in the interests of the insolvent estate.
25 So, for those reasons, we submit that the sort of

1 factors that have been advanced by LBL, factors relating
2 to the size of the contributory shareholding and the
3 like, are irrelevant to the exercise of the court's
4 power under section 150, any way until such moment in
5 time that it is clear that the debts, liabilities and
6 expenses have been, or will be, paid in full.
7 The reason I make that qualification is that one
8 could see that it might not be in the interests to make
9 a full call in circumstances where you were then going
10 to have to make another adjustment call if you could
11 work out that was going to give rise to unnecessary
12 complexity. But unless you are not at that stage of the
13 process, it is very difficult to see how it is that the
14 size of the contributories holding in the company, given
15 they are liable for the full amount of the debt, can be
16 a relevant factor for the purposes of working out the
17 extent of the call.
18 We also say that nomineeship is irrelevant. We do
19 not understand any basis on which nomineeship could be
20 relevant for the sort of reasons that we have already
21 discussed as to why it is that the nomineeship is
22 irrelevant to the underlying liability. We also submit
23 that the circumstances in which the contributory came to
24 hold the share will be irrelevant. Those may be
25 relevant to the question of whether or not they should

1 in due course remain on the list of contributories; who
2 knows? But so long as they are on the list of
3 contributories that is an irrelevant factor as to how it
4 was they came to be there.
5 So, my Lord, that is all I was going to stay on
6 issue 7(v) and, indeed, that finishes off issue 7
7 altogether.
8 We can move on, to issue 8, which we start at
9 page 69 of our skeleton. This is really against the
10 double proof point.
11 Now, this is linked to issue 7. The question is
12 whether, being realistic, LBL could pursue a claim for
13 contribution or indemnity against LBHI2 before the time
14 at which LBIE's debts, liabilities and expenses have
15 been paid in full, because that is the circumstance in
16 which the question arises.
17 LBL says the issue does not arise because no claim
18 can be made against them, but they don't make any
19 arguments in their skeleton, as far as we can see, as to
20 what the position would be if they were wrong on this
21 point. We don't actually have any arguments from LBL in
22 their position paper on the rule against double proof.
23 But can I explain to my Lord what we say the position
24 is.
25 One has to look at issue 8 in two possible

1 situations. The first situation is that there is, in
2 principle, a right of contribution or indemnity
3 available to an overpaying contributory against an
4 underpaying contributory. As I have already submitted,
5 we submit that is not the case, but let us assume I am
6 wrong on that.
7 The second situation is that the rights of the
8 contributory was intersay unlimited to the rights of an
9 adjustment which they may or may not be able to ask
10 the court to conduct.
11 Now, our short submission is that if there is
12 a right of contribution or indemnity available to an
13 overpaying contributory against an underpaying one, the
14 rule against double proof will apply to prevent the
15 overpayer from proving in the underpayer's estate for
16 the contribution until such time as the company's --
17 that is LBIE -- principle claim has been vindicated by
18 payment in full.
19 The overarching principle is that the rule against
20 double proof applies so as to prevent a double proof for
21 what is in substance the same debt.
22 In the present case the following are, in substance,
23 the same debt: LBIE's claim against LBHI2 under
24 section 74, and on the assumption it is LBL seeking to
25 make a contribution, LBL's claim against LBHI2 against

1 for a contribution in respect of its liability to LBIE
2 under section 74. So you have the single estate, which
3 is LBHI2's estate, and the claim into both those two
4 estates is, we say, in substance the same.
5 The reason they are the same is because they are
6 both reflective of the shortfall in LBIE's estate. The
7 insufficiency in its assets for payment of its debts and
8 liabilities. That is what both those claims are
9 reflective of.
10 Now, my Lord, the most recent authoritative
11 description of the ruling against double proof is
12 Lord Walker in Kaupthing which is in the bundles
13 at bundle 3, tab 87.
14 It is the passage that starts at the top of
15 page 184. He describes the rule against double proof
16 initially and largely in the context of suretyship:
17 "The description of the triangle of rights and
18 liabilities between the principle debt of the surety
19 ship and the creditor."
20 If my Lord would just read that. It is also worth
21 just reading the passage from Frid that is cited at the
22 bottom of the page.
23 MR JUSTICE HILDYARD: The rule in Cherry v Boultby.
24 MR TROWER: I think your Lordship does not need to embark on
25 that particular course, I am glad to say.

1 Now, the two points that come out of that, that we
2 particularly need to bear in mine in this analysis is,
3 first of all, is the debt the same debt as a matter of
4 substance?
5 And, secondly, who has the superior claim? You get
6 that probably as clearly in the passage as Frid referred
7 to by Lord Walker as anything else. Frid was a case
8 about set-off. For present purposes I don't think we
9 need to consider that aspect of it.
10 So you have a situation where, for fairly obvious
11 reasons, normally double proof arises in the context of
12 suretyship, where the competition is between the
13 principal creditor and the surety seeking an indemnity
14 against the principal director. That is the
15 competition. That is the triangle of rights of
16 obligation which Lord Walker talks about.
17 It is capable of arising in any situation where, in
18 substance, the two proofs are in respect of the same
19 debt.
20 The point about substance, as opposed to legal form,
21 is clearly expressed in the cases that we cite. I will
22 come back to the Liverpool in a moment, but just so your
23 Lordship sees the sort of different contexts in which it
24 has arisen. The first case we refer to, at the top of
25 page 70 of our skeleton, in paragraph 224, is the

1 Oriental Commercial Bank case.
2 The context in which the rule was applied in the
3 oriental bank case was bills of exchange. So if we just
4 turn up that case, which is behind tab 23 of bundle 1.
5 The factual situation here was that O was liable on
6 the bills as endorser, E accepted the bills and was
7 therefore also liable on them, and A became the holder
8 of the bills. As between O and E, O was liable to E
9 pursuant to a contract of indemnity. Both O an E were
10 insolvent. O an E both paid dividends to A. E sought
11 to prove against O for the dividend which it had paid A.
12 This was not allowed because it was substantially
13 the same debt as the debt on which O had already paid
14 a dividend to A.
15 The way in which it is expressed -- it is expressed
16 crisply by Lord Justice Mellish, starting at page 102.
17 So the Oriental Commercial Bank is the person in the
18 position of being the principal debtor. The Agra Bank
19 is the person in the position of being the principal
20 creditor, and the European bank is the person in the
21 position of being the surety, if one is equivalating
22 this to a suretyship context. Bearing that in mind, if
23 your Lordship would just read from:
24 "It is quite obvious ..."
25 Down to the bottom of the page.

1 MR JUSTICE HILDYARD: What you have to do? You have to
2 imagine payment and determine whether that would release
3 the --
4 MR TROWER: Yes.
5 MR JUSTICE HILDYARD: -- the liability? That is it really?
6 MR TROWER: Yes.
7 MR JUSTICE HILDYARD: If it would, that is that.
8 MR TROWER: That's it. You can see from that, that you have
9 a double proof. So, in this case, it could be seen from
10 the fact that once O had paid A, as holder of the bill,
11 that would have discharged its obligations to both A and
12 to E.
13 MR JUSTICE HILDYARD: Yes.
14 MR TROWER: Both holder an acceptor under the undertaking.
15 MR JUSTICE HILDYARD: Yes. If they were separate debts and
16 the one did not discharge the other, you can go against
17 each?
18 MR TROWER: Yes, that is right. Because they will not, in
19 those circumstances, be substantially the same debt.
20 MR JUSTICE HILDYARD: Okay.
21 MR TROWER: One of the points that this case is normally
22 cited as authority for is the fact that the obligations
23 arise under different contracts is not a factor that
24 matters. So that is the principal in the context of
25 bills of exchange.

1 It is well-known as a principle in the context of
2 guarantees, Melton and Fenton are the two older cases
3 one normally goes to in this context.
4 What I think most people regard as one of the most
5 significant descriptions of the principle is in the
6 TOSG Trust Fund case where Lord Justice Oliver discussed
7 it. There it arose in the context of bonds, which are
8 very similar to guarantees for these purposes.
9 At bundle 2, tab 65, I think. Yes. Tab 65 has both the
10 judgments of the Court of Appeal and the judgments of
11 the House of Lords.
12 The House of Lords, Lord Templeman took a rather
13 shorter approach to the analysis than
14 Lord Justice Oliver had, but there is a very lengthy
15 description of the rule against double proof and the
16 context in which it arose in this case starting at
17 page 636.
18 MR JUSTICE HILDYARD: Tab?
19 MR TROWER: Tab 65.
20 MR JUSTICE HILDYARD: 65.
21 MR TROWER: Having said that he was unable to accept any of
22 Mr Millett's submissions, he then explains what was
23 fundamentally wrong with the assumptions on which they
24 were based, starting at B, on page 636. If my Lord
25 reads down to the bottom of the page --

1 MR JUSTICE HILDYARD: This is in the Court of Appeal?
2 MR TROWER: This is in the Court of Appeal. As you see, the
3 House of Lords do not -- first of all, they dismiss the
4 appeal. Secondly, they do not adopt the sort of
5 detailed approach that was adopted in
6 the Court of Appeal. Most texts always seem to rely on
7 Lord Justice Oliver's judgment as a fine example of how
8 it is that one needs to approach these problems.
9 So this concept of discharge is dealt with in the
10 last paragraph of the page.
11 MR JUSTICE HILDYARD: That was the point we were discussing,
12 isn't it?
13 MR TROWER: It is.
14 MR JUSTICE HILDYARD: It doesnt matter if there are two
15 contracts, you just ask the single question: if the
16 money is paid in full are both obligations discharged?
17 MR TROWER: Yes. He does actually put it even more broadly
18 than that, slightly higher up, because he talks about
19 questions of: would it be unjust to allow both
20 liabilities to rank independently for dividends? Would
21 it be unjust to the other unsecured creditors?
22 He is thinking in slightly broader terms and that is
23 helpful in this sense: that it focuses on the position
24 in relation to the protection of the other unsecured
25 creditors who are also proving in respect of the

1 insolvent fund where it is that the rule against double
2 proof applies.
3 MR JUSTICE HILDYARD: Is he saying any more than that if you
4 allowed both liabilities to rank independently dividend
5 that would produce injustice?
6 MR TROWER: He is not saying any more than that.
7 I am sorry if I gave the impression he was. The
8 only point he is making is that the principal is simply
9 one of justice in the context of whether or not more
10 than one dividend is being permitted to rank for --
11 MR JUSTICE HILDYARD: I quite like the simple test at the
12 end.
13 MR TROWER: I think that, I am perfectly content with that
14 as the test.
15 MR JUSTICE HILDYARD: Yes.
16 MR TROWER: The only other case that is worth looking at is
17 the Liverpool, which your Lordship finds behind tab 59
18 in the same bundle. Another context in which it arises.
19 The Court of Appeal this time.
20 The facts are a little bit complex here, but what
21 happened was that there was a collision in the port of
22 Liverpool.
23 MR JUSTICE HILDYARD: This is tab?
24 MR TROWER: This is tab 59.
25 There was a collision in the port of Liverpool in

1 which the ship called the Ousel was beached through the
2 fault of a ship called the Liverpool. It is slightly
3 confusing: the port was Liverpool and the ship was
4 called Liverpool.
5 The owners of the ship, Liverpool, obtained a decree
6 of limitation under the Merchant Shipping Act and
7 constituted a limited fund of 112,000, so there was
8 a mechanism under the Merchant Shipping Act from
9 limiting the liability through their fault in relation
10 to the collision.
11 The claims against the fund, i.e. the fund that had
12 been constituted by the owners of the ship, Liverpool,
13 greatly exceeded its amount. Such that there was only 6
14 shillings in the pound payable.
15 The claims that matter, for present purposes, are
16 the Mersey Docks and Harbour Board claimed 130,000 for
17 the salvage costs of the Ousel, which was their net
18 claim after deduction of certain realisations.
19 The owners of the Ousel, who of course had had their
20 shipped beached as a result of the Liverpool colliding
21 with it, had a claim for 70,000 of which 10,000 was
22 a claim to be indemnified against a sum which they owed
23 the Mersey Docks and Harbour Board, because the Mersey
24 Docks and Harbour Board had a claim against them in
25 respect of some of the costs that they incurred.

1 Then the cargo claim was for 170, 000.
2 Now, what happened was that the cargo claimants, who
3 were the creditors unaffected by the -- they were
4 affected by the double proof, but they claimed that the
5 10,000 was being claimed twice because they claimed that
6 it was being claimed twice; once by the Mersey Docks and
7 Harbour Board and once by the owners of the Ousel in
8 respect of the amount which they had had to indemnify
9 the Mersey Docks and Harbour Board. That is the
10 background to the case and the points of principle are
11 dealt with on pages 84 and 85 of Lord Justice Harman's
12 judgment. It is the second question that is referred to
13 on page 84, starting just under halfway down.
14 MR JUSTICE HILDYARD: Is this right in this case: the real
15 issue is whether the same principles that applied in
16 a limitation action in admiralty as apply in insolvency
17 situations?
18 MR TROWER: Indeed, that is right. Well, there were two
19 questions really: the first was does it apply in
20 relation to an insolvent fund other than a winding-up?
21 It is also important because it is another context
22 beyond principle in surety where there are statutory
23 rights and claims in tort where because of the operation
24 of the Merchant Shipping Act there was the ability for
25 there to be a double claim in respect of what was

1 essentially the same debt.
2 It is very close to principle in surety, but then
3 these cases always will be very close to principle in
4 surety, even if they are not actually properly
5 analogisable as such.
6 MR JUSTICE HILDYARD: Anyway, they are no help, says
7 Lord Justice Harman.
8 MR TROWER: I am sorry?
9 MR JUSTICE HILDYARD: Lord Justice Harman says: don't worry
10 about the analogy because it is of no help.
11 MR TROWER: Yes, because his analogy is that you simply look
12 to see whether it is, in substance, the same liability.
13 MR JUSTICE HILDYARD: Yes.
14 MR TROWER: So, we say, against that background, the rule
15 should exclude an overpaying contributory if we are in
16 wrong in relation to the fact the contribution does not
17 apply at all, should exclude the overpaying contributory
18 from claiming in the insolvent state of the underpayer
19 until such time as the principal creditor has been paid
20 in full because it is, in substance, the same debt.
21 MR JUSTICE HILDYARD: I mean, Lord Justice Harman accepts it
22 is not always easy -- and wasn't in that case -- to
23 determine whether the two debts are the same. But, in
24 the event, the claim for expenses, then in one case
25 there was a cap and then in other not, were being twice

1 asked for.
2 MR TROWER: Yes, because the £10,000 was, in substance, the
3 same as the amount of the salvage costs.
4 MR JUSTICE HILDYARD: Yes, these are the very same expenses
5 as claimed in damages in tort against the Liverpool.
6 Three quarters of the way down to 85.
7 MR TROWER: So one of the helpful things you do get from
8 this case is a focus on the cause of action which
9 underpins the claim not necessarily being determinative
10 of the question. In the same way you don't have to have
11 the same contract, double contract.
12 MR JUSTICE HILDYARD: The fact that in one you may get less
13 because of the limitation is irrelevant too.
14 MR TROWER: That is of some potential significance in the
15 context of our case.
16 MR JUSTICE HILDYARD: Yes.
17 MR TROWER: The only additional submission I thought your
18 Lordship may or may not find helpful is that the answer
19 that one gets in this context -- and I touched on it
20 when making submissions to your Lordship about issue
21 7 -- is consistent with the way the contributory rule
22 works. I think, technically, this is all about the
23 question of who has the superior right in the present
24 case. We would say that LBIE would have the superior
25 right in relation to the claim against the underpaying

1 contributory.
2 It is consistent with the contributory rule because
3 the policy which underpins the contributory rule is the
4 contributory should pay what he owes to the fund before
5 he claims in competition with the fund, that is the
6 underlying policy. The operation of the rule in double
7 proof has the same economic effect in the context of
8 an attempt by a contributory to claim against his
9 co-contributory in competition with the principal
10 creditor, in this case LBIE.
11 MR JUSTICE HILDYARD: Is the rule in Cherry v Boultby you
12 must pay up before you extract?
13 MR TROWER: It is, yes.
14 MR JUSTICE HILDYARD: That is why, in one of the cases, they
15 venture the thought that maybe this rule originates from
16 the rule or springs from the rule in Cherry v Boultby.
17 MR TROWER: The interrelationship between the rule against
18 double proof, the rule in Cherry v Boultby and the
19 contributory rule is dealt with in Kaupthing. That was
20 the issue in Kaupthing. The House of Lords said
21 the Court of Appeal had its head in a bit of a muddle
22 about how they all fitted together. That is where your
23 Lordship gets that relationship from.
24 MR JUSTICE HILDYARD: I see.
25 MR TROWER: There is one further submission I need to make

1 in relation to issue 8 and it is simply this: the
2 submissions I have addressed in relation to the rule
3 about double proof have been on the assumption we are
4 wrong in saying that there is no right of contribution
5 as between shareholders.
6 The rule against double proof, we submit, has no
7 relevance at all to questions of adjustment, which is
8 the other part of issue 8. The adjustment process is
9 what it is. Adjustment is conducted through the
10 centralised system for the purpose of ensuring that,
11 ultimately, through the process of call, where the
12 company has become solvent, the rights of the members --
13 or the return to the members reflects the amount of
14 their nominal shares. But it is done through
15 a centralised process, not through -- and we could not
16 see anyway in which the rule against double proof had
17 any application in that context.
18 So, my Lord, that brings me to the end of my
19 submissions on issue 8. I am conscious of the time. It
20 leaves the preliminary issue on issue 9 and 10 as the
21 issues which are not presently agreed issues left for me
22 to make submissions on.
23 There are then issues 2, 4, 5, 6 and 12 which are
24 the agreed issues and we are very conscious of what my
25 Lord has said about that and the need to ensure there is

1 a proper argument to explain how the issues work. I am
2 very much in your Lordship's hands as to how to deal
3 with the agreed issues but I could either say something
4 about them at the end of my submissions or -- and it may
5 be what your Lordship would find most helpful, is for me
6 just to run through them with you, so that I can remind
7 you of how they fit in the overall scheme of things. Or
8 we could leave over any argument about them, given that
9 everyone is agreed on them, until after you have heard
10 the argument on the other issues, when you might have
11 seen a more rounded picture of the totality of the
12 contested issues. I am in your Lordship's hands-on
13 that.
14 MR JUSTICE HILDYARD: Beyond what you have already told me,
15 am I going to get an insight into the contentious issues
16 from the agreed issues?
17 MR TROWER: I think 2 and 4 --
18 MR JUSTICE HILDYARD: Which we have dealt with.
19 MR TROWER: -- probably do. I do not think, 5, 6 and 12 are
20 elucidated in anyway by anything else. Everybody else
21 is probably asleep as a result of this afternoon and is
22 unable to contribute.
23 MS TROUBE: The only point I would make, my Lord, is that
24 I am supposed to be going next. My only issues are 6
25 and 12, which are two of the agreed issues. So it will

1 require a re-jigging of the timetable if your Lordship
2 does not want to hear those until the end.
3 MR JUSTICE HILDYARD: Well, I am agnostic about this, but if
4 Ms Toube would be, discombobulated by this or have to
5 come back a different day, I think we should stick to
6 the timetable.
7 MR TROWER: That is fine, I will say what I think your
8 Lordship needs to hear.
9 MR JUSTICE HILDYARD: You have the one hour tomorrow, have
10 you?
11 MS TROUBE: Yes, my Lord, although I cannot imagine I am
12 actually going to be more than about 10 or 15 minutes.
13 MR JUSTICE HILDYARD: Right, and the others; you have
14 stepped out of the frame?
15 MS TROUBE: Yes, we don't have a direct interest in them,
16 although we have an indirect interest in quite a number
17 of them, which is why we are still here.
18 MR TROWER: Would it be convenient if I then just carry on
19 as was and take your Lordship through the agreed issues
20 and explain why it is that we say that they are issues
21 on which your Lordship can give directions, and see
22 where we get to at the end of that. It may be your
23 Lordship would want further argument, but your Lordship
24 will probably have a better idea once you have heard
25 what I have to say about it.

1 MR JUSTICE HILDYARD: Let's stick to that if that is all
2 right from your point of view?
3 MR TROWER: Yes.
4 MR JUSTICE HILDYARD: If any of you congregate together and
5 decide on a different course of action at the end of
6 today, I will, you know, I will take my medicine.
7 MR TROWER: Thank you, my Lord.
8 MR JUSTICE HILDYARD: Is that a good time?
9 MR TROWER: If that is convenient to your Lordship.
10 MR JUSTICE HILDYARD: You are on course.
11 MR TROWER: I am ahead of time, because I have only have 9
12 and 10 left to do. There is quite a lot in 9A, but
13 I will definitely finish by lunch time tomorrow, which
14 means I am half a day ahead.
15 MR JUSTICE HILDYARD: I partly ask because, although
16 commendable in some ways, you envisage replies following
17 immediately on various arguments; is that sensible?
18 MR TROWER: My Lord --
19 MR JUSTICE HILDYARD: Or will you each need time to gather
20 your thought?
21 MR TROWER: We have actually had a bit of a debate about
22 replies anyway, which is why your Lordship will have
23 seen there was a rather vague description as to what the
24 position was on replies because I think where we all
25 ended up was we were not sure who would be replying to

1 who on what.
2 MR JUSTICE HILDYARD: No.
3 MR TROWER: That may well continue to be the case until
4 Mr Marshall sits down, if I can put it that way.
5 MR JUSTICE HILDYARD: Now, I mean there is a sort of
6 complicated concoction of who is against whom in what
7 context.
8 MR TROWER: There is. We did of course think about whether
9 just going one after the other was better than doing it
10 issue by issue and we all, I think, reached a fairly
11 clear conclusion that issue by issue was not sensible
12 and this was a better way of doing it. That does, of
13 course, lead to greater complexity on the replies.
14 MR JUSTICE HILDYARD: Yes, attracted yesterday issue by
15 issue but then realised that some issues impacted others
16 and therefore I would be peering behind the curtain
17 inappropriately, or at least, you know, without proper
18 foundation.
19 MR TROWER: Yes.
20 MR JUSTICE HILDYARD: How shall we leave it? I mean, I am
21 not going to be pedantic about it. I will need all the
22 help I can get, really.
23 MR TROWER: Yes. I mean we can talk about it amongst
24 ourselves overnight, as to whether we are any further
25 forward in relation to what the sensible thing to do is.

1 I mean, I suspect that it will not be until we are
2 a little further into the argument that we will see
3 exactly how firmly the battle lines are drawn in
4 relation to each of the issues, and the component parts
5 of the issues, so we can form a better view about which
6 things we are actually going to need proper replies on.
7 MR JUSTICE HILDYARD: Yes.
8 MR TROWER: So, perhaps a sensible way to leave it is we
9 will have a further think overnight and if we have
10 anything to add at this stage -- I fear, my Lord, we may
11 not have a view tomorrow morning that is any different
12 from the view --
13 MR JUSTICE HILDYARD: No, I quite understand that. I am
14 simply flagging the point that, from my point of view,
15 I need all the help I can get. On the other hand,
16 I will not get that if there is an eternal shuttlecock
17 between you.
18 MR TROWER: Quite.
19 MR JUSTICE HILDYARD: You may need to pause at the end of
20 the various arguments to work out who is going to do
21 what and who really needs to respond or not. If you
22 follow straight on, depending on the timetable, that may
23 be a difficult matter. If you need more time, then even
24 if it stretches over the weekend we could do that, but
25 we need to know in advance.

1 MR TROWER: Yes.
2 MR JUSTICE HILDYARD: Putting forward for your discussion.
3 It will depend on availabilities and all that.
4 MR TROWER: I suspect we are slightly ahead of time and will
5 continue to be so, would be my guess. I know not. If
6 that is the case, there may be, in any event, on the
7 existing timetable be room for a pause before we come
8 back, yes.
9 MR JUSTICE HILDYARD: Good.
10 MR TROWER: Thank you my Lord.
11 MR JUSTICE HILDYARD: Thank you very much. 10.30.
12 (4.25 pm)
13 (The court adjourned until 10.30 am
14 on Thursday, 2nd February 2017)
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