Wednesday, 20 November 2019

(10.00 am)

Closing submissions by MR PHILLIPS (continued)

MR JUSTICE MARCUS SMITH: Good morning, Mr Phillips.

MR PHILLIPS: Good morning, my Lord.

My Lord, can I invite you to take up authorities volume 2 at tab 56. This is the second of the pensions cases.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: My Lord, this case is the AMP case and, my Lord, your Lordship will see -- although I'm not going to take your Lordship to every paragraph, your Lordship will see that this involves a pension scheme of a company called NPI and it involved an amendment to increase incapacity benefits and the trustees and a member of the board who approved the rule changes had overlooked the fact that early leaver pensions were calculated as if they were retiring because of incapacity and it was a classic case of unintended legal consequences, it was an unintended legal consequences amendment.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: So if I can go to paragraph 64, my Lord, which is on page 91 of the report. My Lord, your Lordship sees that Mr Justice Lawrence Collins says:

"I have had the benefit of more elaborate argument on the requirement of common accord in a case like the present one. The rules give the trustees the power to alter the rules by written resolution or deed after obtaining the consent of the principal employer."

He refers to the rule:

"What happened in the present case is that NPI proposed changes, they were formally approved by the board's sub-committee after the trustees passed the relevant resolution."

So, my Lord, your Lordship sees that what was required was consent and your Lordship has seen the need for noteholder assent in our case. And, my Lord, if I can go forward to 67, where Mr Justice Lawrence Collins summarises the test:

"Consequently what AMP has to show convincingly is a continuing common intention by the trustees and NPI to affect only incapacity benefits. It is clear from the factual findings that there is overwhelming evidence that their intentions were limited to improving the benefits for those leaving on account of incapacity and they had not the slightest intention to benefit early leavers in general. If objective manifestation of their intentions is a separate requirement, then there can be no doubt that is fulfilled in abundance."

And, my Lord, your Lordship can see that it was only incapacity benefits and it was limited to improving the benefits of those leaving.

Then paragraph 69:

"The next question is whether the right to rectification is affected by the fact that the trustees and the board's sub-committee intended to pass or consent to the very wording in the resolution."

So your Lordship sees the "very wording" point:

"It is plain that it is not so affected. In Re Butlin's Settlement illustrates another general proposition in the law of rectification which is that rectification may be available even if the parties have quite deliberately used the wording in the instrument."

Then on to paragraph 70 and your Lordship will have a note of this already because this was referred to by Mr Justice Henry Carr in FSHC and Four Seasons. He says:

"Rectification may be available if the document contains the very wording that it was intended to contain but it has in law as a matter of true construction an effect or meaning different from that which was intended."

And he then refers to some cases and he says:

"It is sometimes said that equitable relief against

mistake is not available if the mistake relates only to consequences of the transaction, or the advantages to be gained by entering into it. This distinction seems to have been derived from former cases."

And he goes on and if I can pick up six or seven lines from the bottom:

"The cases certainly establish that relief may be available if there is a mistake as to law of legal consequences of an agreement or entitlement. In the present case Mr Simmons ultimately accepted that if there was a mistake it was a mistake as to legal effect and not merely as to consequences."

And then 71:

"It is therefore quite unreal to contend that the intention of the trustees and NPI was simply to pass a resolution containing the words which it did in fact contain, or that they did not intend or agree to abolish the link between the calculations of benefits under [two rules], nor can it be said that they intended, as was held in it Lansing Linde, simply to sign anything that was put before them. The resolution was the subject of preparation, advice and discussion. It was not the result of a rubber-stamping exercise and the fact that, as a result of an oversight or of negligence, it had an effect going far beyond the intentions of the trustees

and NPI not only does not prevent rectification, but is a ground for it."

Now, my Lord, what we take from these points -- and I'm coming on to the evidence shortly -- is where you've got an existing contract that is amended, if the relevant person only intends to make limited changes, which I have called change X, where X has been the subject matter of preparation, advice and discussion, which is what you see from the cases, then it follows that you have an intention not to effect change Y. That's what we get from the cases.

There may be a case like the case in Lansing where the decision-makers have no particular intention with regard to a set of amendments, so that there cannot be a mistake if consequence Y occurs and that's because the decision-maker is content, come what may, to approve any legal consequence from their solicitors' drafting.

MR JUSTICE MARCUS SMITH: And you say one doesn't need the common intention because this is effectively unilateral change --

MR PHILLIPS: It is.

MR JUSTICE MARCUS SMITH: -- that hasn't been consented to, but no more.

MR PHILLIPS: And of course in this case we've got the intention of everybody because it is internal to

Lehmans, but this case is like the pension cases because one has got an amendment to a note and it requires consent and your Lordship has seen how that consent was obtained.

Finally, the final third point I wanted to make on the case is that there is no separate and additional requirement that you have to have a positive, subjective intention not to do Y and that is my learned friend's case and that's clear from those authorities, my Lord.

Can I turn to the evidence.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: Your Lordship heard the evidence of Ms Dolby as to her intention and as to that of a number of other individuals, including Mr Rush and Mr Triolo, and as to her own subjective intention her evidence was clear. First, she confirmed she was not aware of any reasons for the amendments other than tax and the only intention she had was to defer interest to get a specific tax benefit and I'm going to give your Lordship some references, I'm going to refer to four -- I will turn up four.

Day 3/90:2-17, she covered a further and we say important point in her interview, which your Lordship might like to turn this up, it is in C at tab 21, at pages 284 to 285 and if you look at line 24 where she is

talking about the accounting treatment and she says:

"Potentially I guess we would have gone and got a tax opinion on the whole structure before we implemented ... been happy that we get a tax deduction from it so it probably wasn't Allen & Overy's call."

And the point she makes here is that Allen & Overy were not advising on the tax and for your Lordship's note, there is a very detailed memorandum by PwC which is at F, volume 5, 2391 to 2391 and they were referred to in the exchange in Ms Dolby's interview and that document, the tax advice, which is approximately 100 pages long, concluded the notes were debt not equity and that interest was tax deductible. Crucially, Mr Grant was not aware of the PwC memo and that you see from Grant 1 at paragraph 57, which is C2/27.

So Allen & Overy were not dealing with tax. Mr Dehal's concern related to the tax position under the pre-existing notes and Allen & Overy had already advised on that.

Now, on various occasions Ms Dolby confirmed that the sole purpose of the transaction was to defer interest and I just give you the notes. That's Day3/96:10-11; Day3/96:24 to 97:2; Day3/101:10-17, Day3/109:20-21 and Day3/110:9 and in particular at page 110:18 she accepted that all she intended was that

the interest should be deferred or could be deferred to achieve the tax benefit. She confirmed that she did not have any issues with the original unamended condition 3 when it was issued in May 2007 because it wasn't of a tax concern to her, Day3/66:10-11, and one can see why, given PwC's memo. And your Lordship will note she never instructed Allen & Overy to change the solvency condition or the payability condition, no one at Lehman asked for the mechanism to be changed, it was something, as your Lordship has heard, that Mr Grant did unilaterally.

She accepted that if the effect of the 2008 amendments was the ranking alteration, then it was a disadvantage and she said she would have thought that SLP3 would have needed to consider it and she said that at Day 3 -- and actually I think for the next little bit we should get hold of the Day 2 and Day 3 transcript, my Lord. The first one is in Day 3.

MR JUSTICE MARCUS SMITH: Day 3?

MR PHILLIPS: I'm sorry, my Lord?

MR JUSTICE MARCUS SMITH: Day 3, yes.

MR PHILLIPS: Day 3, my Lord. Day 3 I just wanted to turn up first at 104 and if your Lordship has that, do you see from line 2, I put this to Ms Dolby:

"Question: Yes, and so you would expect Mr Grant to

have pointed out to the readers of this corporate benefit memorandum, that when they consider the benefits or the disadvantages, that they should have regard to the fact that the ranking was being changed; do you follow?

"Answer: Yes."

And then it is against that background that PLC raises its second criticism, which I touched on yesterday, which is she would have blindly approved anything a lawyer put in front of her, having no intention in respect of that document, and that's the Lansing Linde approach. We are nowhere near that.

Ms Dolby's evidence was that had Mr Grant raised a priority issue she would have discussed it with other departments and she said that on -- if we can go back to page 91 and you can see this section and I think really, my Lord, let's just look through this section as we go:

"Question: So if Tom Grant had said to you: this means that the sub-debt is going to take priority over the sub-notes, or vice versa; what you are saying is that if that had been drawn to your attention, you would have discussed it with your legal and regulatory colleagues, is that right?

"Answer: Yes. It wouldn't have created me a tax problem, but it might have created the other guys in the

team, in the other departments, a problem, I don't know.

"Question: And if you had been made aware of that change, you would have discussed it with them, is that right?

"Answer: I would have hoped to have discussed it with them.

"Question: Yes, so it would have been the sort of -- a change like that would have warranted some discussions, wouldn't it?

"Answer: Yes, but I can't recall any discussions happening.

"Question: No. What you wouldn't have done is you wouldn't have just signed off without there being any discussions, would you?

"Answer: I think it is unlikely, but I can't -- I can't recall can't recall."

What she is saying there is she can't recall there being any discussions:

"Question: And you wouldn't have just signed it off, if Mr Grant had said to you: I am changing all of this; you wouldn't have just signed off on it because Mr Grant had come up with it, would you?

"Answer: As I say in my statement, I think I would have raised it with my colleagues, who were probably more interested in it than I was.

"Question: And I don't know if you were in court yesterday, but Mr Grant told us that if the amendments had meant that the sub-debt would take priority over the sub-notes, he would have told Ms McMorrow and taken instructions, and that is what he told us yesterday. So he would have -- says he would have raised it and you would have discussed it; that's right, isn't it?

"Answer: I would hope so, yes."

So the evidence, my Lord, is inconsistent with Allen & Overy having a general authority to make amendments -- and I'm going to look at what Mr Grant said in a minute. It's inconsistent with Allen & Overy having a general authority to make amendments to the document without discussing them with Lehmans first and it is inconsistent with any suggestion that Lehmans would have just signed off on something of that sort and the second limb of their instructions that your Lordship postulated yesterday was not wide enough to cover a general approval of the amendments. There would have to have been discussions between Allen & Overy and Lehmans and internally within Lehmans.

Your Lordship will recollect what Mr Justice Lawrence Collins said at paragraph 71 when rejecting a similar argument inspired by the Lansing case: the resolution was the subject of preparation, advice and

discussion. And that's exactly what we see in relation to the amendments in this case. We see each of those three steps here in Lehman, all discussions were focused on deferring interest, a corporate benefit was produced solely on that issue, lawyers were instructed solely for that purpose and to confirm continuing LT2 status. That was -- well, we will look in a minute. And by contrast there was no discussion of a ranking alteration.

So your Lordship of course had the advantage of hearing evidence from Mr Grant himself and to be clear, we do not and never have said Mr Grant was the relevant decision-maker; he was not. Nor do we say that Ms Dolby adopted or shared his intention. Now, he did not consider himself to have a general watching brief and I think we need to go back to Day 2 for Mr Grant's evidence please and I just wanted to start just a little part -- yes. Can your Lordship go to page 97 please.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: Can you look at line 22:

"Answer: I saw my instructions as covering three key areas. The most important one would be to make the changes that I had been instructed to -- to make, specifically relating to the deferral. Secondly, we were being asked to confirm that as a matter of GENPRU, the notes continued to be lower tier 2 capital, so I --

my instructions extended to making sure that those changes wouldn't prejudice that capital treatment ..."

And of course your Lordship has seen that there was a discussion and a requirement that Allen & Overy continued their confirmation of that fact.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: Which they had given in the original waiver application -- the original opinion, sorry, not a waiver application, I misspoke:

"Answer: ... and, finally, the changes would need to be done in a way which didn't impair the tax treatment~..."

Impair the tax treatment, and that of course is the tax treatment that arises out of the deferral:

"... by which I mean specifically either the deductability or the withholding tax treatment of the securities."

Now, Mr Grant, despite being pushed by Mr Beltrami that there were other purposes, gave evidence that he saw interest deferral as the key commercial change and the other changes were not points that were intended to change the core commercial rights of either issuer or the holder. He said that at 124:16-21 which I don't need to turn up.

To address Mr Dehal's tax concern Mr Grant's

evidence was that he intended to come up with language which was to preserve the ranking of the securities -- he says that at page 131:22-25 -- and that the intention was that by using the technique in 3(b), securities continued to rank at the same level where they ranked beforehand, which is at 134:25 to 136:4. His intention was specifically to preserve ranking while addressing the tax concern and if an alteration occurred, that was contrary to what he was trying to do and he confirmed again that his intention was to preserve ranking at page 135:21-24.

Then, my Lord, if we can look at 139:8-11, because this is the important other side of the discussion/signing off and the question whether or not Allen & Overy were instructed on a roving basis to just produce whatever amendments they thought fit and he says this:

"Answer: If I had thought that the amendment did change the ranking I would have expected to have a discussion with Sarah McMorrow at LBIE and seek her instructions on that."

So your Lordship sees that what Mr Grant told you is that if he thought he had changed the ranking he would have had a discussion and taken instructions and on that basis his instructions were not sufficiently general

that anything that he changed would be covered by those instructions and there was no such discussion.

So to summarise the evidence, my Lord, first it is a point in which Ms Dolby's intention was narrowly focused on only effecting one right by the amendment, the right to defer interest, to secure the discrete tax benefit that we have heard about. She was the relevant decision-maker and she did not have, to use your Lordship's words yesterday, a secondary purpose. She did not consider Allen & Overy to be her tax advisors with a roving commission or what your Lordship described as a watching brief to address any tax concern they had. PwC were her advisors on the notes and they had already opined on their tax treatment.

Second, your Lordship also heard from the draftsman -- the draftsman gave evidence he actively sought to avoid the ranking alteration. However, he wasn't instructed to check the tax implications of pre-amendment condition 3, he was not instructed to remove the solvency condition and change the ranking mechanism, your Lordship has seen it is something he did unilaterally, and third, your Lordship heard that if Mr Grant had intended to make this particular legal change, the amendment of ranking, he said he would have expected to tell the Lehman Group and to take

instructions, and similarly Ms Dolby's evidence was that she would have expected to have been referred to about such an alteration and then there would have been discussions at Lehman. And her intention only to defer interest was focused and specific. It was not at large as regards the amendment and therefore if legal change Y has occurred, as a result of the amendments, these were contrary to the specific intention only to defer interest without more.

My Lord, that deals with subjective intention and before I move on, a general chilling effect type argument was made in opening. It is said that if your Lordship orders rectification it would mean that rectification apparently responds to a solicitor's initiative just because the initiative is not shared expressly with the client and that was Day 1/156:5-9. Well, with respect the point goes the other way. If, 1, the instructing client does not intend the solicitor to have a roving brief; and 2, the solicitor then amends a provision he is not instructed to amend; and 3, with the intention of not altering the parties' legal rights regarding say ranking in a winding up and intending instead specifically to preserve the status quo ante on ranking, but for whatever reason on a true interpretation the amendments have effected

a fundamental legal change to the detriment of the client, then we say that is classic rectification and non-rectification would be chilling.

Can I move on to outward expression of accord.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: Our position on outward expression of accord is twofold. 1, we say it is not a requirement in a case like this. As my learned friend Mr Arden points out, correctly, in his submissions, that's paragraph 56, the current facts are far closer to the pension cases and in those cases mere consensus/consent is sufficient so converging intentions suffice and we have shown your Lordship condition 12. Second, all the internal documents disclosed do in fact indicate an express intention without more to defer interest.

On the first point, as your Lordship picked up yesterday, the outward expression of accord is not a requirement in cases where one does not require a true meeting of minds, but where one party is merely consenting to amendments. Lord Justice Leggatt referred to the pensions cases and the lack of the outward expression of accord treatment in paragraph 76, 78 and 79, which I know your Lordship has got, and there is nothing to suggest that where there is no outward expression of accord requirement prior to Four Seasons

in amendment cases, there is subsequently, so it hasn't been introduced subsequently.

So when my learned friend Mr Beltrami in his skeleton, 161.7, submits that our submission is there need be no outward expression of accord in this case, that it must be rejected after FSHC and is not considered further here, that is mere assertion, that is not supported by the authorities. Prior to Four Seasons there was no requirement of an outward expression of accord in the pensions type cases because where one is dealing with an amendment only requiring consent, one is not dealing with the sort of contract your Lordship and I were discussing at the outset of our discussion of rectification. So we say it is sufficient in this case for there to be a convergence subjective intention and there was.

On the second point, even if that was correct, if one were to look at the matter objectively the same conclusion would necessarily follow. An external observer would conclude from the correspondence, the minutes, the instructions to Allen & Overy, that the common intention was to do no more and no less than enable the deferral of interest and that comes across very clearly in the rectification chronology which I handed up to your Lordship yesterday.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: Can I then deal with attribution. We say applying the correct legal approach Ms Dolby had the relevant intention and she was either the decision-maker, or shared her intention with the technical decision-makers, or that her intention was either adopted or given effect by the technical decision-makers. So if I can just explain that.

First of all, I should take your Lordship to Murray Holdings v Oscatello which is in authorities bundle 6 at tab 142. This is Mr Justice Mann's decision. Now, my Lord, the facts are not important for current purposes, but just to tell your Lordship -- you will see it from paragraph 1 -- the dispute related to the construction or the rectification of a framework agreement and paragraphs 193 and following deal with the question of how the intentions of two individuals are attributed to the principles, to Isis and Oscatello, and Mr Justice Mann draws the principles together. If your Lordship sees, he discusses it through that section and he draws it together in paragraph 198 which I do want to look at with your Lordship and what Mr Justice Mann said is:

"What one derives are the following principles ..."

(a) and (b) are not particularly important so we can

look over:

"One is looking for the person who is in reality the decision-maker ...(Reading to the words)... usually the person with authority to bind the company."

So that's the starting point:

"Someone who is not a person with power to bind can nonetheless be treated as the decision-maker if that is the reality on the facts. The intention of a mere negotiator may be relevant if it is shared with the actual decision-maker but as it seems to me, that is because the intention has become that of the actual decision-maker."

And, my Lord, I'm going to be making the submissions about the relationship between Ms Dolby and Mr Rush shortly, but your Lordship can see where it's going.

"Where a person would normally be expected to be the decision-maker, such as a board, leaves it to a negotiator to negotiate a deal and produce contract by instructing solicitors on the understanding that the decision-maker would do a deal on those terms, then the negotiator's intention is the relevant one, either because the person is the decision-maker, or if that description is not apt because the technical decision-maker has simply adopted the intentions of the negotiator."

So that is the legal framework and in their skeleton at 152 PLC make a case that it needs to be extreme or exceptional to fit into (c) to (e) and our response to that is there is no apparent reason why it should be because one can understand when one is looking at decision-making why those are examples of where you look to someone who is not the technical, authorised decision-maker in order to ascertain the intention, which is what one is looking at.

So turning to the facts, when one looks at the reality here it is clear that Ms Dolby was the real decision-maker. She instigated this discrete tax-driven change. Her email served as the instructions to Allen & Overy and we say it is clear that she supervised the whole implementation process relating to the amendment. She was the team leader and stepping back, whilst it may be right that she did not have actual authority, formally, to bind either LBHI2 or SLP3 to the formal modification, the decision to implement this was in fact implemented well before those formal steps were taken and if you look at (c) of Murray v Oscatello and ask about the reality of the facts, the reality of the facts is that she should be treated as the technical decision-maker.

Your Lordship may recall an interesting exchange in

relation to this with Ms Dolby, in relation to an email chain in July 2008 between her and Mr Rush, who of course was her boss and I'm going to come back to him again in a minute. He was her direct superior in UK tax and also a director of LBHI2. Those emails are at F6/3201. I don't want to turn them up, but the past tense was used -- your Lordship may recollect, the past tense was used in that email: "We have put in place the deferral of interest". And Ms Dolby then responded you remember to Mr Rush's question about how much is this deferring and she said it is 20 million a month and you see that from F6/3203. And we put the curiosity to Ms Dolby that in fact the formal resolution wasn't passed until 3 September and she accepted that the decision had already been made as at that date and there may have been legal formalities afterwards, which is Day3/123:9-12. She then rowed back a bit, as your Lordship may recall, saying she wasn't sure if the accounting treatment had in fact been put in place in June 2008, noting that it was "very odd" and that was at Day3/128:11, and "very unusual", Day3/128:8-9, that deferral might have happened before the board meeting. In fact it appears that is exactly what happened.

Mr O'Grady's evidence is that the book entries settling interest on the LBHI2 subnotes continued up

until 1 June 2008 and for your Lordship's note that is C8/126 at paragraph 90 and that evidence was not challenged. So what appears to have been happening, in other words the deferral of interest, happened from June. Now, the formalities didn't happen until September, but that is important. And Mr O'Grady's evidence is supported by contemporaneous documents and I will just give this for your Lordship's note, it's F volume 6, 3103, on 30 June a Mr Ben Hall wrote to Mr Gavin Netzel copying Ms Dolby saying:

"As discussed the other day there's an automatic paydown generated on the first of each month between the entities, so to meet Jackie's tax requirements and ahead of the technology fix that you had to ..."

There was a technology fix going on:

"... we will need to manually kill this flow tomorrow so as to leave the accounting interest on the intercompany between these entities."

So "so as to meet Jackie's tax requirements" is very clear. This is June 2008. They stopped the fund flows manually. The deferral of interest kicked in in June 2008, which is entirely in accord with everything that we saw passing between Jackie Dolby and Mr Rush and it just demonstrates that this didn't start on 3 September when the resolutions were in fact passed

and so the nub of it was it was operative, from a bookkeeping point of view, in June, long before that September date.

Shared or adopted, so the fallback, if you like, from that is that even if Ms Dolby was not in reality the decision-maker, she accepted she was the driving force in relation to all of these transactions, she led the cross-departmental team that led the 2006 restructuring, the 2007 restructuring and then the 2008 amendments themselves and she acknowledged in her oral evidence that she coordinated the amendment project steps and instigated the change to be made, that's Day3/86:12-13, and in this case she put the proposal to Mr Rush for approval, and she told us Mr Rush already knew about the transaction. It was tax-driven. He was the head of the tax department, he adopted recommendations made to him by Ms Dolby and she gave evidence as to Mr Rush's intention.

She accepted that the purpose stated on the face of the 2008 board minutes was exactly what Mr Rush would have expected based on discussions she would have had with him in the run-up and she said that on Day3/129:9-12. And she noted by reference to the July 2008 email exchange with Mr Rush that he sat in if the office next to her and they spoke a lot, "but

yes, this email supports the fact that I was updating him on a regular basis". So Mr Rush, who signs off in September, was absolutely sharing Ms Dolby's intention that this was to do with the deferral for tax purposes.

She described it, she said she would often go into his office, he knew what she was trying to do because he had already signed off for her to continue with it and critically she accepted Mr Rush shared her views about the purpose of the transaction and for your Lordship's note that's Day3/129:16-24, Day3/136:15-18. And her acknowledgment that she shared Mr Rush's intention and he shared her intention about the transaction is significant in the context of Murray v Oscatello. The position is very similar to that in Murray v Oscatello. At paragraph 217 -- I'm going to turn it up -- Mr Justice Mann held that even though the negotiator, a Mr Brown -- I see your Lordship is turning it up.

MR JUSTICE MARCUS SMITH: Yes, sorry.

MR PHILLIPS: No, not at all. Where he says:

"Since I have found that in effect she had the same intention ...(Reading to the words)... does not adversely affect the claimant's rectification claim."

She had the requisite intention herself. So what Mr Justice Mann was saying was even though the

negotiator, Mr Brown, wasn't the decision-maker, the actual decision-maker, Ms Peck, shared his intention and that was sufficient for the purposes of the rectification claim.

Ms Dolby also gave evidence about Mr Triolo's intention. She accepted that an email attaching the resolution was sent to Mr Triolo and Mr Steinberg on the basis that they "will approve" it, that was Day3/133:5-10, and it sounded like a forgone conclusion, but she accepted Mr Triolo would have known about the interest deferral because he was the one driving it from a US tax perspective and she said that on 133:21-24.

When Mr Triolo was asked to sign the Delaware consent, the final draft of the notes wasn't attached. So all of this just points to the subjective intention that he had, that he shared as well was that subjective intention that we have seen Ms Dolby had. However one looks at it one comes back to the same subjective intention shared by everyone in it Lehman involved. It was to do no more and no less than to defer interest.

Turning then to discretion, my learned friend invites your Lordship not to exercise your discretion in favour of rectification, even if the grounds are made out.

For your Lordship's reference, declining the remedy

after its requirements are made out would require exceptional circumstances and Mr Justice Vos as he then was in Barden v Commodities Research, which is in authorities 5, at page 110, there are no exceptional circumstances.

PLC also complain about the nature and scale of the rectification sought and that is neither here nor there. If the court finds that condition 3(a) effected an alteration to the ranking then we say that was contrary to the common intention of the parties in the context of a subsisting contract, and the remedy is easily applied by removing the offending language, which for these purposes is the amendments to condition 3(a). And we remind you of the reference to Chartbrook in our skeleton. There's no limit to the amount of red ink but there's such a simple answer to this: it may be 30 lines, but it's one point.

MR JUSTICE MARCUS SMITH: Well, Mr Phillips, is that actually right?

MR PHILLIPS: Which bit?

MR JUSTICE MARCUS SMITH: The deletion of the 30 lines being the appropriate response, assuming that you are correct on the other requirements for rectification. Because reasoning it through, we are only getting to rectification if I find that you lose on construction of

the amendments.

MR PHILLIPS: Absolutely, my Lord.

MR JUSTICE MARCUS SMITH: So let's suppose that I reach a view on the wording that because of certain words that have been used, the ranking was altered, isn't the appropriate course to correct that deficiency, whatever it might be, in those 30 lines so as to make the wording compliant because there was of course always an intention to change the manner in which the ranking of these instruments was articulated?

MR PHILLIPS: My Lord, that is a very good point and I take your Lordship's point. I take your Lordship's point. Your Lordship's point is that one can continue with a payability condition but one can take out anything that might suggest that --

MR JUSTICE MARCUS SMITH: Yes, I mean it's a slightly tricky question I ask you because of course no one has articulated what the wording means.

MR PHILLIPS: I understand. How to do it. My Lord, can I take that away as a matter of drafting. That's not something that I'm going to try and deal with on my feet, but I understand the point your Lordship is making. The point that I was making was really the simple point which is however many lines it is, it's one point, but I take your Lordship's point that there may

be a smaller, a tighter amendment that one could make perhaps by reference to --

MR JUSTICE MARCUS SMITH: If there had been an insertion of these 30 lines simply by mistake, that there had been a simple cut and paste on the word processor and the thing had been signed, then of course you would say "Of course it all goes out".

MR PHILLIPS: Yes.

MR JUSTICE MARCUS SMITH: But what we've got is a definite desire that these words go in, provided they achieve a certain end, which is what your case is. So if I find that end is not achieved then it seems to me that the rectification would be not to delete what everyone wanted in but to correct it so as to match what everyone wanted on your case.

MR PHILLIPS: I completely follow your Lordship's point, and the point that is in there that was supposed to be there is the assumption that they were entitled to receive 100% and I completely understand that point and what I need to look at is the precise bottom-up mechanism that was used and the reference to preference shares, because without any disrespect to Mr Grant, all of that was just not necessary to -- but anyway, my Lord, can I --

MR JUSTICE MARCUS SMITH: No, of course.

MR PHILLIPS: I will take that away and we will filter it down.

Now, my Lord, may I say something very, very brief in relation to the amendments are not otherwise engaged. We set out the reasons for this submission in our joint position paper, in our reply position paper and in our skeleton argument at pages 391 to 401 and my learned friend Mr Beltrami made a couple of points in his opening, but one of which was that the administration is a distributing administration and not a "save the company" administration, in other words it wasn't an administration for the purposes of rescue.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: What your Lordship should be very careful about, if I can put it this way, is not to say in your Lordship's judgment that administration and winding up are the same and the reason why I say that is that what your Lordship sees is an acceleration provision and if that was to be read -- as my learned friend did when he took you to (inaudible) -- if that was to be read widely as a suggestion that administration and winding up are the same thing, functionally or otherwise, that would then potentially impact more widely on parties when they are restructuring because you cannot have a whole series of accelerations going through banking

documents, through the market.

So what your Lordship should do, if I may respectfully put it this way, when considering the particular clause in this case, is to identify the limits of its application to administrations other than for the purposes of distribution. And with that, my Lord, there is nothing more that I want to say about it at this stage. Or at all actually seeing as this is closing.

My Lord, can I move on to release?

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: My Lord, the totality of the materials before the court clearly show that the PLC subdebt has not been released by the settlement agreement. This is obvious from the plain meaning of the ordinary language used both in the recitals and in section 802 itself. It is the construction we advance that accords with commercial common sense and if your Lordship was in any doubt about the issue, the subsequent conduct of a number of parties to the settlement agreement, some of whom are before the court, clearly points as a matter of practical construction to the PLC subdebt not having been released as a result of the settlement agreement.

Your Lordship should have in mind that this issue comes before the court in unusual circumstances. The

parties to the settlement agreement, by submission in our case, by conduct, or in the case of LBL I'm going to show your Lordship a letter, either reject or do not support Deutsche Bank's construction. Not one party to the settlement agreement has either made submissions or given evidence in support of Deutsche Bank's case. Not one party to the settlement agreement has argued that a debt that they were liable to pay should not be paid because on its assignment to LBHI it had been released.

Deutsche Bank was not a party to the settlement agreement and ordinarily would not be able to make these points and your Lordship should not forget that they make submissions as an outsider to this agreement.

MR JUSTICE MARCUS SMITH: Well, yes, but they're not --

MR PHILLIPS: I'm not saying they have no locus, my Lord.

MR JUSTICE MARCUS SMITH: No, indeed, nor is it right to say that they are seeking as a third party to benefit from it. All they're doing is advancing a construction of 802 that --

MR PHILLIPS: No, I absolutely accept that. But the first opening point, because it is unusual, is that the court does not have, which is ordinarily the case, the two parties to the release arguing about its effect and scope.

MR JUSTICE MARCUS SMITH: No.

MR PHILLIPS: One hasn't got that. Now, instead what you do have is a total of over £955 million sterling and 72 million euros has been distributed to LBHI by UK parties to the settlement agreement on claims that were acquired by LBHI after the date of the settlement agreement. So it's about a billion.

The summary. As a matter of ordinary language, section 802 does not release after-acquired claims. The recitals refer to outstanding issues among the debtors and the UK affiliates. The release in section 802 is a release of extant causes of action existing between the parties at the time of the settlement agreement. Those causes of action have to be based on or connected with alleged or related facts or circumstances in existence at the date of the settlement agreement.

There were no facts or circumstances in existence between LBHI and PLC with respect to the PLC subdebt that could constitute a cause of action. Judge Smith accepted this. The fact that the PLC subdebt was in existence, without more, is not sufficient to meet this requirement. The parties to the PLC subdebt were LBUKH and PLC. Without a factual nexus between LBHI and PLC there was no basis for what Judge Smith accepted was the necessary pre-existing legal relationship. Judge Smith described it as a "jural relationship".

A cause of action is based on pre-existing legal rights and obligations. An after-acquired claim is not based on pre-existing rights at all.

Deutsche Bank's fallback argument was that after-acquired claims are unforeseen or unforeseeable. However, absent a jural nexus, the releasor's state of mind is irrelevant. An unforeseeable claim is necessarily also an unforeseen and an unknown claim and an after-acquired claim is a totally different creature. It is one where the necessary pre-existing relationship that might have given rise to a claim that is unforeseeable, or unforeseen, or unknown, does not exist and Judge Smith's subrogation analysis does not assist. A right of subrogation is not an after-acquired claim, it is a secondary claim based on a pre-existing primary right. The analysis would be the same in London and in New York, but in any event it doesn't assist in the context of this settlement agreement because subrogation claims were expressly included in the release by specific terms, providing that they were claims based on an asserted right of subrogation, indemnification, contribution or reimbursement. I'm going to come back to that because it deals with the subrogation point.

Finally, my Lord, Prosac doesn't assist. The parties had agreed in Prosac to release all of claim 41

bar any potential subrogation right in the event of a part payment by the Shiff estate. An assignment back of claim 41 was contrary to the spirit of the settlement, it was contrary to the purpose of the release and it was an abuse. And, second, of course this is the only US decision anyone has found where an after-acquired claim has been released and that is a very strong indicator that generally speaking after-acquired claims are not released under release clauses, no matter how general and we will come to look at the reasons for that.

In relation to commercial common sense it was no part of the commercial purpose of the settlement agreement to release all after-acquired claims.

In relation to post-contractual conduct, Mr Geraghty's claims schedule that we will look at, showed us that LBHI has received dividends of 951 million sterling, 72 million euros in respect of claims acquired from various UK affiliates and other third parties. There are a total of 87 after-acquired claims and dividends have been paid by 15 different UK affiliates, if my ability to count things up on a schedule is good enough. That again is a strong indicator that the PLC subdebt was not released. Indeed if the effect of the settlement agreement was to release

all after-acquired claims then the parties to the settlement agreement have been proceeding on a mistaken basis.

As to the two agreements relied on by Deutsche Bank, the STG settlement agreement and the Deutsche Bank settlement agreement, they are different agreements between different parties.

Now, I will just say a little bit about the background. Your Lordship heard from Mr Geraghty about the background to the settlement agreement. Mr Geraghty was heavily involved in the process of negotiating the settlement agreement, he confirmed that on Day 3/96:1-3. He was the only factual witness at the trial able to assist your Lordship in relation to it. Deutsche Bank expressed surprise in cross-examination that he was the only LBHI witness to give evidence on the topic, the suggestion being that his evidence was somehow unrepresentative of the collective thinking.

Deutsche Bank did not seek to adduce evidence from any of the other parties to the settlement agreement and, as I have indicated to your Lordship, there are parties present before your Lordship in court at the moment. And it only put forward one witness, a Mr Sutton, who wasn't a party to the agreement but his evidence was withdrawn in late September and for

your Lordship's note there are letters at H/309 and 306.

Further, Mr Howell, one of LBHI2 administrators, played a key role in negotiating the settlement agreement which we deal with in footnote 7 of our skeleton argument, and Mr McKay the liquidator of GP1 was also a party to the STG agreement and none of these individuals gave evidence.

So "You are the only person giving evidence" point really gets no one anywhere.

Mr Geraghty is immersed in the facts of the Lehman insolvency, had a detailed grasp of both pre and post-contractual situation. He put it at one point, he said "I'm the only person in this room who was there", I think, I seem to recollect. But the key points we learned from Mr Geraghty about the background, both from his witness statement and in cross-examination, are: 1, the purpose of the settlement agreement was to settle and resolve certain intercompany balances and claims that were in dispute between the US debtors, the UK affiliates. This was the population of the claims that was contained in the agreement. In simple terms, on the one hand there were the Lehman US entities, collectively part of the Chapter 11 in the Southern District of New York, and on the other hand the UK entities that were mostly in administration, mostly under the control

of administrators from PwC. The claims in dispute did not relate to claims held by one UK affiliate against another UK affiliate and none of the issues concerned allowing or releasing claims held by one UK affiliate against another UK affiliate. And that would have concerned issues between UK administrators and would have been resolved between them.

As a result of the global close process, LBHI and its affiliates achieved a final reconciliation of intercompany balances as at 14 September. The UK affiliates used a similar process. Mr Geraghty explains it in paragraph 16 of his statement. And there was an important meeting on 13 September 2011. Your Lordship will have seen the agenda of the meeting, it is at F, volume 7, 3713. The parties agreed to carve out what they called excluded items, which were points that were too complicated and these claims were expressly carved out of the releases as they related to known issues that continued to subsist between the parties and which otherwise might have been released and Mr Geraghty deals with that in paragraph 50.

As Mr Geraghty said in cross-examination, the agreement was the outcome of claims over which the parties had been fighting for 18 months and he said that Day 4/11:18-20.

Mr Geraghty explained the commercial objective underpinning the settlement agreement was that once the bankruptcy date balances and net intercompany claims between the US debtors and the UK affiliates at the commencement of the bankruptcy had been agreed, the debate would not be reopened. The pre-existing intercompany claims between the US debtors and the UK affiliates would be settled, the estates would be able to get on with making distributions and that is what has happened.

Mr Geraghty was cross-examined about this. It was put to him the whole purpose of the agreement must have been for the release to cover pre-existing claims but also to use my learned friend Ms Tolaney's words, "claims the parties might have in future so that things didn't come out of the woodwork" and that was Day 4/110:1-3. Mr Geraghty didn't agree with this. His evidence was that it was no part of the commercial purpose of the settlement agreement to compromise claims of one UK affiliate against another UK affiliate, or to prevent the acquisition of after-acquired claims by LBHI as part of the wind-down process of the group.

Where one of the companies further down the chain owes LBHI money, where there is a claim that LBHI has got against one of the companies down the claim, LBHI

could wait for that to be turned into cash and then the money could be distributed up to LBHI, or, as has been happening, assets can be put up into LBHI and then the funds follow later and that makes the administrations of all these estates just much more efficient. And that's what these administrators and the US company Chapter 11 have been doing. This is all part of efficiency to move the cash ultimately to the external creditors.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: All of this has been borne out by the subsequent conduct. As Mr Geraghty said in oral evidence, all the subsequent activity in the eight years that have passed is overwhelming proof that all the other parties felt the same way.

Can I then look at 1202 of the settlement agreement, my Lord, which is in bundle E, divider 16.

Sorry, I should first of all just remind your Lordship of section 1202 which is at 504 of the agreement. Does your Lordship see:

"The agreement and all claims and disputes relating to the construction and application of the terms of this agreement shall be governed by and construed in accordance with the laws of the State of New York and the bankruptcy code."

And that's important. It is important for a number

of reasons.

First, and your Lordship saw this when I put it to Judge Smith, the bankruptcy code defines what is a claim and how debts are to be proved, and the recitals to the settlement agreement record that the UK affiliates had filed proofs of claim against the debtors and those claims could only have been made if the bankruptcy code test was satisfied.

Second, Judge Smith quite properly accepted that he is not an expert in the bankruptcy code and he told your Lordship that he was unfamiliar with its provisions.

Then, my Lord, if we can just remind ourselves of paragraph 1 of Mr Justice Hildyard's order, which is in tab 12 of bundle A, and it is just to remind your Lordship that paragraph 1 of the order directed that -- I'm sorry, my Lord.

MR JUSTICE MARCUS SMITH: I have it.

MR PHILLIPS: We haven't had to look at this but we should just look because the questions were, first:

"What are the rules of contractual interpretation under New York law and the bankruptcy code insofar as relevant and applicable to the interpretation of 802?"

So Mr Justice Hildyard's order and the questions that the experts were dealing with applied both to

New York law and the bankruptcy code.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: And, my Lord, your Lordship should have in mind that the settlement agreement was sanctioned by the Southern District of New York bankruptcy court. So the US bankruptcy code is not as irrelevant as Deutsche Bank suggest.

So then going back to the settlement agreement, your Lordship has seen between whom the settlement agreement is made on 457. I'm just going to walk through. It is between the US debtors and the UK affiliates. The US debtors your Lordship knows, the UK affiliates are the UK administration companies and the UK liquidation companies and the LBLIS group companies who are described in footnote 2, the LBLIS.

Then, my Lord, the recitals. Your Lordship sees the first recital is that:

"The UK affiliates filed the proofs of claim listed in schedule 1 attached hereto collectively. The proofs of claim against certain debtors."

So one has got UK companies filing proofs of claim in the Chapter 11 bankruptcy, okay, that's the first point. Then the second point was:

"Certain of the debtors have asserted they have claims against certain UK affiliates, including claims

asserted by LBHI against LBIE and certain other UK affiliates in respect of intercompany funding."

They've got funding claims. And again that's the US having claims into the UK and of course in the UK if you have a claim against a company in the UK in administration, you know, one gets into all the prudent provisions.

The last recital:

"The debtors and the UK affiliates desire to resolve all disputes and all other outstanding issues among them, except as expressly excluded herein, to avoid extensive and expensive litigation."

So what you get from the recitals is it concerned a resolution of intercompany claims between the US debtors on the one hand and the UK affiliates on the other; it is not between UK affiliate and UK affiliate. It related to proofs of claim filed by the UK affiliates filed against the US debtors and to claims of the US debtors against the UK affiliates and the ability to file proofs in those insolvencies was essential before those claims were within the scope of the settlement agreement and when your Lordship comes to consider what disputes the parties contemplated, when they executed the releases, your Lordship should have this well in mind.

The disputes and outstanding issues were those that have or could have been raised in the insolvency claim processes and it was intended to avoid expensive and time-consuming litigation in relation to those claims in the future.

So then, my Lord, we get to the release at page 498. First of all, there's a release that starts on 497 which is the UK affiliates release and then we get to 802 which is the US debtors release.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: So can I just work through this.

"Upon the occurrence of the effective date ..."

And, my Lord, that is defined at page 463. It is the earliest of two dates and in this case the earlier date was the plan becoming effective in accordance with its terms and that date was 6 March 2012 and your Lordship will get that from Mr Geraghty at paragraph 15.

Deutsche Bank seemed to characterise the effective date as a condition precedent. We disagree. It states when the agreement is effective and when the release takes place. This happens upon occurrence of 6 March 2012.

There are then certain carve-outs to the release, so "upon the occurrence" and then it says "except with

respect to" and then:

"1, the allowed claims and the admitted claims and any rights and distribution entitlements in respect thereof."

Allowed claims are defined at page 460. They are the LBIE guarantee claims which are dealt with in section 2.01 and three other defined claims that are dealt with in section 2.02, 2.03 and 2.04 which your Lordship will find at 476. So your Lordship has got -- I'm giving your Lordship a framework as we walk through.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: The admitted claims are defined at 460 and they are two identified US debtor claims which are defined at 469 and then other US debtor claims that are dealt with in section 2.05 at page 477.

Going back to 802:

"2, the agreements, promises, settlements, representations and warranties set forth in this agreement ..."

So, in other words the parties' obligations under the settlement agreement are not released:

"3, the performance of the obligations set forth herein."

Which is the counterparty to that. And 4, the

excluded items. They are defined at page 463 and we know from Mr Geraghty's evidence that these were complicated claims left over deliberately for another day and that's at paragraph 44 and that was unchallenged.

The key point is that there were disputed items between the US debtors and the UK affiliates that were in existence at the time that would otherwise have been released but which the parties decided not to release. So this is not as all-encompassing as my learned friend suggests. There were things that were going over to another day.

Then, having got through the exceptions, we then get to the words of the release itself:

"Each debtor ..."

And then you get:

"... on behalf of itself, its estates, its successors and assigneds ..."

And in the brackets you get identified lots of who they may be:

"... hereby fully and forever releases, discharges and acquits each debtor released party ..."

And they are defined at 462:

"... from all causes of action."

I'm going to pause there. And then we get, in the

parathesis:

"... including in respect of a derivative claim by any third party representative ..."

And so on, which doesn't matter. So it is:

"... releases each debtor released party from all causes of action whether at law or in equity, whether based in contract (including quasi contract, guarantee, indemnity or estoppel) statute regulation, tort or otherwise ..."

So that is then identifying types of claim, types of claim that are included in the words "all causes of action". And there is a fraud exclusion and we then come to what those types of claim may be:

"Accrued or unaccrued, foreseen or unforeseen, foreseeable or unforeseeable, known or unknown, matured or unmatured, fixed or contingent, liquidated or unliquidated, certain or contingent, in each case that arise from or are based on or connected with alleged or related to any facts or circumstances in existence at the date hereof."

What you have there, my Lord, is a series of juxtaposed concepts, so the first thing one has to look at is a series of juxtaposed concepts. So it is accrued or unaccrued, foreseen or unforeseen, known or unknown, matured or unmatured, fixed or contingent, liquidated or

unliquidated, certain or contingent. So the one would never include the other. Okay?

There are six objective elements. If one looks at these, there are subjective and there are objective. We're going to start with the objective. The six objective elements: accrued or unaccrued, matured or unmatured, fixed or contingent, liquidated or unliquidated, certain or contingent and also foreseeable or unforeseeable. Those are all objective.

There are then two subjective tests: known or unknown, foreseen or unforeseen.

Now, looking, my Lord, at the objective elements, a number of the objective elements overlap. So an accrued claim can be a matured claim, it might be a liquidated claim, or an unliquidated claim, it may be a certain claim, it may be a contingent claim. An unaccrued claim might be liquidated, or unliquidated, unmatured, certain or contingent. So you can see that amongst the objective, there are overlaps.

Any of the subjective elements can apply to any of the objective elements, okay? So if you're looking at any of the objective elements those might be known, or unknown, and they might be foreseen, or unforeseen and -- does your Lordship see the point? Yes. And an unforeseeable claim will also be unknown and unforeseen

because it's unforeseeable.

So what you cannot do when construing this part of the release is to parse each constituent word into just that word and say "Well, what does that separately from all other words refer to?". The subjective elements, known/unknown, foreseen/unforeseen -- the subjective elements have to be read in context with the objective elements, so that you should have a claim that is either accrued, unaccrued, matured, unmatured, fixed or contingent, liquidated or unliquidated, certain or contingent, and you then apply the state of mind to it. And whilst foreseeable and unforeseeable is objective, that's a state of mind, it's just an objective as opposed to a subjective state of mind. But you have to fit it into accrued/unaccrued, matured/unmatured, fixed or contingent, liquidated or unliquidated, certain or contingent, before you ask was it known or unknown, was it foreseen or unforeseen, was it foreseeable or unforeseeable?

The fact that something is unknown or unforeseeable or any of the above does not mean you have a claim because you have to fit into those objective parts first and what we submit when you construe this, my Lord, is it is illegitimate to take the subjective elements, foreseen and unforeseen, and that say an after-acquired

claim was unforeseen, it may have been unforeseeable and therefore after-acquired claims fall within clause 802.

The subjective state of mind, without first finding the objective existence of a claim, is not enough. So "I did not know I was going to acquire an after-acquired claim, I did not know I was going to acquire a claim". "I did not foresee I would acquire a claim", or "It was unforeseeable that I would acquire a claim", are not enough for you to have a claim you could release.

My Lord, I'm going to develop this even further. And then in 3:

"Except as explicitly set forth in 2.04, any claims based on a certificated right of subrogation, indemnification, whether express or implied, contribution or reimbursement, including any such claims ..."

So those are included, your Lordship sees in little 3:

"Claims based upon an asserted right of subrogation."

So it is a claim based upon an asserted right, but I will come back to that but just have that in mind for this point when we come back to subrogation.

MR JUSTICE MARCUS SMITH: So it is not just a right of subrogation, it is something which needs to be

communicated or stated?

MR PHILLIPS: It is an asserted -- the critical point is -- I'm going ahead, but my learned friend's re-examination point linked -- he asked a question "When does a subrogation claim arise?" and His Honour Judge Smith said "Well, when the claim is made". Well, under the contract it's actually whether or not there was an asserted right of subrogation.

I will come back to that, if I may.

Each of those claims, my Lord, has to have a factual nexus in existence prior to 6 March, which your Lordship knows from the words "In each case that arise from, are based on, connected with, alleged in or related to any facts or circumstances in existence prior to the date hereon", which is 6 March. So you have to have a claim, you have a state of mind and the claim has got to exist prior to -- all of that is being tested prior to 6 March, okay?

My Lord, I promise I will say even more about these, but that is the structure of how this works.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: And then just quickly, section 4.04(b), which your Lordship has seen, which is the no prior transfer of claims at 493:

"Other than expressly set forth ..."

So:

"No UK affiliate may convey, transfer, assign or participate any of the claims or receivables that are allowed, compromised, settled, waived or released hereunder, or any rights or interests hereunder and any of the foregoing in whole or in part."

And what 4.04 as a whole indicates, and 4(b) in particular indicates, is that the affiliate must own the released claim at the effective date and, my Lord, Deutsche Bank called this a boiler plate provision at 112/4, but your Lordship sees the warranty as to title. Then 5.04, if I can just read 5.04(a), which is on 495:

"Each debtor owns all the claims it may have against the UK affiliate including all claims released hereunder."

So there is a warranty, my clients gave a warranty that it owned all the claims, including all the claims released under the agreement.

My Lord, if that's a convenient moment for the shorthand writers.

MR JUSTICE MARCUS SMITH: Yes, thank you very much. We will rise for five minutes.

MR PHILLIPS: Thank you, my Lord.

(11.21 am)

(Short Break)

(11.28 am)

MR PHILLIPS: My Lord, I'm turning then to the evidence and to Judge Smith and on the effective date -- we took Judge Smith to the position on 6 March 2012 and he accepted that LBUKH had both matured and unmatured claims against PLC arising from facts or matters existing prior to that date which could form the basis of a release and he also accepted that there were no such facts and matters existing as between LBHI and PLC as at that date which could form the basis of a release.

He agreed that for LBHI to release PLC it could have agreed that, in the event that LBHI acquired the PLC subdebt, it would release. So there could be a covenant of prospective release. That could have been agreed but of course we say it was not. That's Day 5/92 to 96.

On purpose he agreed that outstanding claims arise from pre-existing facts. That was at page 111:6-7. He agreed that accrued/unaccrued, foreseen/unforeseen referred to actual disputes based on pre-existing facts, future disputes based on pre-existing facts and contingent disputes based on pre-existing facts and that was at page 114.

He agreed that there were cases where even the broadest release could be limited to the claims that are shown to be in the contemplation of the parties and,

my Lord, your Lordship will recollect that we looked at those authorities where the parties were settling and releasing specific litigation claims and of course your Lordship has the context here.

On general releases against specific releases he agreed with your Lordship that an accurate description of a general release was to describe a class of claim and that was 113:16-21. Although I think it is fair to say, my Lord, that there was an agreement that it's not a term of art, the word "general release", and your Lordship posited an example of a release that was combined -- IP rights which did not extend to tort rights and he agreed, having seen Long v Neill(?), that unripe, unmatured and contingent claims all depended on a pre-existing relationship. However, he was not prepared to agree that the release in Long v Neill could not extend to after-acquired claims which are not based on a pre-existing right and that was at 114 to 145.

He was shown paragraph 25 of his report and he agreed with our analysis of unmatured and unripe claims, that they depend on an existing right and that in each case the releasor does hold that right when the release was granted and that was at 146:23-25. And that in each case the releasor can release the claim because he holds the right and that was a direct contradiction of

paragraph 25 of his report where he said -- and I'm quoting:

"It would not be accurate to say that such claims were claims that the releasor held at the time that the release was granted."

Having accepted that the release of unripe and unmatured claims is a release of claims that are held, he said variously -- and this was at pages 147 to 153, and I'm quoting:

"Answer: It is unforeseen. It is a claim that the releasor does not foresee. Whether or not he or she has it at the moment of the foresight is not expressed. Second, when you are releasing unforeseen claims, one of the many things that you don't foresee might be the future acquisition of the claim."

And third, the question I asked is:

"Question: Well, what you are saying is that it is not foreseen at the time you will acquire some -- a right at some time in the future?"

And he said "Well yes".

Now, with respect the evidence is confused and the judge is wrong about this. There is no such analytical difference between an unmatured and unknown claim on the one hand which is a claim that arises out of a jural relationship that the releasor has and an unforeseen

claim on the other. There is, however, a very material difference between having a claim that one does not know about and not knowing whether one will have a claim at some point in the future once it has been acquired and with respect, Judge Smith failed to grasp what is a crucial distinction.

On subrogation he accepted that under the US bankruptcy code it is not possible to file a claim in relation to an after-acquired claim and that concept is not caught within the definition of a claim in section 1015 of the bankruptcy code and that was at 162:2-3, and he also explained that unmatured claims and after-acquired claims are different things. That was in 162:6. And as we explained, that is because you have to have a claim before you can file it.

However, he then said that an unmatured claim is not a claim that can be sued upon and was therefore different to an unmatured claim in a bankruptcy filing. That was 163:16-21. With respect, that doesn't follow. And even if he was correct in the context of the settlement agreement, the context was claims made in LBHI's Chapter 11 plan and the bankruptcy code is the relevant benchmark.

His evidence was that subrogation claims are in effect claims that are originally owned by one person

and then subsequently acquired by another and that was 165:14-15, although he also appeared to accept they are based on pre-existing rights, that was 165:17-21, and of course those two propositions are mutually inconsistent. I will come back to subrogation claims.

Then Prosat. He appeared to accept that the purpose of the settlement agreement was clear in that case in the sense that all other routes to make a claim were released by the agreement other than Shiff's rights of potential subrogation in the event he made a part payment on claim 50 and that was at 178:8-18, and he agreed that the post transaction events in Prosat were quite different from the facts of this case.

He insisted that the opposite interpretation would open the door to abuse, whether or not the abuse was committed, that was said at 183:11-15. And finally in response to your Lordship's question, the judge said that the holding he takes is that subject to exceptions a release in the form of Prosat will as a general proposition serve to release after-acquired claims and he said that at 165:20-25.

He accepted the acquisition of Imagitas' claim against Prosat was against the purpose of the settlement agreement in that case and that was 180:10-18. He didn't like the use of the description "against the

spirit" and preferred the reasoning of Judge Benitez to Judge Alder. However, he admitted that he had not read Judge Alder's decision. He said "I must confess I had not read Judge Alder's decision" at 180:11 to 12.

So where does this leave us? My Lord, it remains a relatively straightforward point. It is not a point that has ever been taken to any party to the settlement agreement including those before your Lordship.

There are three elements.

One, as a matter of ordinary language and the purpose and context, clear on the face of the recitals, the PLC subdebt was not released when LBUKH assigned the claim to LBHI. It simply does not fall within section 8.02.

Two, it is common ground between the experts in the joint report that the New York courts should also consider commercial common sense and that's at D4, paragraph 11 and that militates in favour of our construction.

Three, if your Lordship needs to consider it -- and we say you don't -- then the subsequent conduct of the parties to the settlement agreement, of whom of course Deutsche Bank was not one, all point to the same conclusion. If Deutsche Bank is correct then several UK administrators have made payments totalling about

a billion sterling on claims that had in fact been released.

So going back to the ordinary language, the purpose and intent of the settlement agreement is clear from the recitals. As I have shown your Lordship, it is to settle outstanding issues between the debtors on the one hand, the UK affiliates on the other; they are based on pre-existing facts and pre-existing legal rights and obligations; to compromise intercompany claims that arose out of the global close process; and to avoid unnecessary expense and litigation.

Deutsche Bank do not ascribe any, certainly no sufficient, meaning to the word "outstanding". An after-acquired claim is not an outstanding claim. It necessarily falls outside the scope of the settlement agreement. To support the textual context the evidence more broadly shows that the purpose of the release was to address US/UK intercompany claims that Mr Geraghty said had been the subject of 18 months of disagreement. And Deutsche Bank also take no account of the context of the settlement agreement being the settlement of claims in the US bankruptcy and the UK administrations. They ignore entirely the definition of claims in the US bankruptcy code, they seek to sidestep the reference to the US bankruptcy code in 12.02 and when your Lordship

comes to ask what controversy the parties were concerned to settle between them -- to use language that your Lordship will have seen in the American cases since 1959: what controversy were they concerned to settle between them -- your Lordship should have in mind that they were settling claims in the US estates with the UK affiliates and claims in the UK estates from the US debtors.

The release relates to all causes of action based on facts or matters existing as at the date of the settlement agreement. They are released as at the effective date and compare Deutsche Bank who incorrectly suggest that LBHI have relied on different or inconsistent dates.

The language of the release does not contemplate the release of after-acquired claims. It contemplates the release of causes of action based on pre-existing facts and pre-existing rights and obligations. As the case law shows us, that can -- and as the bankruptcy code shows us, it can include contingent claims or unripe claims or unmatured claims and indeed those claims can be unforeseen. It can be very broad. However, it cannot cover after-acquired claims where there are no pre-existing facts or rights and obligations that bind the relevant parties together. There needs to be

a sufficient factual nexus between the parties to the release and the claim being released to form what Judge Smith described as the jural relationship. And in relation to this we showed Judge Smith, and your Lordship will recollect, the in nexus between LBUKH and PLC -- we must not lose sight of the fact that on the effective date LBUKH held this claim and the lack of any nexus between LBHI and PLC in relation to the subdebt at the time of the settlement agreement.

Deutsche Bank rely on the fact that the three facilities have been drawn down under the PLC subdebt as being the relevant pre-existing facts and that's what they say in their position paper at 31.2, they say it in their skeleton argument at 121, they say it in their oral opening and I'm quoting:

"The PLC subdebt facilities were agreed and utilised prior to the settlement agreement. On the face of it this requirement was met."

That was my learned friend on Day5/9:21-25. So they are relying on the fact that there have been drawdowns under the subdebt agreements. But the pre-existing facts and circumstances in 802 need to be pre-existing facts and circumstances existing between the relevant parties to the release which can form the basis of pre-existing rights and obligations that are the basis

of a release and that is the critical point and Deutsche Bank are wrong. The facts and circumstances cannot be independent and free-standing.

Can I just then address Deutsche Bank's specific textual points. The first point is a broad interpretation of the phrase "In each case that arise from or are based on or connected with, with or alleged in or related to facts and circumstances in existence prior to the date here of", and that analysis doesn't work and I will just give you some quick reasons.

The facts relied upon are the sums advanced under the PLC subdebt, which it is said pre-existed. It is said in their skeleton at 121.2 that any claim in respect of the PLC subdebt arises from is based in, connected with or alleged in or related to facts and circumstances is because the claims are in respect of a debt arising from the sums advanced.

The pre-existing subdebt agreements are not facts that could underlie a cause of action between LBHI and PLC because the facility agreements were between LBUKH and PLC not LBHI and PLC. So again -- I hope I don't labour the point too much, but there's no factual nexus between LBHI and PLC in relation to the agreements. They were agreements between different parties.

The second point is DB's reliance on the broad

wording of "causes of action". Initially Deutsche Bank relied on the words as unmatured and unripe and unknown and they described these in their submissions as "plainly expressions of an intention to release claims that the debtors did not have at the time of the settlement agreement". It was the forward-looking provision argument that they were developing and that is inconsistent with Judge Smith who agreed that accrued/unaccrued and so on referred to actual disputes based on pre-existing facts, future disputes based on pre-existing facts and contingent disputes based on pre-existing facts and that's on page 114 on Day 5. And he also agreed that in each case the releasor does hold that right when the release is granted and that was at 146:23-24.

The fallback from that, since it now appears to be common ground that these are all based on pre-existing rights and obligations, is the reliance on unforeseen and unforeseeable, as the words within the broad definition that equate to after-acquired claims. We have already explained that relying on the state of mind without first finding the existence of the claim or the legal right that gives rise to the claim is not enough, and of course an unforeseen claim is subjectively unforeseen, an unforeseeable claim is a claim that could

not be foreseen, so there is an objective element in that it is impossible to foresee and we had all sorts of examples, 9/11, the Madoff ponzi scheme, the LIBOR rigging, all sorts of things that could be unforeseeable. But it is not the fact that something unforeseeable happened that means you could release a claim. You have to have a claim.

So it may have been entirely unforeseeable to me that 9/11 would have happened, but I haven't released any claims in relation to that unforeseeable event, unless between me and someone -- I mean suppose for example that I was insured on the Twin Towers and I could have agreed, I could have released my insurance company, and it was completely unforeseeable that 9/11 was going to happen and that's an unforeseeable event, but I have to have that legal nexus between me and the insurance company before you start to ask whether or not the event is unforeseeable.

An after-acquired claim is not an unforeseen claim, or an unforeseeable claim and this, with respect to Judge Smith, his evidence was unsatisfactory and inconsistent. He just wasn't prepared to accept the analytical difference between a pre-existing cause of action that had not been foreseen and the inability to foresee a cause of action that might be acquired in the

future and that distinction was part of an exchange on Day 5 between pages 146 to 153 and eventually we moved on, but, with the greatest of respect, Judge Smith's analysis was wrong.

And Judge Gropper said several times in his evidence that the key point is that one can only release claims that are indeed claims of the releasor at the time of the release. You can't release what you don't own. In the context of this settlement agreement, you can't release something that wasn't proveable.

The third point is the deemed inclusion point and this is set out at 125 of the Deutsche Bank skeleton and the argument runs that if a claim is not excluded specifically from a general release, it must be released and as a matter of analysis any rule of deemed inclusion only arises if the claim falls within the scope of the release clause in the first place. It's only then that you can look to see whether or not it has been excluded, so if the scope of the release clause is wide enough to include the claim, then a failure to exclude it might well confirm its inclusion, but if a claim isn't carved out the reason might be that it is no part of the release in the first place and you can't just say "It's not excluded therefore it is included".

The fourth point was the subrogation point. That is

dealt with in 126 to 130 of Deutsche Bank's skeleton and it is self-evidently wrong as a matter of New York law and English law, which is very close to New York law in this respect, but even if it was right it's actually a point against Deutsche Bank and not a point in their favour and let me explain why.

Deutsche Bank argue that a right of subrogation, like an after-acquired claim, it is a claim that the claimant has acquired from someone else. That's their language. And the release clause includes claims based on subrogation. Therefore it must include all after-acquired claims. This is legally misconceived. Under US bankruptcy law, guarantee rights and obligations are not considered to be after-acquired or future acquired claims. The same is the case in relation to subrogation rights and with the greatest of respect to Judge Smith, this is an area where Judge Gropper's bankruptcy expertise was obvious and where his evidence should be preferred and we would respectfully suggest that your Lordship accepts the evidence in the Gropper report on this point which is at paragraphs 49 to 51, on which he was not cross-examined, he was not challenged in oral evidence and that's D1/26 for your Lordship's note.

Now, we showed Judge Smith -- your Lordship will

remember this -- the relevant provisions of the US bankruptcy code which show that unmatured and unaccrued claims, like claims in relation to guarantees, are claims that can be filed in the bankruptcy and of course your Lordship knows it's the same here. He did not appear to appreciate that claims under guarantees operate differently to after-acquired claims. His view is that rights of subrogation are comparable to after-acquired claims, but it is inconsistent with the starting point that unmatured and unaccrued claims are based on pre-existing rights and of course all proveable in the bankruptcy.

So to counter this, Deutsche Bank's final stand is to argue that there is a distinction between pre-existing rights of subrogation, so in other words if you are a guarantor and you have a pre-existing right of subrogation and subrogation claims which only arise when the guarantee has been paid -- okay? And this is the point that was put to Judge Smith in his re-examination, it's the rationale behind the re-examination and it's a bad point.

What Deutsche Bank ignore is that subrogation claims are not subject to the general terms of the release. They are expressly not dependent on when the claim is made -- and I have shown your Lordship the clause. The

question when a subrogation claim arises is the wrong question. Section 802 -- and I don't know if your Lordship would be assisted by just getting it up again, or turning to it.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: It provides in terms:

"Except as explicitly set forth in section 204 ..."

So we've got this:

"... any claims based upon ..."

And it is an "asserted right of subrogation, whether express or implied" and so on. 802 did not turn on the date when a claim was made, it turned on the assertion of the right out of which the claim was based.

A subrogation claim is only included in the release if it arises out of an asserted right and an asserted right can only be a pre-existing right. So what you cannot do with 802 is say that subrogation claims are covered by 802 and that shows you that after-acquired claims are covered and that's the reasoning of Deutsche Bank's argument and it is wrong because subrogation claims are expressly provided for and it expressly depends upon the asserted right. It doesn't depend upon the claim being made and your Lordship will remember the question put to Judge Smith "When is the claim made?"

MR JUSTICE MARCUS SMITH: Presumably -- you say that the use

of the term "asserted" ties in with the point that you referred to a moment ago regarding Judge Gropper's evidence that these claims are not after-acquired claims, they are present claims which presumably, if you don't assert in the bankruptcy, you lose the ability to recover anything, is that right?

MR PHILLIPS: Well, absolutely. They are claims that have to be asserted and of course go back, we're talking in the whole settlement agreement about outstanding claims.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: And so what they're looking at in relation to subrogation is they're looking to where there has been an asserted right of subrogation or indemnification and so on and that just tells your Lordship that it is talking about pre-existing rights that are being advanced, pre-existing rights that are being released and settled.

MR JUSTICE MARCUS SMITH: You say it is a binary position.

MR PHILLIPS: Yes.

MR JUSTICE MARCUS SMITH: That either it's an asserted right of subrogation, et cetera, in which case it is covered by the terms of 802, or it is an unasserted right, in which case it doesn't exist anyway.

MR PHILLIPS: It doesn't exist and it wouldn't fall within 802, but the point is that they rely on this in order to

say it applies to after-acquired claims and it plainly does not work. The subrogation point proves the reserve of Deutsche Bank's arguments because they are based on the assertion of a right, they are based on a pre-existing fact and after-acquired claims are not based on pre-existing facts and that theme runs right the way through this settlement agreement.

MR JUSTICE MARCUS SMITH: Yes, thank you.

MR PHILLIPS: Then, my Lord, Deutsche Bank's fifth point places an unsustainable amount of reliance on the Prosat decision, which we showed to both Judge Gropper and Judge Smith and we went through the facts very slowly because -- and your Lordship has seen it -- you have to go through those facts carefully in order to understand first of all what was being released, what claims were being allowed to continue, in other words the right to make a claim under 41 would arise if a dividend was paid under 50, in order to understand why the court then said that this is against the spirit or against the purpose of the release.

So your Lordship has seen, it very specifically governed the treatment of claims 41 and 50. If Mr Shiff had made his payment under claim 50 that reduced claim 41, he would be subrogated to the rights under 41 and those were the only circumstances in which

Mr Shiff's estate could make a claim on 41. And he released all other rights.

The point was that he then took an assignment claim 41, came along and said "I'm proving claim 41" and they said "I'm sorry, whether it's against the spirit or against the purpose, it doesn't matter, one can see that it is completely against the intention of the settlement agreement and it is no assistance for the simple proposition that very widely drawn releases will release after-acquired claims". And my Lord, in relation to that it will not be lost on your Lordship that this is the only one anyone has found.

So Prosat just doesn't assist on the present facts. And your Lordship will recollect that Judge Smith agreed that the facts are very different from the present case. He agreed there's no question of abuse on our present facts, as there was in Prosat, and the circumstances and purpose of that agreement need to be kept very well in mind.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: My Lord, can I just say something very short then about the commercial considerations. It is a very short point. Your Lordship will have seen that there is a presumption against absurdity, which of course is familiar to English lawyers, and that New York abhors

a forfeiture. The consequence of Deutsche Bank's construction is that LBHI released a claim with a face value of $2 billion for no consideration, which is a forfeiture, and if the court is in any doubt on the construction, it's a point that assists and your Lordship knows that this was put to Mr Geraghty in oral evidence and he was shown our skeleton argument. He quite rightly pointed out that it didn't say that the claim is actually worth 2 billion, he was shown the progress report which did not suggest the claim was worth 2 billion and unsurprisingly, they didn't attribute a value to it because at that time the senior creditors hadn't all been paid. And he was then shown the LBHI accounts and they didn't show the PLC subdebt as an asset and Mr Geraghty agreed and again that's unsurprising. LBHI's primary position in this litigation is that SLP3 should prevail on the LBHI2 application and that affects the money flows to the PLC subdebt. So the value of the PLC subdebt is uncertain.

And, my Lord, this wasn't a point made in the written submissions, taken for the first time in Mr Geraghty's oral evidence, which means that there hasn't been a substantive response to it, but we do no more than use the obvious analogy of claims under a guarantee, or claims in litigation. They are only

ascribed a value on a balance sheet as a matter of general accounting principles when there is a certain prospect of recovery. It doesn't mean that in real economic terms they have no value, that's merely how they are accounted for, and in this context Deutsche Bank dismissed the release as a mistake and a bad bargain, which speaks volumes. Sophisticated parties do not tend to release claims worth several hundred or billions of dollars for no consideration and we didn't take Judge Smith to it, Consolidated Edison at D158, the New York Court said:

"It is inconceivable that sophisticated parties would bargain away such a claim without any monetary consideration."

And that sort of consideration applies here. So my learned friends ignore two things: 1, the parties are presumed to act sensibly; 2, outcomes which would result in a forfeiture are to be avoided. And Deutsche Bank's only response is to reverse the point and to try to argue, contrary to the purpose of the settlement agreement, to leave in place a substantial intercompany liability, and the expression "leave in place", my Lord, is telling because it was six and a half years later when that particular subdebt was assigned up the chain and Mr Geraghty said:

"The difference is that we spent a year and a half working through populations of trades and issues so that that territory was closed. This territory hadn't been opened up yet, that was the difference."

And that was at Day4/113:12-15. So in reality it was no part of the purpose of the settlement agreement to release after-acquired claims, acquired many years after the event.

My Lord, I've got some submissions on subsequent conduct. I'm going to hand up part of the speaking note shortly -- I would like to hand up part of the speaking note and then I will just show you two things, if the interests of time.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: My Lord, your Lordship is seeing the note that I just spoke to, probably rather ineptly, as well as what I just want to turn to. (Handed).

MR JUSTICE MARCUS SMITH: Thank you.

MR BELTRAMI: Can we have copies?

MR PHILLIPS: I know Mr Beltrami is acutely interested in the subsequent conduct arguments on the release and I would hate for him not to see this in its full glory.

My Lord, this was the final point on the release and it is subsequent conduct and just to make it clear, we say this isn't engaged because we submit that the

position is clear, but if your Lordship is in any doubt, subsequent conduct is clear and unequivocal and militates in our favour and I just want to show your Lordship -- if your Lordship skips over the note you will see that we refer to the claims schedule, the STG agreement and the DBB agreement. I just want to show you the claims schedule, which is at F10, at 5821.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: My Lord, this is the claims schedule. This is claims that were acquired subsequently and we say are not released, on which dividends have been paid and what your Lordship can see is you see the assignors on the left-hand side and you see the UK affiliate and then you can see that, on the right-hand side, "Amount paid to LBHI" in respect of the claim.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: And what is of interest is first of all you've got Mable, then over the page Storm, then we get at 11 LB Refinancing, then Lehman Commercial Mortgage and your Lordship sees that there are -- and I added them up and I think I said there were 15 of them, but your Lordship sees that there are individual UK affiliates who have been paying dividends and I just wanted to show your Lordship -- if you can look at 25 through to 32, that's Lehman Brothers Limited, LBL.

Just have that in mind because I'm about to show your Lordship a letter.

Then at 38 to 40 we've got the STG claims, which Mr Geraghty was cross-examined about and your Lordship is aware of the fact that my learned friend cross-examined him about a whole series of others, but she actually got it wrong, but we dealt with that in re-examination.

Then there are a lot of LBIE claims. LBIE is, if you like, the main trading arm in the UK, it's the bottom of that structure chart.

Then at 72 we see LBEL. Then, my Lord, on the last page, 82 to 87, your Lordship sees PLC.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: That's my learned friend Mr Beltrami's clients who have been paying us dividends on assigned claims and your Lordship sees the figures on the right-hand side, the aggregate total, 955 million sterling, 71 million euros-odd, give or take. Those are sums paid on those 87 claims by those 14 or 15, I can't remember -- I got it right first time -- UK affiliates and if my learned friend is right, all of those claims should have been released, they're all after-acquired. So that was the first document that I wanted to show your Lordship.

I just draw your Lordship's attention to the two

points in the note when it says there has never been any assertion by any of the parties to the claims schedule that any of those claims were released upon transfer, that's the first point, and the second point is the fact that they have paid those distributions strongly evidences that they have not been released. And I then want to just show your Lordship one letter.

So, my Lord, when your Lordship comes to look at this you will just see we set out the various arguments in relation to subsequent conduct and we come to LBL and I just wonder if we could look at bundle H I think. If I could just ask your Lordship to turn to page 98, this is a letter from Decherts to Sidley Austin, who is Deutsche Bank's instructing solicitors, and as you can see from the letter, Sidley Austin wrote a letter to Decherts in relation to LBL, so that's Deutsche Bank writing to LBL, and then this is the response:

"Your letter suggests that our clients ought to apply to exclude any LBHI proofs relating to pre-administration claims under 14.11 of the rules on the basis that such claims may potentially have been released and therefore have been improperly admitted."

I showed your Lordship the dividends that have been paid.

"Our clients have admitted paid distributions in

respect of claims made by LBHI in LBL's estate in the full knowledge of the terms of the settlement agreement. In doing so it is evident from that conduct that the LBL administrators did not consider the settlement agreement to have released such claims. On that basis, based on your correspondence to date, our clients decline to interfere in the matter at this time."

LBL, and that's Mr Jervis, they were a party to the settlement agreement, Deutsche Bank raised the point, said "You have to stop paying dividends to LBHI" and that is the response, and your Lordship has seen that LBL have been making dividends to LBHI.

So that's the position of other parties to the agreement.

Then, my Lord, you will see in the note we deal with STG and I don't propose to do that orally. And the third point we deal with is the DBB agreement which actually Mr Geraghty wasn't taken to that point but we have dealt with it here.

May I just say then something about partial release; my Lord.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: If the PLC subdebt has not been released in full, Deutsche Bank run an alternative argument that it has been partially released and that is at

paragraphs 144 to 158 of their skeleton.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: My Lord, that argument was first raised very shortly before the issuance of the PLC application and I can just show your Lordship how it is addressed in the position paper. Can I just show you A8/140 please. This is Deutsche Bank's position order.

My Lord, this paragraph 33 -- and for reasons I'm about to explain, I'm not going to invite close analysis at this stage, but what they say is that:

"If, contrary to Deutsche Bank's primary position, LBHI's claims under the PLC subnotes have not been released in full, Deutsche's alternative position is that LBHI claims under the subdebt in administration are released, discharged or diminished in part as follows ..."

And they refer to Blakely and Amalgamated Investment and they run a point based on clause 7(f) of the subdebt and the point is that the proceeds of enforcement of the guarantee are held on trust.

But anyway, if we can go to our reply which is in 10, and I just want to turn up 210, we deal with -- your Lordship sees paragraph 64.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: We deal with each of those points, explaining

why they are wrong.

The reason why I'm taking that to your Lordship is that in paragraphs 144 to 158 of Deutsche Bank's skeleton argument, the points advanced in their position paper that we respond to here have all been dropped. There's no Re Blakely, there's no amalgamated and there's no trust point, so it's another of those occasions where the case has changed and they have raised two new points for the first time.

The first point, which they describe as a fundamental principle -- and I'm quoting from them -- in the law of guarantees is that a part payment by a surety diminishes the principal debt pro tanto and they rely on a case called Milverton which is a case reported in the Estates Gazette in the 1990s and in fact when your Lordship looks at that case -- because it is a landlord and tenant case -- it was a principal debtor case, so it's not a guarantee and surety case anyway and the reason why the debt was refused is that the construction of the guarantee was it was a principal debt.

So that's the first of the points and of course, my Lord, this principle was so fundamental that they didn't identify it until 11 days before the trial.

The second point is that they do now appear to

accept that Re Saas, which is the case that we referred to in our position paper, is good law. They say it doesn't apply on the facts because we are both creditor and surety and, my Lord, it may be me, but the legal reasoning is very difficult to follow.

So these are both new points and addressed very briefly shortly before the trial and the proper way for us to proceed in relation to those points is for us to hear what they really are and then we will address them insofar as we need to in reply.

My Lord, that then brings me to the discounting issue.

MS TOLANEY: My Lord, can I just rise on that. We obviously have put our case in our skeleton argument.

MR JUSTICE MARCUS SMITH: Yes.

MS TOLANEY: So it is a little surprising to be told that these are new points and they need to be developed orally.

MR JUSTICE MARCUS SMITH: Well, I think the point is that they are new in your skeleton.

MR PHILLIPS: Yes.

MS TOLANEY: But the point is that my learned friend has chosen to go first addressing the points in the skeleton, so if he has no answer that's fine, but if he raised new points in his reply --

MR JUSTICE MARCUS SMITH: Then he won't be able to do that.

MS TOLANEY: Indeed.

MR PHILLIPS: I'm not intending to raise new points, but I would really like to know how my learned friend is putting what appears on the face of it to be an absolutely hopeless argument, but, you know, let's see if she can do better than appears from the written material.

Now, in relation to the discounting issue, my Lord -- and I'm looking at the time -- I'm going to hand up my speaking note, because what we discovered on the discounting issue was 40 pages in the skeleton, including lots of new points, so I'm dealing with it on this speaking note. It is utterly impossible for me to go through 40 pages of largely new material. (Handed).

My Lord, can I just give you the references on discounting to our papers at A5/87 to 90, our reply papers at A10/211 to 215, and our skeleton at 572 to 619, and I hope your Lordship will forgive me if I ask your Lordship to consider what we have written here before my learned friend comes to address your Lordship on the discounting point, which should not be until I think Friday -- it shouldn't be until Friday. I apologise for doing that but I really don't have many options.

So this is the fourth issue and our position is that the quantum of PLC's liability under the subnotes for distribution purposes falls to be discounted under rule 14.44 of the rules and that the effect of that rule is mandatory. I showed that to your Lordship in opening, I showed your Lordship Lord Sumption's judgment in relation to that, and your Lordship will have seen, or may have seen that Deutsche Bank advance a number of counter-arguments, all of which support a conclusion that the PLC subnotes should either: 1, not be discounted at all; or 2, discounted in some other way to that which is proscribed under the rules; or 3, should be entitled to interest accrued after the date of the administration.

So those are the three points.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: So just going through my note, my Lord, if I can just speak to parts of it.

MR JUSTICE MARCUS SMITH: Yes of course.

MR PHILLIPS: I want to turn to the second point because it relates to the maturity date of the subnotes and the fact that the ECAPS holders were fully notified of the risks associated with holding them for such a long period of time. Of all the subordinated debts at issue in these proceedings, the Lehman Group elected to give

the subnotes the most distant maturity dates and your Lordship has seen that: 30 years in the case of each of the series of notes and I refer to the Group presentation where it says:

"30-year subordination debt is issued out of UK SPV ...(Reading to the words)... preferred securities to fund the purchase."

Each series of the notes was issued with a 30-year maturity date as envisaged in the presentation and I am actually just going to turn up the subnotes in a minute. The initial point to note is that the 30-year maturity date was an intentional feature of the notes and Deutsche Bank is now suggesting that the notes should be treated as if they were presently due, which is entirely at odds with a key feature of the notes, which is their maturity date. And, my Lord, as your Lordship knows, the ECAPS were issued as perpetual preferred securities and your Lordship has condition 4.1:

"The preferred securities have no final redemption date and holders have no right to call for the redemption of the preferred securities."

And, my Lord, your Lordship may recollect that there was a discussion about what would happen when the subdebt got to their end date because there were then going to be replacement securities and the investment

considerations acknowledged the risks:

"The preferred securities no fixed and final redemption date, no right to call for the redemption of preferred securities, holders should be aware they may be required to bear financial risks ..."

And so on.

So despite having no rights even to redeem the ECAPS, Deutsche Bank is now suggesting that it should be entitled to compel the early redemption of the subnotes. So you've got perpetual ECAPS, the ECAPS holders have no right to redeem and they now argue that they should be entitled to compel the early redemption of the subnotes. And your Lordship sees the way in which they do that.

Can I just remind your Lordship of the offering circular which is in tab 9 at 124 and it is not a difficult point to spot and we see it in all of them:

"Subordinated notes due to 2035."

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: "Unless previously redeemed they will be redeemed by the principal amount on 30 March 2035."

That's what one sees at the start. The offering circular makes reference to redemption at the offer of the issuer, subject to FSA approval, and your Lordship -- so:

"The notes may also be redeemed at the option of the

issuer. The issuer may not redeem or purchase any notes prior to their maturity date unless the FSA has given its prior consent."

And then, my Lord, the one I wanted to just look at was condition 6, just to turn up condition 6, "Redemption and purchase". My Lord, I'm not going to go through all the details, but what condition 6 does is it deals with the various circumstances in which the PLC subnotes might have been redeemed and those circumstances are carefully defined and of course they don't fall into it at this point.

Then, my Lord, if I can go on in my note to paragraph 1 of the global note and again it's the same:

"The issuer promises to pay on 30 March 2035 or on such earlier date as the principal amount in respect of the global note may become due under the conditions."

So your Lordship sees this was all 2035, subject to specific redemption points. And just to make the bald points which are in my note at 12: PLC is subject to an obligation to redeem the notes at their full principal value at the maturity date in 2035, that is the date on which the notes become due. Redemption under condition 6(c) is carefully defined and circumscribed. FSA permission is required to redeem after March 2010, but ahead of the maturity date and there is no provision

permitting noteholders to accelerate the subholders. The noteholders remedies are limited -- and this is not unusual -- to instituting proceedings for insolvency. That is their remedy. They can institute proceedings for insolvency. They don't have a right to accelerate the PLC subnotes.

I'm sorry that is slightly compressed.

Then, my Lord, your Lordship will remember the 2016 rules and the rules set out in detail how future debts fall to be discounted in an administration. I showed it to your Lordship, I don't intend to show your Lordship again. The subnotes are quite plainly future debts. Their quantum for distribution must be discounted in accordance with the rules and with respect to my learned friends, it is impossible to read those subnotes as being anything other than future debts that mature in 2035.

My Lord, I mentioned this in opening, that Deutsche Bank accepts that if the subnotes are properly treated as future proveable claims, which is what they are, discounting is unavoidable. So if they are future proveable claims discounting is unavoidable.

I won't take your Lordship to the rules again because I showed your Lordship most of those rules, but 14.2 which is on paragraph 16, which deals with what is

proveable -- and I don't know if you still have my little red book, but we can read it from --

MR JUSTICE MARCUS SMITH: I do.

MR PHILLIPS: 14.2:

"All claims by creditors, except as provided in this rule, are proveable as debts against the company whether they are present, future, certain or contingent, ascertained or sounding only in damages."

Does your Lordship see that?

MR JUSTICE MARCUS SMITH: I have that, yes.

MR PHILLIPS: And then it identifies in 2 the not proveable exceptions. Does your Lordship see that?

MR JUSTICE MARCUS SMITH: I do.

MR PHILLIPS: And 14.2 and also 14.23 and then 14.4:

"There are debts that are not proveable until all other claims off creditors have been paid in full with interest."

And under (b):

"In administration or winding up a claim which by virtue of the Act or any other enactment is a claim the payment of which is to be postponed."

So it is clear that postponed debts are proveable debts, it is clear that future debts are proveable debts and a classic example of a postponed debt is a sum due to a member of a company in his character as a member by

way of dividends and so on.

So it is significant, my Lord, that in paragraph 253 Deutsche Bank concede that:

"But for the subordination provisions the claims would be proveable."

We know that they are proveable, we just know that they are proveable at a particular time. We get that from the Supreme Court, we get that from Waterfall I. And your Lordship will see from 14.2 there is no statutory exclusion based on whether or not a debt contains a subordination provision. Provided you have a debt, the debt is proveable. Unless the proof is excluded or postponed under 14.2, which this isn't, none of those categories apply.

And then we get to 14.44 which I have read but while your Lordship has got it, it's always worth just turning over to it:

"Debt payable at a future time."

It is the key provision, it provides:

"Where the creditor has proved that for the purposes of dividend and no other purpose the amount of the admitted proof must be discounted applying the formula."

Three points: it is engaged whenever the creditor has proof of the debt; LBHI submits in relation to the ranking issue GP1 is entitled to have its proof admitted

at the same time as LBHI's proof for the subdebt and they rank pari passu; and a debt falls within 14.44 where it is a debt of which payment is not due at the date of the declaration of a dividend. That's how it works. That is the relevant question, so the relevant question isn't whether or not payment is due at the declaration -- sorry, the relevant question, as your Lordship sees from the note, is whether or not payment is due at the declaration of the dividend. And the third point is that you have discounting.

Can I just show your Lordship Nortel please because we haven't look at this yet. It is in A5 and it is at 118. This is Nortel in the Supreme Court and if I can just tell your Lordship that the question was whether or not a potential liability on the issuing of a financial support direction fell under 1312 of the insolvency rules, which is then the equivalent of rule 14.1 and the distinction is between "subject to a liability" or "may become subject". But the point was that you could have an FSD, which was a financial support direction, issued by the pensions regulator and the question was whether or not that was proveable and it would only be proveable if it was a contingent debt and that's the question and the Court of Appeal had come up with this wonderful concept of a black hole into which non-proveable

liabilities fell and that was completely disabused, the world has been disabused of that particular canard. But I just want to show you a couple of paragraphs. 72:

"No doubt the liability which is imposed on a target ...(Reading to the words)... by reason of any obligation incurred."

So in order to be a proveable debt it has to be a liability arising -- for the purposes of contingent liability it has to be arising by reason of an obligation incurred before.

74:

"The issue thus centres on the meaning of the word 'obligation' ...(Reading to the words)... number of different meanings and nuances ..."

And so on. And what they addressed is that the nature of the obligation under the pensions legislation was sufficient pre-existing obligation to make it a contingent liability and therefore proveable. That's what the ratio was all about.

Then I just want to look at 76. This is in Neuberger, where he says:

"Where the liability arises other than under a contract ..."

And we're going to look at what Lord Sumption said about contracts:

"... the position is not necessarily so straightforward."

Actually I should pick it up at 75, sorry:

"Where a liability arises after the insolvency event as a result of a contract entered into by a company, there is no real problem."

And the reason for that, my Lord, is there is a legal relationship between the parties as a matter of contract, so when you're asking "Is this debt proveable, is it a liability proveable in the insolvency?", the first thing that Lord Neuberger says -- and I'm going to show you Lord Sumption as well -- is where it arises as a result of a contract there's no real problem and of course the reason why I'm relying on that is the obligation under the subnotes arises on a contract. So:

"The contract insofar as it implies any actual or contingent liabilities on the company can fairly be said to impose the incurred obligation. Accordingly in such a case the question whether a liability falls within (b) will depend on whether the contract was entered into before or after the insolvency."

And the same point -- and this is 131 -- and this is Lord Sumption, Lords Mance and Clarke agreed with Lord Sumption, and 131:

"The paradigm case of an obligation within the

subparagraph is a contract which was already in existence before the company went into liquidation. It is implicit in the argument of those who contend on this appeal that there is no proveable debt in this case that contract is not just the paradigm case but the only one."

That's the paradigm case.

"When one asks what it is about a contract that qualifies, it is as a relevant source of obligation. The answer must be that when a subsisting contract gives rise to a contingent debt or liability, a legal relationship between the company and the creditor exists from the moment the contract is made and before the contingency occurs."

So that's the reasoning and your Lordship will be interested to note, if you look at this again, paragraph 93, you get the thread of policy being to reduce the number of non-proveable liabilities over time, so over time you can see a history in which non-proveable liabilities have been reduced.

But the important point is that the decision in Nortel is the end of Deutsche Bank's argument that the claim on the subnotes might be non-proveable. That submission is impossible. It arises on a contract, your Lordship can see the contract, it is a contract to

pay in 2035. It is a contract for a future debt and there are no two ways about this. Sorry to be quite so blunt: there are no two ways about it.

I just want to show you bundle 6, again going back to Waterfall I, because my learned friends -- and Waterfall I was in 146 and if I can go back to 70 to 72, your Lordship will remember we have looked at this in the context of the contingent debt analysis and why Deutsche Bank got very excited is because of paragraph 71, because in paragraph 71 what Lord Neuberger said is:

"On the face of it at any rate it seems a little strange that a proof can be or has to be lodged for a debt which ranks after statutory interest which can only be paid on a surplus and non-proveable liabilities."

So just pausing there, my Lord, as your Lordship knows there is a waterfall and what the waterfall has within it is of course statutory interest is only payable when there is a surplus and then there are the non-proveable liabilities which need to be paid and where one has got subordinated debt -- and your Lordship knows which subordinated debt they were looking at here -- that subordinated debt on its terms, as they rightly found, comes afterwards. So you have the

ranking of the subordinated debt coming after the non-proveable debts and the statutory interest, but it doesn't prove until after the two of them have been paid because of the terms of the statutory interest and so what Lord Neuberger then says is "Well, that might seem a bit strange" and one can understand that point as far as it goes because he then -- but this payment point, in other words that you get paid after the statutory interest and the proveable debts, the ranking point does not effect the provability point and what Lord Neuberger then said is he said:

"It may be that the proper analysis is that the subordinated debt is a non-proveable debt which ranks after all other non-proveable liabilities."

And he says it is unnecessary to decide that point as it was not argued, and it was not argued and rightly not argued because what he is doing is -- and your Lordship gets the point immediately, it's not argued and it's obiter and we can obviously make those points -- he raised the question because of the, if you like, commercial oddity of the subordinated debts coming in underneath the interest and the non-proveable and that is a consequence of the subordination provision, but what your Lordship has seen is subordinated debt isn't in a nice category within the rules, it is

a contractual function that provides that the subordinated creditor can't prove until after certain other people have been paid. The fact that those other people who are entitled to be paid includes the interest and the non-proveable debt might at first blush seem a bit odd, but that's a function of the contract and it's a function of the ranking. The ranking is unchanged.

It does not mean that it becomes a non-proveable claim, because a non-proveable claim is very limited, your Lordship has seen it under the rules, and it is not and cannot be a contract. Your Lordship has seen from Nortel it cannot be a contract. That's the paradigm case. So what you can't do is you can't sort of operate this by reverse reasoning by saying "You get paid at this point in the waterfall, there are non-proveable claims that get paid above you in the waterfall, ergo you must be a non-proveable but subordinated claim". That was the question Lord Neuberger threw out in his judgment. It hadn't been argued. Had it been argued I have little doubt, and no doubt frankly, that that would have been pointed out to Lord Neuberger, but he didn't have the benefit of argument about that, and that obiter comment goes no further than that. It is a -- well, I don't know if one should describe something said

by the President of the Supreme Court as amusing, but he raises a question arising out of what you might think is an unusual consequence, but to say that the debts are not proveable would be wrong.

So I just remind your Lordship on page 13 of the note that I showed your Lordship Lord Sumption referring -- he was referring to the foreign currency conversion claims and that's where he said where the insolvency rules deal expressly with a matter in one way, it is not open to the courts to deal with it in a different and inconsistent way and that is a very important principle, particularly in relation to all of these arguments.

So our case on discounting is straightforward. First of all, they are debts, they entered into a contractual relationship; secondly, they are proveable debts under 14.2; third, they are future debts that fall within 14.44 and it follows that they need to be discounted -- and this is mandatory -- they need to be discounted in accordance with the formula in 14.44.

I'm just going to show your Lordship, we then go on to deal with Deutsche Bank's skeleton and we identify the propositions: first they make the contention the PLC notes are presently due; secondly they make a contention they are not due but should be made to be presently due,

I will explain that; and third they say they are non-proveable liabilities, I have dealt with that; and distinctly they make a number of points on future interest which I'm going to come to at the end.

In relation to the presently due arguments, the various arguments that they make are hopeless. They are absolutely hopeless, I'm sorry. They're based on contorted constructions of the subnotes and the acceleration provisions and then they go on to say that they accept that you could obviously read 6(c) more narrowly and as only concerned with contractual redemption outside an insolvency; well, yes, and that doesn't work, so we can put that to one side.

Then we deal with the various -- we actually deal with that argument at some length. I don't need to go through that now. It doesn't work.

Then they go on to an implied term, an implied term that the amounts payable become immediately due and payable in their full face value amount in circumstances where PLC has entered into a distributing administration. Well, as an implied term one can imagine that logically, if that was right, you would be implying that all over the place in relation to future debts. It doesn't meet the relevant test.

Then we get on to the ex parte James and

paragraph 74 arguments. This is always the last refuge of the desperate, frankly. The line of argument is to say that if the PLC subnotes can't be construed to be presently due or be automatically accelerated on entering a distributing insolvency, PLC's joint administrators -- that's Mr Beltrami's clients -- ought to be directed not to treat the liabilities under the subnotes as future liabilities. They say that in 244 in their skeleton. They say in particular:

"It would be unfairly prejudicial or unfair for the administrators to take advantage of these legal rights in the circumstances of the case."

I do say it is a remarkable submission, we do say that, and I'm not going to take you to Nortel now, but that sort of argument was run in Nortel, the ex parte James "It would be unfairly prejudicial for everyone to act in accordance with the rights under the contract", and I will just say this, because we have it in our note: at all three levels of Waterfall I, the courts confirmed that you discount the future debts and your Lordship sees that at all three levels. There is no unfairness in discounting future debts for the purposes of dividend and that is not surprising because that's what the rules provide. It's expressly provided in the rules. The court can't be asked to say "That's

all terribly unfair and therefore I'm going to do something different", that's precisely what Lord Sumption said that we can't do.

Then in our note we go on to deal with non-proveable liabilities and I think I made the points that we make in relation to Lord Neuberger, although I didn't do it at this point, but I think, my Lord, you've got the point. Which brings me to future interest.

So can I go to future interest?

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: I think we're good.

Deutsche Bank's final contention is that if the PLC subnotes are treated as a future proveable debt, then it has a claim to prove for future interest.

MR JUSTICE MARCUS SMITH: Yes.

MR PHILLIPS: And our position is that this possibility is both dealt with and precluded by the terms of 14.2 and I think I ought to open those, 14.2. 14.23. There is a mistake in our note, this is 14.23 that deals with interest. My Lord, I did read this to your Lordship but this really is important to have in mind. 14.23(i):

"Where a debt proved in insolvency proceedings bears interest, that interest is proveable as part of the debt, except insofar as it is payable in respect of any period after the relevant date."

So future interest is not proveable. That's what the rule says.

The PLC subnotes are debts which bear interest, your Lordship has seen that. The interest on them is proveable as part of the debt up to the date of the administration, but not thereafter and the reason for that is that regardless of whether a debt is interest-bearing or not, for the period after an administration interest is payable, statutory interest is payable under 14.23(vii) at the judgment Act's rate of 8%.

My Lord, the legal concept behind all of this is very straightforward. An insolvency involving distribution -- it is as simple as this -- notionally takes place at a single moment. Notionally all the assets are realised, all the debts then receive their distributions notionally, the rights are all assessed at that one moment, and so the right to interest runs up to the date of the administration but thereafter you get paid interest at the judgment debts rate. And, my Lord, it is also worth noting that if Deutsche Bank is right and is entitled to prove the contractual future interest, in the event of a surplus it would also have a claim to statutory interest on that future interest, so that if they prove for future interest and we get to

statutory interest being payable, they would be paid statutory interest on the sum that has been admitted for future interest. They would be paid the statutory interest and that would, with respect, be nonsensical.

So we say this is an instance where the 2016 rules deal expressly with the matter, the treatment of an interest-bearing debt, and where Deutsche Bank is asking the court to depart from unambiguous statutory provisions and your Lordship has seen Waterfall. And then Browne v Wingrove, they rely on a 19th Century case, Browne v Wingrove -- and I'm not going to turn it up, but they rely on this case as establishing the position prior to the insolvency rules 1986, to the effect that interest on a future debt was treated as being proveable, but as that case made plain there was no settled statutory provision dealing with up future interest at that point in time.

Your Lordship sees that it was a rule of practice and Deutsche Bank properly concede that's the case and the Court of Appeal noted the relevant statutory provisions didn't include references to the mode of dealing with interest after the date of the receiving order.

The point that we make in our note is that by contrast, 14.23 is not a rule of practice. It is part

of the mandatory rules applicable to all proved debts regardless of whether they are future or present debts and it is not possible now to adopt a judge-made approach which came into being -- that approach came into being at a time when there was no statutory provision preventing proof for future interest, so there is now no gap in the statutory scheme for judge-made law to fill.

So we then deal with the question of "bears interest" and we respectfully submit that the argument that it should be treated as limited to interest on debts which have fallen due is just wrong and their approach is contrary to Waterfall IIA and we just referred to this, David Richards held statutory interest, under 288.7 of the rules, ran from the date of administration and he reasoned that interest on future debts could only be proved up to the date of administration and, my Lord, we set out the quote there and we refer to Waterfall II which agreed with David Richards and what the Court of Appeal said:

"At first sight it is an attractive and persuasive argument ...(Reading to the words)... and on which there is no appeal."

So Deutsche Bank then come on to a list of policy and general fairness arguments and in particular the

central claims are that Browne v Wingrove was not criticised in the Cork Report in 1986 and I'm sure your Lordship is familiar with this, but in 1986 -- the 1986 Act followed on from the Cork Report and the fact that Browne v Wingrove wasn't criticised is frankly neither here nor there.

A cursory consideration of the legislative history of 14.23 and 14.44 is fatal and I just want to just track through this. Deutsche Bank's approach simply chooses to ignore the fact that the 1986 rules plainly had the effect of codifying the law in such a way as to depart from the Browne v Wingrove approach to future interest and replace it with something different. The starting point of course are the 1986 rules. 4.93 of the 1986 rules was in materially the same form as 14.23 which we have looked at and provided that where a debt proved in the liquidation bears interest, that interest ask proveable insofar as payable in respect of any period after the company went into liquidation. So it must follow, if Deutsche Bank are right, that 4.93 was restricted to presently due debts such as to permanent proof of future interest.

Then we look at 11.13 which provided for the discounting of future debts. That was the "then" provision, the formula later amended to correspond to

14.44, but there was an additional provision as to future debts and we set this out:

"11.13 provided other creditors are not entitled to interest out of surplus funds any creditor to whom 1 and 2 apply has been paid the full amount of his debt."

So the discounting -- there's a catch-up before you got paid interest, that was the point:

"The future creditor had a catch-up right to be paid the full undiscounted amount of his debt prior to the payment of statutory interest."

So the approach in Browne v Wingrove which permitted the proof of future interest didn't subsist after the insolvency rules, one can see it did not subsist, and instead you had a stand-alone catch-up right and there can be no suggestion that 4.93 was to provide the future creditor with both a catch-up right and the right to prove for future interest.

The stand-alone right -- that right was criticised by Lord Millett as he then was in Park Air and following Lord Millett's criticism there was a great deal of excitement all around the insolvency legal market, as it were, amendments were made to 11.13 which included the deletion of 11.33. So the effect of the deletion was that future creditor became entitled to claim statutory interest and David Richards confirmed that in Waterfall.

So the catch-up goes, statutory interest comes in and that's what was done.

So Deutsche Bank's case necessarily requires the court to accept that the deletion of 11.13(iii) had the effect of altering 4.93(i) of the rules because there was no right under 4.93(i) for a future creditor to prove a future interest when the rules first came into force given that there was a stand-alone right and that went, and what we say in our note is the notion that the deletion of 11.13(iii) in and of itself altered the original meaning of 4.93(i) is unsustainable. The decision to delete 11.13(iii) conferred on the future creditor the right to statutory interest. So they lost the catch-up right and they got the right to statutory interest and what my learned friends want to say is that they can prove for the future interest, keep the right to statutory interest and then of course they have lost the catch-up right, but what we say is in view of the legislative history of how future creditors' claims have been treated since the 1986 rules there can be little doubt that 14.23 of the rules, like its predecessor 4.93, applies to all interest-bearing debts, including future debts, only permitting proof of interest up to the date of the insolvency and not thereafter, there is mandatory discounting under 14.44,

there is a right to proof for interest under 14.23, there is no right to proof of future interest, there's no catch-up right, the position is clear.

So having considered this analysis, the new points in Deutsche Bank's skeleton are either obviously wrong or irrelevant.

That was a very long-winded way, I'm sorry, of saying the answer to this question is, Lord Sumption, he said we do what we're told in the rules and then the application of two rules, 14.44 and 14.23, that apply to discounting of future debts and the provisions as to interest.

My Lord, those are our submissions.

MR JUSTICE MARCUS SMITH: With two minutes to spare. Well done, Mr Phillips. Well, thank you very much.

Mr Beltrami, you will be on at 2 o'clock, is that right?

MR BELTRAMI: My Lord, thank you, yes.

MR JUSTICE MARCUS SMITH: We will resume at 2 o'clock.

Thank you very much.

(1.00 pm)

(The luncheon adjournment)

(2.00 pm)

Closing submission by MR BELTRAMI

MR JUSTICE MARCUS SMITH: Mr Beltrami.

MR BELTRAMI: My Lord, can I indicate we hoped to have a note for your Lordship. It is still in preparation and will be overnight, but we hope to have it by tomorrow morning.

MR JUSTICE MARCUS SMITH: Thank you very much.

MR BELTRAMI: Which will at least act as a record of I hope of what I have said this morning and will assist for tomorrow as well.

My Lord, as you are aware I appear in two roles in the applications, neutral in the PLC application and as a subordinated creditor on the LBHI2 application for the benefit of the estate. Just one point to flag on the PLC application, I mentioned in oral opening and Mr Phillips mentioned this morning, that bit of the Deutsche Bank case that the administrators be compelled to redeem the notes early because otherwise they would be acting unfairly and as I said in opening, obviously we will abide by the order of the court and are neutral on that. The only issue to mention is that it has been raised that there may be -- I simply say this in the abstract because it hasn't been looked into. A question has been raised whether there would be -- that may be a better way of putting it -- some tax consequence if the administrators redeemed early 700 million euros of notes. That hasn't been looked into. I'm not saying

there is or isn't such a consequence.

MR JUSTICE MARCUS SMITH: You're simply raising the --

MR BELTRAMI: The money hasn't been spent to find out. Only to say if that were where we ended up on this application I would ask for some time just to look into that in case it were relevant, but I thought I would just flag it as an issue.

MR JUSTICE MARCUS SMITH: Thank you.

MR BELTRAMI: Beyond that, my Lord, as far as the LBHI2 application and the appeals to the application are concerned, the applications are distinct and different and must be considered separately, even though of course both raise priority issues.

Now, my learned friend sought to bring them together effectively as a single issue in opening, I think in closing too he referred to what he called the "juniority construction" as if it were, if you like, a single point, and it is certainly correct that he is facing arguments in both applications that his clients are more deeply subordinated than the competing creditors, but otherwise we submit the issues of construction are distinct and need to be considered separately, specifically as far as the LBHI2 subnotes are concerned. Those are the only instruments drawn under the GENPRU regime, ie outside the standard form. They have,

we say, materially different wording to both the PLC subnotes and the PLC subdebt and of course they were then amended. So it's a different question.

Now, we have no strong views. I think your Lordship raised the question at the end of last week as to the order in which your Lordship addresses the questions, but that's entirely a matter for your Lordship, but they all need to be addressed and what we say is important is that they are addressed separately.

MR JUSTICE MARCUS SMITH: I understand.

MR BELTRAMI: One word -- and not wanting to cause any heat about this but just to mention it -- on the witnesses. Only four witnesses gave evidence relevant to, or primarily relevant to the LBHI2 application: Ms Hutcherson, Mr Grant, Mr Miller and Ms Dolby. There were limits to the admissibility of their evidence and we will deal with some of that in a minute. They largely sought to assist the court, to the extent able and there's no question about it. The only issue to mention and we don't think this is going to matter once one looks into the issues, but we do suggest that it would be appropriate to have some caution in relation to Mr Grant's evidence. The case doesn't turn on it and it may never need to be mentioned in your judgment. However, he had been shown large chunks of the skeleton

arguments, slightly unusual for a witness, and he appeared to us at least, at least sometimes, to be concerned to argue the case or to defend his position. In a sense nothing unsurprising about that because the background to some of the arguments are a criticism of Mr Grant and possibly a significant criticism of Mr Grant and therefore it is unsurprising that to some extent he sought to defend his position or what he thought was the defence of his position.

It does mean that some of the things he said -- all I'm saying is you need a little bit of caution.

Three examples. He refused to accept that preference share ranking came below debt ranking as a general proposition even though I think everyone else agrees, that was I2, page 128 to 130. He sought to emphasise in his witness statement and orally that it was a winding up not an admin that was being referred to but he then accepted that he just copied the wording from somewhere else. And he was pretty adamant in his witness statement and orally that he intended to preserve the status quo, which is all very well and we will have to look at that when we get to the rectification argument, but the reality was, and I think as he conceded, he had no idea what the status quo was because he hadn't found out about the existence of the

subdebt.

So all that needs to be taken with a little bit of caution is all we're saying about that. I don't think ultimately it will matter for the judgment but some of that needs to be viewed through those spectacles.

Last point just by way of introduction. My learned friend made some comments yesterday, I think mainly yesterday, of a forensic nature about cases changing and evolving and we didn't -- as far as PLC are concerned we don't essentially agree with that, if it matters, but two points to mention just at this stage of what we say are some pretty significant evolutions, if I can use that word, on my learned friend's case. It goes to the rectification argument which we will deal with I suspect tomorrow, but the two highlight points I think of change are first -- at least as I follow it -- a suggestion that there is a special rule about intention in the case of amendments, a novel argument we say in terms of it wasn't appearing before, novel in terms of there's no law about this that there is such a special rule, but anyway, as I understood the argument there's a special rule about amendments and when the court is asking the question about intention, there's a different question to ask in relation to amendments as opposed to ordinary contracts. That was, we say, a significant change and

we will deal with that tomorrow.

The other significant change and it goes to rectification, is that the actual decision-maker, according to Mr Phillips this morning, was Ms Dolby. Now, that's a change and it it's not an immaterial change because all the way until this morning the actual decision-makers on my learned friend's case were expressly Ms Dolby and Ms McMorrow, so there were two of them allegedly the actual decision-makers and today it has changed just to Ms Dolby. And it's not an insignificant change. As your Lordship is aware, there is a technical cause of action and one has to be rigorous about the analysis all the way through and the fact that a change can be made such as that without any indication of why or any heralding about it may suggest to your Lordship that the rigour for other bits -- we will have to go into all that, but we say that's material.

Last point just on rectification in advance, your Lordship discussed with Mr Phillips this morning about whether a smaller amendment could achieve what he says would suffice and your Lordship will remember it has been our position throughout that one of the problems with this case, apart from anything -- there are many problems, but one of the problems is the

amendment sought is a massive axe which could never be justified because it is just far too much. It doesn't correspond with the facts.

If my learned friend wishes to try to amend that -- we will have to have a discussion about that if he does -- but we don't believe that any amendment is possible consistent with his case theory, ie one starts and one stops on whatever it was, 5 June and everything else is unauthorised and therefore unintended. So if he is going to change his case, if he is going to suggest that a narrow amendment -- we will look at it, but if that requires a change of case, again we will have to consider that.

So that's just a sort of prefatory observation about rectification.

MR JUSTICE MARCUS SMITH: No, I understand, and in one sense it is a somewhat unfair task that I'm not sure I necessarily set Mr Phillips in this point. It just seemed to me that there was a logical gap in the submission that he was making and the excision of these 30 lines which I wanted to explore, but it does seem to me quite difficult to require Mr Phillips -- if he wants to produce something, by all means, but to require him to produce a rectification to the 30 lines, in circumstances where I haven't yet ruled as to whether

the construction favours him or doesn't, and if so why it doesn't. It's actually quite a tall order to rewrite those provisions now.

So it seems to me it's more a question that I need to bear in mind when considering the overall rectification case, that it isn't a case where 30 lines must go, as I think Mr Phillips came close to accepting; it's a case where something, but an unarticulated something, needs to be adjusted and it was simply to clarify my thinking that I made the point.

So I'm not necessarily expecting --

MR BELTRAMI: No, no.

MR JUSTICE MARCUS SMITH: -- an amendment from Mr Phillips. If he wants to produce one of course I will look at it, but it does seem to me that it was more a question of how I should see the overall remedy that was being sought in this context.

MR BELTRAMI: My Lord, yes, I wasn't demanding -- I was only trying to explore the fact that as I understand the case, one draws a line after what we call the first draft, because the first draft does interest deferral and everything after that line was unauthorised and unnotified and needs to be rectified and that's the case that's being presented for the court.

Now, if the answer to that is, hang on a minute,

that produces an answer which looks a bit odd, then there is a problem with the case theory, but I don't want to spend a lot of time on that now. We have more on the list of issues to deal with.

MR JUSTICE MARCUS SMITH: Yes. Well, you have put your finger on authorities being another --

MR BELTRAMI: Yes.

MR JUSTICE MARCUS SMITH: -- difficult question, particularly in the light of Mr Grant's evidence.

MR BELTRAMI: Yes.

MR JUSTICE MARCUS SMITH: Where you went through the purposes of the Allen & Overy review and he agreed that there were three or perhaps four objectives that he had in mind, one of which, but only one of which was the deferral of interest.

MR BELTRAMI: One of which was the deferral of interest, yes.

MR JUSTICE MARCUS SMITH: But there were others.

MR BELTRAMI: Your Lordship is -- we can maybe look forward to that or otherwise tomorrow I suspect.

MR JUSTICE MARCUS SMITH: I'm grateful.

MR BELTRAMI: Now, my Lord, what I have is a number of topics which I hope will be matched when you see the speaking note, topic number one anyway, and there are some if you like discursive point in a thematic basis

before we get on to the issues.

The first issue as we see identified is the negotiability of the subnotes and therefore the limited admissible relevant factual matrix, because we have a dispute about that. That appears to us the key outstanding area of dispute on the law of interpretation.

We say the factual matrix for the subnotes is limited because these were publicly listed negotiable instruments. The relevant audience was wider than just the Lehman Group and the critical question, as we said in opening, is the objective characterisation of the notes which were expressly created as negotiable instruments.

Now, your Lordship has seen the notes many times but just to highlight this point, if you go to bundle E4, page 50, objectively and on their face these were plainly written as tradeable notes. The first page identifies them as issued in definitive form to be listed on the Channel Islands Stock Exchange. If you go to 54, clause 2:

"Form, denomination, title and transfer ...(Reading to the words)... should be achieved."

58, paragraph 6, how to pay the noteholders. Page 60 -- I will come to clause 12 on a different point

later on, probably tomorrow, provisions for the meetings of noteholders and the qualified majorities for noteholders and in fact it is two-thirds to agree what's called a reserve matter, all of which clearly anticipates there will be noteholders who are separate and who need to have meetings.

And 65, provisions about taxation including clause 3, taxation information for individuals.

There was also -- we can put that away and if you go to bundle F4, at page 2257, which is the accompanying procedures memorandum for how the notes were to be operated, so 2258 is the certificate, or the certificates held by the noteholders. 2259, the provisions for transfer. 260, detailed provisions for the meetings and again majorities, et cetera, and how that should happen in the meetings, and 2266, these are provisions for the registration and transfer of the notes.

So all the way through the documents, as will be expected, they anticipate on their face transferability and provision amongst a class of noteholders.

Now, we say that's the appropriate and relevant evidence. As far as the law is concerned, if you go to bundle 5 please, authorities 5, 112, which is Cherry Tree Investments which is in connection with the

factual matrix of a registered charge, so the facts are different, but Lord Justice Lewison analysed those cases which limit the factual matrix by reason of the negotiability and if you go to 125 just below letter F, having gone through all the cases:

"In all these cases the justification for the restrictive approach ..."

That's factual matrix restrictive:

"... is that third parties might ...(Reading to the words)... extraneous material."

And we say objectively these were drafted on the basis that third parties might well need to do so.

We say it is an error, as we submit in opening, for the court to answer this question by reference to this subjective intention of parties at the time. That's inconsistent with the objective approach. Your Lordship suggested that there was a parallel with Street v Mountford, which we have produced. Can we maybe hand that up into the bundle. (Handed). There is a supplemental bundle of authorities. Maybe we can put it into the back of that.

Your Lordship will recollect it is the definitive case about lease or licence depending on the terms of the agreement and a specific factor in that case, as you can see from the headnote on page 809, is that the party

concerned -- at the bottom of the page -- signed a declaration to the effect that she understood the agreement didn't give her a tenancy. So she had given a, if you like, subjective statement of her views, but that didn't cut much ice.

If you go on to 826 at letter F Lord Justice Slade in the Court of Appeal was:

"... impressed ...(Reading to the words)... give me a tenancy."

But then the answer to that from Lord Templeman at letter H:

"The only intention which is relevant is the intention demonstrated by the agreement to grant an exclusive possession for the term of the rent."

That may be the bit your Lordship had in it mind. We say the only intention which is relevant here is the intention demonstrated objectively by the documents, not by anything else.

My learned friend went to a decision of Mr Justice Briggs in Excalibur which is bundle T4 -- we don't need to turn it up -- T4, tab 98. In that case the judge reduced the factual matrix when the relevant audience was outside the Lehman Group in respect of notes which were in fact used as security for third party lending, so we don't understand how that gives

rise to a support for a suggestion that subjective intention is a relevant enquiry. It's certainly not what the judge said in that case.

But in any event, the evidence wouldn't support my learned friend's case anyway, in particular your Lordship will recollect the evidence of Ms Hutcherson that there were teams of people within Lehman examining tax and regulatory developments and conditions and amending the structure to respond accordingly and in particular there was no commitment to the FSA to maintain the May 2007 structure. When we asked her that -- this is bundle I/2, page 36 to 37 -- whether this was fixed in stone or whether it was a matter of commitment, she said:

"Answer: No, we would never have -- we didn't commit to something being permanent and forever because we knew it would change."

Ie the conclusion from that is any intention at the time was no more than a present intention, in circumstances in which there was every chance that that intention would change and as soon as you start construing contracts on that basis, you get into obvious difficulty because your approach to contractual construction changes depending on when the intention changes in the future and that simply can't work and

that's why subjectivity doesn't come into it.

Your Lordship will also recollect on the detail of that if your Lordship still has bundle F4 -- you may have put it away -- 1883. This was the preceding letter to the FSA about the Liberty Hampshire transaction which didn't actually happen, two weeks later they moved to a different structure, but it was sufficiently advanced for them to tell the FSA they were going to do it and under that structure, as your Lordship may recollect, 1887, the idea was that $725 million of the bond was going to be transferred to the newly created Luxembourg company, Luxembourg Finance, who were going to be financed by Liberty Hamphire and I put it to Ms Hutcherson and fair do's she didn't know the answer, but we would suggest it is inconceivable that that transaction could happen without the bond being given as security for Liberty Hamphire. The Luxembourg company was stated to be a newly formed company. Liberty Hamphire wouldn't be lending a billion dollars on an unsecured basis, they would be doing so on the security of the note.

So it's an example of a potential structure, not a actual structure, where even though the note wasn't transferred out of Lehman it was used out of Lehman and relied upon by third parties, which is a similar sort of

transaction to Excalibur.

So it can't possibly be said that there were no conceivable circumstances in which these notes could have been available to third parties either by transfer or security, because that wasn't the case of exactly what they were contemplating in that transaction.

So we say subjectivity doesn't come into it, but if it does the evidence doesn't support it.

The question is what difference that makes to your Lordship's task. The most likely difference, as we see it, is in respect of the background history of the internal funding, in particular that the subnotes were used to replace the subdebt. We say that shouldn't be part of the factual matrix for the court because that piece of the story would be unknown to a relevant audience.

What the relevant audience would know is explained in bundle E, tab 4, page 63, where there is a statement as to the use of proceeds and the statement is:

"The net proceeds of the issue of the notes ...(Reading to the words)... general corporate purposes."

That's the external story about these loans. There's no external story about the repayment of subdebt, the terms of the subdebt, whether it was

replicated or not replicated. That's behind the curtain in terms of the objectivity required.

That's not just, if you like, a pure construction question because it also goes to how the issue is framed for the court. The way my learned friend has framed the construction issue on the pre-amendment the position, the way he put it in the written opening, 3355, was whether the language of the subnotes altered the status quo, the status quo being pari passu under the existing subdebt and in closing he said -- this was bundle I, tab 6, page 5 -- that my client needs to show an alteration in the ranking.

It was also suggested, built onto that, your Lordship will recollect, that there must be a clear indication to depart from the original pari passu and I will come on to the pari passu bit in a minute, but at the moment I'm just framing the question and at bundle I, tab 6, page 5, he says:

"Answer: There is no clear and unequivocal language to effect a change."

Now, because of the right approach to factual matrix, that is the wrong question. It includes an inadmissible assumption that the questioner knows about the pre-existing history of the Lehman debt. The only relevant question for the court when approaching

pre-amendment and also later on post amendment, is what do the words mean. There's no loading of the question on the lines of "Do these words change something else?" because the something else is not part of the factual matrix.

Similar issues arise when your Lordship gets on to the amendments. My learned friend in closing yesterday, which is I/6/112, said relevant material for that question are the board minutes and the Allen & Overy letter about the purpose of the amendments. But again maybe in terms of the rectification argument, we will have to come on to that, but in terms of the construction argument the same factual matrix issues arise. The internal mechanics and intentions of the parties, whether written in a document or expressed orally, are not part of the factual matrix of determining the issues of construction with which your Lordship is faced.

There is also -- I will just mention it -- so that's what he said. The factual matrix on the subnotes is limited because of the tradeability point.

There is also a further question which in a sense goes beyond the tradeability point which is that from time to time my learned friend goes beyond what's admissible on any view. So even if the relevant

audience is just within Lehman, you still can't include evidence of subjective intent. And laced through the written material and the oral submissions every now and again are things about what Mr Miller thought or what Ms Dolby thought or whatever and all of that may be relevant for rectification but doesn't become relevant for construction.

So it is limited. I'm conscious that for some of the issues I'm going to deal with I fall into the trap of referring to some of that evidence too. All of it is with a caveat, if you like, that when the question comes it's a narrow legal question, but obviously as it is a bit of a free-for-all and the way some of the arguments are going to go and we have had the evidence, I can draw it to your Lordship's attention, so I'm riding that horse too.

So that's the first issue, the admissibility of factual matrix given the instruments concerned.

The second issue is the limited relevance, we say, of the regulatory background in the forms. As far as regulatory background is concerned, we say, as we said orally in opening, it is admissible but of little relevance for the issues for the court. It is clear on the evidence there was no regulatory requirement to layer subordinated debt, but equally there was no

regulatory prohibition against the layering of regulatory debt and the reason for that, at least as explained by Ms Hutcherson, was that it was irrelevant to the FSA from a regulatory capital adequacy point of view because what they were concerned about was that customers and clients got paid first and that was who they were protecting, but in any event the rules didn't provide any such prohibition.

In any event, all of the instruments on their face allowed for the potential layering of subordinated debt, so the question as to construction is whether they did so. That question has to be answered on the terms of the instruments rather than what the regulations did and didn't require.

Now, allied to that question -- that's a broad issue -- is the reliance continually placed by my learned friends on the regulatory forms and you will recollect -- I read it out in opening -- my learned friend's case that each of the relevant instruments was based on or related to an existing standard form or precedent, but the evidence shows the subdebt was required to follow the form and subject to Ms Hilliard it may or may not have done so but that's no part of my case. The subnotes however had no precedent under GENPRU.

Mr Miller's evidence was that he started with the PLC subnote as a base document. Your Lordship will remember that at F9/5250. That was a document which was based on FSA 10 because that was the document for which a waiver had to be obtained through the FSA IPRU regime. So he started with that document but he then heavily amended it. We don't have to go back to it but there were significant amendments throughout, in particular clause 3 which was almost entirely rewritten.

He was unable to identify the source of the amendments, but, as I think we had a discussion, I'm not sure it would be particularly relevant if he did because it only begs the question as to what the source means. But what is clear, as I think my learned friend accepted, it wasn't FSA 10 or indeed FSA 5. So that wasn't the source of his amendments to the PLC subnote which then created the LBHI2 subnote.

His evidence in fact was that sophisticated parties saw GENPRU as the opportunity to move away from standard forms, so in a sense it was a deliberate choice to move from standard forms and his evidence in his witness statement was the need for flexibility. So the idea that you ought to be guided by the standard forms when this document didn't follow the standard forms and the draftsmen specifically intended to move away from

standard forms we say doesn't stand up.

To be clear, and if it matters and if looked at objectively, the subnotes -- and unsurprisingly given what we have just discussed -- the subnotes do not replicate the standard forms. Can you just look please at bundle J2, tab 18, 1007. These are the former IMRO forms which became, as I understand it, form 5 -- is that right? Anyway, this is the form 5 being put forward.

Your Lordship will see, 1009 has a definition of senior creditors. The wording isn't the same as the wording in the subnotes and in particular -- and we just flag this and we will come back to it in due course -- the definition of senior creditors under (b) is:

"Subordinated creditor to the borrower other than those whose claims are expressed to rank and do rank ..."

It may seem a little bit pernickety at the moment but if you can just note the word "and" because you will see that's a difference and apparently important difference when we look at the LBHI2 subnotes.

And 111 there's a solvency condition which is 7(b)(i) which your Lordship see just glancing down bears no relation to the solvency condition that we're concerned with in the LBHI2 subnotes.

So the FSA form I is not just moved away from by Mr Miller but as a consequence of that is not a relevant ancestor to what we have.

So in the light of all that evidence we say there's no relevant link between the subnotes and the standard forms. There's no assistance to be gained therefore from the standard forms and the exercise of the court is to be conducted in the light of the wording in fact adopted.

The same point just to mention in passing about bundle K, about which not much time has been spent. We have always been unclear as to what use was intended by these documents. They weren't adduced by any witnesses, they weren't put to any witnesses, they obviously weren't relied upon at the time by any draftsman. They just seem to be other instruments which my learned friends have obtained from the market. Not a promising start for a probative document, but in any event again the wording of those documents does not replicate clause 3 of the LBHI2 subnotes. There are bits that are similar and bits that are different. So we say that doesn't help your Lordship either.

So overall when deciding the pre-amendment question you are not going to be assisted, we say, by the FSA forms and clearly post amendment is of no relevance at

all because the amendments were, on Mr Grant's evidence, a bespoke solution.

And in any event -- I think I made this point in opening -- even if individual clauses on their own had standard meanings, which they don't, the question would still arise as to what they mean when matched together because the question for your Lordship is how do they mesh together given the formulation of the two and that was a point expressly made by Lord Neuberger in Waterfall I. So that's the second issue about the regulatory background and the regulatory forms.

The third issue, again something we discussed orally in opening but we need to go back to, we say there's no relevant extra-contractual principle that can resolve the priority issue, so we maintain the case all the way through that this is an issue of contractual construction and that's at least in part extra-contractual construction which seeks to obtain the answer through the Insolvency Act pari passu principle can't work. Now, it seems to be common ground, as I understand it, that -- well, certainly we accept that if instruments merely subordinate to some other debts and don't deal with their position inter se, then they are likely to be pari passu inter se. Either -- there is a question -- we don't have to deal with it -- either

through the Insolvency Act or through some implied term in the contract. But if they're not, if the contracts aren't complete then pari passu may have a role to play.

All parties accept that the parties are able to agree to subordinate their debts below others and that the court will give agreements effect. There was a distinction in oral opening about agreement to rank below or agreement to rank above which is said to be important. I don't think any point is made about that because there is no suggestion here that if on the true construction of these instruments the subnotes are subordinated to the subdebt, it's not an effective agreement so that's not an issue.

Now, it is clear also, we say, that when parties do agree to subordinate their debts then the pari passu rule is displaced. Sorry, when they agree to subordinate their debts inter se, the pari passu rule is displaced. I think you have had mention but not actually looked at Golden Key. Can you go to authorities bundle 3, tab 83. It is paragraph 3 to 6 of Lady Justice Arden's judgment. Paragraph 3 begins with the pari passu rule equality and equity but then quotes from Cox v Bankside, Lord Justice Peter Gibson, paragraph 4:

"The fairness ...(Reading to the words)... express

or inferred."

And then paragraph 5:

"Pari passu provisions are commonly found in debentures."

And then some discussion about that. Last sentence:

"Such an implication is now however possible ...(Reading to the words)... should be on some other basis."

Now, my learned friend said yesterday that the submission I just made, which is that the pari passu rule is if the parties agree otherwise is wrong because he said you never disapply the rule, you are simply deferring your contractual right to prove and that was yesterday, I, tab 6, page 65. It is important, we say, not to be diverted by irrelevant distinctions. If there is a contractual subordination then the pari passu rule is disapplied as against the debt to which you are subordinated. That's the point of the subordination. So you are disapplying the rule against the debts, against which you are subordinated, ie in respect of the priority dispute in question and in respect of the priority dispute before the court, the pari passu rule is, we say, contractually disapplied.

Now, it may be true that once that issue has been worked through the pari passu rule may come back when

the subdebt is able to prove. At that level, yes, it hasn't gone for good, it hasn't been forgotten, but it can come back when you come to prove against the debts against which you are pari passu. That is technically accurate but uninteresting and wholly irrelevant on the facts. If the parties here agreed to subordinate their debts they were not pari passu between themselves because they displaced the pari passu rule. If it's of difficulty for the other side I'm not saying it disappears forever; it disappears as far as relevant.

So the consequence of that we say is that the pari passu rule has a role only in gap filling, ie where the contract runs out, ie where the parties haven't agreed their ranking inter se.

Now, we had always understood and in fact still do understand, at least in part, my learned friend's case is the contract has run out on his case because that's why he says you get the answer in the rule. As we said orally, that is erroneous because these contracts don't just provide for subordination against unsecured creditors, they provide exhaustively for ranking against all debts, including debts inter se, hence that's why one has to engage the process of construction to see what the answer is on that contractual question. You don't do it, stop and then apply pari passu.

Now, in closing my learned friend said that his case isn't that the contract has run out, but I think what his case is is that somehow the contract imports pari passu, so you get to pari passu not formally through the pari passu rule but through contractually the application of the pari passu rule, let's put it that way. So I think he is saying it comes within the contract, so it is not extra-contractual.

As we understand it, this argument has two stages, or maybe two separate elements. The first is the contention that the pari passu rule applies unless the contract says something different, so it's an emphasis point and it's the justification for the suggestion that the contract must be in the clearest of language, the high threshold, so you start as a default with pari passu and therefore you are looking into whether there is a contrary expression to disturb pari passu. That was the way it was put yesterday, tab 6, page 27.

We say that isn't correct, it's not supported by any case law, that one approaches a contractual subordination provision by a starting position of pari passu and asking whether there is sufficiently clear to displace that. There is no such rule of construction. We agree if the contract doesn't deal with the position, pari passu may be the answer, but as

the contract on its face purports to deal exhaustively then there's simply no default to begin with. There's no room for pari passu. There's nothing to be disturbed because the parties' agreement itself determines the matter exhaustively.

So the first way it is put is that you start as the default rule and ask is it really strong enough to displace that rule, we say is the wrong way of looking at it. The question is what does the contract purport to do and if the contract purports to rank differently then that's the answer.

The second part of the argument, I think, is to try to extract value from the word "or" in the subnotes. Can you go back please to bundle E, tab 4, page 55. What you will no doubt remember is that in the definition of senior creditors in the middle of page 55, it is:

"Subordinated creditors other than ..."

We know all that:

"Those whose claims ...(Reading to the words)... the claims of the noteholders."

So the argument is "Well, you look at the contract and you focus on the word 'or'", there's a disjunctive here. So you can either express to rank pari, or you are just be pari and if you just be pari then you don't

need to express pari and therefore because you can be pari under the Insolvency Act, you can be pari for the purpose of that definition. This doesn't work either as a matter of contract.

First, on our interpretation, as we have made absolutely plain throughout, the answer is found in the express words. So you're not into the "or" anyway, you're always into the express words and we say the express words give you the answer. So you never get to this alternative, if it arose.

But putting that to one side, the mechanism we say can't work because of course these have to be mutual because we're looking at the documents together. There's no corresponding mechanism in the subdebts. If you go back to the subdebt, which is at tab 1, as we know there's nothing at all about pari in relation to other instruments, but more significantly, on page 7, in relation to the definition of excluded liabilities the wording is differently expressed. So liabilities were expressed to be:

"... and in the opinion of the officer to rank junior to subordinated liabilities."

So the "or" in the subnotes definition as far as there is anything in the subdebt is an "and" in the subdebt and of course "and" is a very different

formulation which doesn't work for my learned friend because it has to be both express and rank as opposed to express or rank and if it can't fit into the subdebt on his analysis it can't fit into either, because they have to work together.

So the focus that he now has on the word "or" doesn't get any traction if there's no corresponding "or", which there isn't, in the subdebt.

Now, a third separate question, what is meant by the word "or" in the subnotes? We don't know and it may be just an error -- it's not, as we saw -- that's why I showed your Lordship it -- in the FSA Standard Form 5. So the purported half source of this document doesn't have the word "or", it has the word "and". So that's not the source. And equally FSA 10 doesn't have the word "or" in it. So quite where it comes from we don't know.

It is also very difficult to give any real meaning to it because if "or" means a disjunctive qualification, you have two competing qualifications in this clause, so it is unless you are expressed to rank pari, or you do rank pari. So you have competing qualifications with no resolution as to which takes priority. What if you are expressed to rank pari but were different, or you didn't express to rank pari but were pari? What's the answer?

If it's "or", how can you have a competing qualification.

It would also mean that half the language here would be redundant because the language "expressed to rank pari" would be completely unnecessary if you are by default ranking pari anyway. So that would be meaningless because you wouldn't need to in any circumstance "express to rank pari" because you could always rely on your "or rank pari" as well.

So it doesn't appear to work in practice in terms of two qualifications. If it does work it doesn't make any sense because it has concepts which don't actually operate. That's why we think it is probably an error, for what it is worth.

Insofar as we can give any meaning to it, and we're trying our best, or try to find some logical way it might be said to work, is that it might refer to, or might be said to refer to, if there were such a thing, a mandatory rule. So one could have, in theory at least, a mandatory overriding rule, essentially: no matter what you say, this debt will be pari, or this debt will be junior. So we know that there are some regulations, for example, I think under GENPRU, or maybe under IPRU, that tier 1 had to be over tier 2 or whatever it is, but there could in theory -- I'm not

saying there is such a thing, but I'm trying to postulate what this could possibly work for. If you had a mandatory rule that said, for example, tier 2 debt must always be below tier 3 debt or whatever -- there isn't but one can speculate as to how this could work -- then in those circumstances I think you could find -- or you're getting close to finding some meaning in those words. So ie no matter what you express, if by some mandatory overriding rule the answer is X then the answer is X. I don't know. I'm just trying to work out some way, if one has to find some possible meaning for what may well be a mistake. That's a possibility.

But what it wouldn't accommodate we say is pari passu because pari passu is not a mandatory overriding rule, it's displaced by the contract. So it doesn't override the parties' statements, it only works if the parties don't make a statement.

So whatever way we cut it we say it's a very odd word. It doesn't work with the subdebt. It looks as if it is probably a mistake. If it works at all it might work for a mandatory overriding rule but the pari passu rule isn't one of those because the pari passu rule is subject to the parties' agreement, not notwithstanding the parties' agreement.

So that's what we say about that. That's why we say

that doesn't, notwithstanding their best endeavours, provide an answer to this.

So next topic. The implementation of subordination. Because it is important to understand, because of the way the arguments have been going, the contractual process by which subordination is achieved and I took your Lordship in opening to Lord Justice Lewison's three categories in paragraph 38 of the Court of Appeal judgment in Waterfall I, which was we say -- and we will have to look at this again -- an uncontroversial statement of the different mechanisms which are adopted to create subordination, and in particular through a solvency condition which imposes conditions on payment.

Now, my learned friend says, his Lordship will recollect, that Lord Justice Lewison's analysis was disproved, but we disagree about that. The issue in Waterfall I was not about the mechanism of subordination, ie how do you do it, but about the consequences of subordination as regards proof in an insolvency and in the specific context of the agreements in that case in fact as well. So it is not how to do it, but what happens when you have done it and they are different questions.

So sadly can we start at bundle 5, Mr Justice

David Richards, which is bundle 5, tab 123, paragraph 15. The issue in Waterfall I, or as far as relevant the issue in Waterfall I, one can see from paragraph 15. The two categories of questionable claim in the waterfall were numbers 5 and 6, unsecured proveable claims and statutory interest, and the question was whether those ranked above the subordinated debt or below the subordinated debt and if you go to paragraph 18 at the bottom of that page, the wrinkle, or at least one of the wrinkles -- if you go over the page, still in the paragraph at letter C, is rule 2.887 of the insolvency rules for the payment of that statutory interest and if you look at rule 7 as set out:

"Any surplus remaining after payment of the debts proved shall before being applied for any purpose be applied in paying interest on those debts."

So the wrinkle was on the face of it the statutory interest claim would come only after payment of the debts proved and that's why the proving issue became relevant because when you immediately see the argument which was put on behalf of those claiming on the debt, which is if the subdebt can be proved then they get ahead of the statutory interest under that rule.

Now if you go next to paragraph 54, the issue was in connection with subdebt agreements at the levy level but

pursuant I think to FSA 10. Under paragraph 54 one of the clauses in the subdebt agreements, which we haven't had to look at here, is that -- 54, this is clause 7, subclauses (d) and (e):

"The lender undertook not without the prior written consent of the FSA to attempt to obtain repayment of any of the subordinated liabilities otherwise than in accordance with the terms of this agreement."

So there is a clause in the subdebt agreement not to attempt repayment without the prior written consent of the FSA. We will just bear that in mind in a minute.

If you go to the arguments, at 57 there is an argument as to whether the statutory interest was a liability, we don't need to worry about that.

At 59 the argument came in about 2.88 and you can see just above letter C those claiming the debt:

"They submit that liabilities mean ...(Reading to the words)... statutory interest is to be paid."

So we can see the argument: we can prove our debt therefore statutory interest must come after that. This is why can proving became an issue in that case.

The court is not concerned with the mechanism of subordination, but with the technical question that falls within 2.887 and therefore when you can prove debts.

If you go on to 68 to 69, the way it is disposed of:

"I do not consider the terms of 2.88 and section 189 ...(Reading to the words)... paragraphs (d) and (e) of clause 7."

So the way Mr Justice Richards got round, if you like, the 2.887 issue was that there was a contractual preclusion by reference to clause 7 which meant they couldn't do it.

Now, before we go any further can I ask you to go to bundle F9, and page 5250, which is Mr Miller's amended version of the PLC subnote which then became the PLC subdebt and if you go to 5258, in the middle of that page at section 4 there's a heading "FSA provisions". This was the bit that came from IPRU 10 that was in the subdebt that was the determining point in Waterfall, but was crossed out. So you can see the provisions here corresponding to 7(d) and (e):

"... need the consent of the FSA to set-off ...(Reading to the words)... any security, guarantee or indemnity ..."

Et cetera.

The original IPRU forms had this clause about needing the FSA consent to do things. Subnotes didn't. But the FSA consent provision, as we just saw, was the reason why Mr Justice David Richards found that

paragraph 2.88 of the insolvency rules didn't create a problem.

Going on if we can to the Court of Appeal, which is tab 129, clause 38 we looked at and we say that was simply looking out the ways that agreements can be drawn in order to achieve subordination. Not saying anything at this point about the Insolvency Act consequences, just saying this is how you do it. You can do it through three methods. My learned friend said he uses the word "contingent" in his category 2 and that's a term of art. Well, it may be but it's also a word and the word connotes the fact that there's a condition and there's a condition both in his category 2 and his category 3.

That's what he is setting out, but if you then move on -- that's 38. If you then move on to 39 he deals with the proof point. There's no express provision on the subordinated creditors lodging a proof and if you go over the page:

"The judge considered clause 7(d) and/or clause (e) ...(Reading to the words)... clause 7(d) says that ..."

He says what it says. His conclusion is that's not the answer. So he says, as regards 2.88 and the consequences, he doesn't think clause 7(d) provides the answer, but the answer instead is at 41 provided by

Mr Snowden, as he then was, which is: don't have to worry about that because you can still prove but a value at nil and therefore that gets ranked, 2.887.

So it's nothing to do with the mechanism as explained in 38, it is the Insolvency Act consequences once the mechanism is engaged and what he decided was you can prove after that mechanism but valued at nil. Then when you get to the Supreme Court, which is bundle 6, tab 146 -- I don't know, I wasn't in this case, but it doesn't seem as if 2.88 got much airtime. Certainly it's not very much in the judgment by this stage for whatever reason, I don't know, maybe it was, maybe it wasn't. But there was an issue, and it looks to have been an independent issue by this stage, before the Supreme Court. If you go to paragraph 37, about that question of when you prove. No doubt it was a relevant question in the administration and therefore it was raised as a separate important question as recorded at 37, Mr Justice David Richards' decision which we looked at and then letter G:

"The Court of Appeal entitled to prove at nil."

And 38 there is an issue as to when you can prove. So the parties have raised that issue. It is still a live issue following the Court of Appeal decision.

When you then get to the analysis of Lord Neuberger,

this is why it looks like a separate issue by this stage. If you go to 64 he has made his conclusion on priorities. So the priority question appears to have been answered at that stage but at 68 he then addresses the separate and independent question when can LBHI2 lodge a proof. And just to make the obvious point, he is not saying "What are the mechanisms for subordination", he is talking the specific Insolvency Act question of when you can lodge a proof and what he says there, he disagrees -- we looked at 68. At the bottom of that paragraph he expressly refers to Lord Justice Lewison's paragraph 41, which is the "when can they lodge a proof" point, without making any reference to 38 and when he goes to the next paragraph, 69, if you go about four lines from the bottom -- he disagrees with Lord Justice Lewison:

"As David Richards J said that would appear to fall foul of clause 7."

So it looks as if what Lord Neuberger is doing is agreeing with Mr Justice David Richards that the answer is actually in clause 7 of the subdebt agreements and that's why he concludes at 72:

"I would restore paragraph 1 of the order made by David Richards J ...(Reading to the words)... assuming they can prove."

So as far as we can see, the issue before Mr Justice David Richards, the Court of Appeal and as determined ultimately by Lord Neuberger, turned on the application of clause 7 of the agreement which we don't have.

MR JUSTICE MARCUS SMITH: Yes, I see.

MR BELTRAMI: It may be, Mr Phillips may say -- and he may be right, he may be wrong I don't know -- that there is some more general proposition being made here, even without clause 7. Looks a bit strange when he refers to clause 7 but it may be said there is some general proposition. But in any event, it's a proposition about how you can prove a debt. So it's an Insolvency Act question, when can you prove, and it is important no doubt in many administrations or insolvencies to have that answer. But none of that touches the question as to how on earth you subordinate the agreements to begin with and that's what Lord Justice Lewison was talking about: how can you do it?

So we say Lord Justice Lewison's three categories are frankly uncontroversial, helpful, but even if that were wrong we still struggle to see where this is supposed to go. As I understood Mr Phillips, what he would say is "Well, because category 2 means you can't prove a debt, it must have been a category 3 agreement", ie to -- which was, if you remember -- shall we go back?

I don't want to misstate the position. If you go back to authorities 5. It is tab 129, paragraph 38, simply saying there are three mechanisms for achieving subordination: you can do it by trust, you can do it by conditional contract, or you can do it by an agreement to defer proof:

"Contractual provision precluding the subordinated creditor from proving insolvency of the debtor until all other creditors have been paid."

He says: there you are, that's what, through the Insolvency Act lens, is the consequence of this agreement. Well, we say that's an unfair characterisation of the sequence of the cases, but even if it were right there's a very large "So what?" to all that. We know there was a solvency condition in the agreement, we know that's what, we say, effected the subordination. If the consequence was they were deferred from proving as opposed to they could prove for nil, fine, that's not a question for your Lordship. The question for your Lordship is how do you do it in the first place? And we say you do it by introducing -- or they did it here by introducing a conditional agreement and both 2 and 3 are both conditional agreements of course, because 2 is conditional insolvency here and 3 is conditional to all the other creditors have been

proved, which is actually a condition as well.

So the consequences of the Insolvency Act, we say, are irrelevant to the question. The important outcome of all those cases is there is a recognised method of contractual subordination by rendering payment conditional in insolvency. That's I think all I need to get from that. That's what Lord Justice Lewison said, no one said he was wrong and there's nothing to believe that he was wrong.

In any event -- and this is where I am conscious to some extent tripping over admissible questions albeit probably relevant for rectification -- that's consistent with the evidence of Mr Miller and Mr Grant.
Mr Miller -- because we asked both of them about that -- he agreed that a solvency condition is a method to achieve subordination. That was bundle I/2, page 145 to 149. What he said in fact:

"Answer: It puts it behind the layer that you want to put it behind."

So that's the method of doing, that that's all we're trying to get out of this evidence and we say that's clear in it terms of ranking.

Equally Mr Grant, I, tab 2, 118, is to the same effect, that it is a method to achieve subordination. And indeed the problem, if there was a problem in 2008,

the problem that created the further amendments to clause 3, as Mr Grant accepted, was that the solvency condition was the mechanism for achieving subordination, so when it was removed there was a subordination problem and that's bundle I/2/117. He says in terms if the solvency condition was removed it wouldn't have included a mechanism for that subordination to be effective. And that's what we're trying to focus on, not what the Insolvency Act consequences are, but that the solvency condition is the method to make subordination effective and that's completely consistent, we say, with both of those witnesses' evidence.

The significance of the mechanism is it is what makes the subordination effective, but also it enables the calibration at the level of subordination desired. In very simple terms, the more debts that are included in the solvency condition, the deeper the subordination. That's how you do it. That's the first evidence we say on the initial draft mechanism.

The second mechanism to achieve subordination -- and we can maybe stop after this one.

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: Is to specify that a debt is payable at preference share level. And again, both witnesses agreed with that as a mechanism to achieve

subordination. Mr Miller -- I/2/142 -- and you will remember his email of 17 February which is F1/176 where he refers to that as a benchmark, to exactly the same effect as Mr Grant's evidence -- I/2/118 to 119 -- he referred to it as a reference point. So it is a benchmark or a reference point and he said it is a common tool to rank the subordinated claims by reference to a preference share.

So as with a solvency condition, it's the means to effect subordination with the ability to calibrate the level of subordination which is desired, depending on where to set the benchmark. So Mr Miller's email wanted it ultra subordinated, you set the benchmark low; you want it not so ultra subordinated, you set it high. Your Lordship will remember, we looked at it several times, that was the technique applied for the ECAPS guarantees which ranked them at preference share level.

Now, my learned friend said in opening the detailed terms of the guarantee set it out more specifically and they did but the concept was the same. The concept was exactly the same, not making them preference shares but ensuring that they ranked equally to preference shares was the concept used in the ECAPS and we say is the concept used in the amendments. So both those mechanisms or each of those mechanisms are adopted. One

in the original form through the solvency condition and one in the amendments through the mechanism of preference share ranking. And that's how we say in each case the subordination was achieved.

My Lord, is that a convenient moment to stop?

MR JUSTICE MARCUS SMITH: Yes indeed, Mr Beltrami. We will rise for five minutes.

(3.14 pm)

(Short Break)

(3.22 pm)

MR BELTRAMI: My Lord, my fifth topic is the solvency condition itself, having I submit established that the solvency condition is a method to effect subordination it is appropriate to see what that method achieves. So it is bundle E, tab 4, at page 55 and it is in two different clauses. In clause 3(a) there's the solvency condition and the terms of the condition -- and this fits in with some other point about payability which we will deal with later -- is that "until the condition is satisfied no amount shall be payable". So the mechanism in 3(a) is to impose the solvency condition which precludes the payment of any sum.

And 3(b) then defines the word "solvent" under two tests and before looking at the tests, the consequence we say of the solvency condition is that until the tests

can be satisfied no payment can be made under the subnotes which means that all other payments which are not subject to the same tests must be paid before the subnotes and that's the mechanism of subordination through such a conditional clause.

As I say, when I say "payment" I'm not taking any issue about when you prove, when you don't prove and all the rest of that, it is when any sums shall be payable.

Now, the two conditions, clause 3(b), are what might be called a cashflow test and a balance sheet test in (i) and (ii). Our focus is on the cashflow test, all the debts as they fall due. We know that doesn't come from any FSA standard form, it is very close to the Insolvency Act -- not quite the same words but very close to the words in the Insolvency Act, section 123.1(e) and our case is that that means all of its debts and therefore unless and until the issuer is able to pay all its debts then nothing is payable on the subnotes and therefore even now therefore whilst there is a deficit it is not able to pay all the debts as they fall due and therefore nothing is due on the subnotes and there's no question of pari passu sharing because the aim and effect of a subordination provision is to effect subordination and therefore the solvency condition we say operates precisely as it was intended

to do and as objectively it does do, which calibrates the level of subordination of the debts subject to it and it calibrates these debts at the bottom.

Now, that test contrasts with the corresponding test in the subdebts which is at E1, page 10. Because under E1, page 10, clause 5.2, there is -- sorry, clause 5.1 has the similar conditional solvency test or mechanism and clause 2, the definition of solvency is a single test. It is a bit of a hybrid test I think between cashflow and assets, it may not really matter. But it is a single test in any event, but the important difference is that for that test, whether it is cashflow or assets -- it's a slight hybrid -- excludes certain things. So it excludes subordinated liabilities and excludes excluded liabilities. So it's a different sort of test, not of the comprehensive nature we have seen in the subnotes.

So it is engaged only for so long as there's a deficit against unsubordinated liabilities because everything else gets excluded from the test. And therefore if there's a surplus over unsubordinated liabilities, sums are payable on the subdebt and therefore the solvency test is calibrated above we say the double test in the subnotes.

At one point Mr Phillips said "Well, PLC's argument

differs depending on where you start", well it doesn't differ depending on where you start, because for both of them you have to go back to see what the other one says and the difference wherever you start makes it plain, we say, that there's a solvency test which is different and it's more comprehensive and deeply rooted in the subnotes than in the subdebts.

One can see this, if this is for a minute -- excuse the forensic point. If you go to bundle B, tab 7, my learned friend's helpful comparative table of the various provisions in support of his symmetry argument which I will address in a minute. If you go to internal page 5 there's a comparison between the solvency conditions in the two instruments and they have helpfully in bold put the bits they are seeking to draw attention to because they look kind of similar and the bits unbold not, but you can see that the difference is that they have bolded in subdebt language "pay its liabilities" and bolded in notes language "Pay its debts". One can immediately see they are entirely different, because pay its liabilities then has other than subordinated liabilities and excluding the excluded liabilities, whereas pay its debts has nothing of the sort.

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: So whilst the bits in bold look a bit similar, the actual context is entirely different. So I think that's a forensic point, but just to for one minute.

MR JUSTICE MARCUS SMITH: None the worse for that, Mr Beltrami. But going back to E4, page 55 then, we have as you say the use of the word "debt" not defined in the instrument.

MR BELTRAMI: Not defined, no.

MR JUSTICE MARCUS SMITH: I think according to what Mr Phillips was saying in terms of the interaction between (a) and (b), you are obviously right there's a nexus between the two and (b) feeds into (a), and we see that from the opening words of (b). I think that to put Mr Phillips' point neutrally, he was suggesting that the definition of debt -- which obviously I have to find -- was coloured by the statement of purpose in 3(a) and he made a great play of the use of the "and accordinglies" in line 4 and 6 and is it your case that I simply have to construe debts as its natural English word, it is a debt that is presently due; if it is a debt that's presently due that's it and I don't need to effect any narrower definition. Why is it though that I should leave out of account the as it were expression of purpose in 3(a)?

MR BELTRAMI: Well, my conclusion certainly is your Lordship

should give it its actual meaning.

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: The answer to the point that Mr Phillips raised we say is that it enables the two clauses in fact to be read as a coherent whole and in fact it is for the purposes of condition (a) and it enables and gives sense to condition (a).

Can I take the three points I think that I made -- at least I have summarised the three points, which I hope then will address your Lordship's question. But to be very clear I don't simply say one looks at it as debt in isolation and that's the answer. It is the way the clause works as a whole and in very short-form we say that the words "Its debts" informs the rest of the clause and enables the rest of the clause to work.

Now, there are essentially three arguments -- or at least I put it down in three ways, so if I can maybe deal with it by reference to my note about that.

The first was that what the court is really concerned with, or what the contract is really concerned with is the first bit of 3(a). That was called the dominant language at some point and I think it is the key provisions at some point. So that first bit, it is said, are statements of subordination to senior creditors and therefore you have to go there and

interpret the word "its debts" at that point. And therefore in effect what they say is that the solvency condition can't change the subordination which is already printed into the beginning of clause 3(a) in the definition of senior creditors.

Now, we say that can't be right because it fails to give effect to the clauses. Now, take this in stages. First of all it is wrong to divide up bits of the clauses and say "Look this is dominant, that's dominant", one has to view it as a whole. Nevertheless, even if that were a right exercise, we would say -- and this is one of the reasons I laboured the Lord Justice Lewison point -- that the dominant provision, if that's the right starting point, would be the solvency condition itself, because that is how the subordination is achieved, ie it is the conditional subordination which creates the subordinated debt, and that is also -- I don't think you have looked at this -- consistent with the regulatory background to the GENPRU and to IPRU.

Can I ask you to look at -- keep bundle E obviously -- bundle J, tab 6, 181.

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: There are a number of these in here because there were different implementing regulations following

Basel I and Basel II, and so far as is material they are to similar effect, so I just pick the 2006 one. If you go to 181, so these are the regulations describing what may under national regulations count for the purpose of regulatory capital and right-hand column 181, Article 64.3 at the top:

"Member states may include ...(Reading to the words)... time of being settled."

So the focus of the regulations are that one has to have provisions allowing for late payment in the event of bankruptcy or liquidation. So that's another reason why we say the solvency condition shouldn't be downgraded in the way I think Mr Phillips wished to do so.

But in any event, one has to remember also of importance, at clause 3(a), whilst the initial wording does say "subordinated to senior creditors", the term "senior creditors" is just a name for the class to whom the debts are subordinated, so it doesn't by itself tell you who is in the class. So by saying "The rights of the noteholders are subordinated to the senior creditors", that does no more than frame the issue that has to be addressed. A clause could have said "subordinated to X, Y, Z creditors", it doesn't do that. It simply says "subordinated to a class of creditors who

we're going to call senior creditors". That doesn't itself tell you anything about the answer. You have to go to the definition of senior creditors. The definition of senior creditors contains the referential bit that we have talked about and what we say is that one gets the answer to the referential bit through the solvency condition itself. This is how they work together, because senior creditors are the creditors above the subnotes. Who are the senior creditors? You have to apply the test. You have to apply the test by looking to the referential aspect. When you apply the referential aspect you start by looking at the solvency condition and you see that this solvency condition we say on its face -- we can argue about that -- subordinates the subnotes to all debts.

So on the face of it "pursuant to the solvency condition" on its terms is an expression of juniority to all other debts.

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: So you then go back to the subdebt, because it has to be referential and the subdebt at page 7 has a definition of excluded liabilities:

"... liabilities which are expressed to be and in the opinion of the office holder do rank junior to the subordinated liabilities."

So you get the answer in the subdebt because they have a term for excluded liabilities being those which are expressed to be junior. In the subnotes there is an expression of juniority.

So this is why I say the two mesh together, because the referential bit doesn't give you the answer of who. You have to look for an expression. There's an expression in the solvency condition. On my construction of the solvency condition, that means when one goes to the subdebt that the subdebt is necessarily senior to the subnotes, because under the terms of the subdebt the subnotes are expressed to rank junior to them. So it's a combination of the two.

The definition of senior creditors is merely that, a definition, so the term "senior creditors" is just a term. The definition requires work to be done. The work to be done we say is achieved through the solvency condition because if it is right that the solvency condition (i) includes all debts then there is a full expression of juniority in this subdebt instrument which means that it is an excluded liability in the subdebt and there is the answer to the conundrum.

So you use both parts of the agreement -- you don't single out one and say one is dominant over the other, you use both parts of the agreement to find an answer.

And that's why the words "for the purpose of clause 3(a)" are interesting but don't qualify any of that because it is a combined effort. It is for the purpose of 3(a) because that tells you -- it is for the purpose of 3(a) because it tells you who the senior creditors are, on my approach, because once you have worked out what the solvency condition means and plugged that into the two agreements, it gives you the identity of who the senior creditors are.

So "for the purpose of condition 3" doesn't in any way qualify my interpretation, it explains my interpretation: they have to work together.

And equally the word "accordingly" also works together because accordingly, yes, one still has to do the work to find out who the senior creditors are. You find out who the senior creditors are by applying the closely calibrated solvency condition which is, as we know, the way to do it. So "accordingly" works -- for the purpose of clause 3(a) works -- once you realise there are two exercises going on here. Actually there is one exercise going on, but it is to find the definition of senior creditors; you find the definition of senior creditors by applying the solvency test.

Of course if the solvency were differently calibrated you would have a potentially different

category of senior creditors. That's the way solvency conditions work.

So we do say -- and going back to your Lordship's question -- let me just take a step back. In seeking to answer your Lordship's question I said -- the first submission was Mr Phillips' approach involves a fragmentation of the two clauses and an assumption that the definition of senior creditors provides the answer and at one point he said "The solvency condition just implements the subordination to senior creditors, it does not do anything different". That's a fragmentation to say "Well, senior creditors are senior creditors, don't worry about the solvency condition, it can't change the definition". That is not really realistic when one sees what the definition actually is. It doesn't involve a fragmentation, it involves a composition between the two and the insolvency test we say informs the definition of senior creditors and that's how they work together.

So that's my response to what I would say is Mr Phillips' first argument, which is the answer is in the definitions. We say it isn't in the definitions, it's in the composition and the "accordingly" and the "for the purpose of" work perfectly with that.

The second argument is that the words "its debt"

don't mean what they say and what they actually mean is "debts to senior creditors". And of course if it meant debts to senior creditors then there would be a differently calibrated solvency condition and potentially -- one can even test my theory this way: there would be a potentially different class of senior creditors. So you can see how they work together. If he is right on the wording, the senior creditors class changes and that shows how they interact together. If I'm right on the wording, the senior creditor class is what I say it is. But it just in a sense highlights why that is the pivot which enables the class to be identified.

So he has to say "Well, those words don't mean 'its debts', they must mean 'its debts to senior creditors'", to which we say, well it doesn't, or at least there is no reason why the court should conclude that it does.

MR JUSTICE MARCUS SMITH: And do you draw support from the second set of brackets in line 3?

MR BELTRAMI: Yes, we do. We very much do. Because there's a contrast.

MR JUSTICE MARCUS SMITH: It is "excludes", or it qualifies liabilities.

MR BELTRAMI: Yes, there is an evident contrast between the two tests. The first is that both have to be satisfied

but the evident contrast between the two, the different terminology and the balance sheet test, which is (ii), expressly excludes liabilities to persons who are not senior creditors.

Now, Mr Phillips' answer to that is there should be what he described yesterday, a unitary construction, so that involves the -- it might be a novel prospect -- novel rule of construction that if the draftsman has chosen a contrast it is appropriate to cross the contrast out and make it unitary. Now, we say there's no -- I mean it might assist his case if he gets there, but there's no rule of construction or frankly common sense that would enable that to be achieved. These are, it must be remembered, highly sophisticated contracts drafted by specialist lawyers, for vast sums of money, for important banking regulatory capital.

So it's not a complete answer to that but it's the basis on which one approaches the document and where a draftsman has, we say, first of all used words "its debts" which are on their face unlimited and secondly drawn a clear contrast between the cashflow bit and the balance sheet bit, then the court should give effect to that contrast rather than cross it out. That would be, we say, an eccentric way to approach the construction of those words.

And it is not suggested of course that there's any mistake here, or there's no claim to rectification and we say the contrast in wording is -- well, the wording itself is clear. The contrast in wording underlines that and, as your Lordship may be aware, can you -- if you go to authorities bundle 5 -- probably aware -- 111, this is the Eurosail case, which considered the Insolvency Act test, but only to indicate -- if you go to paragraph 37. Under the Insolvency Act there is the cashflow test and the balance sheet test as well and what Lord Walker explained in paragraph 37 is they both do different things. So the cashflow test, as he says in letter F:

"... is concerned not simply with the petitioner's ...(Reading to the words)... in the reasonably near future."

And at G:

"Express reference to assets and liabilities [which is the balance sheet test] is a recognition ...(Reading to the words)... are burden of proof must be implied ..."

So what he is explaining is they are different tests for different purposes. The cashflow test is in broad terms short-term, the balance sheet test is long-term. Under the terms here both had to be satisfied. But

there's no reason why they have to use the same concepts and if on their face they don't, they don't.

MR JUSTICE MARCUS SMITH: And obviously for the purposes of assessing ranking I'm considering ability to pay debts as they fall due in a non-insolvency situation; I have to do that.

MR BELTRAMI: Well, of course we are in a --

MR JUSTICE MARCUS SMITH: I know where we are, yes.

MR BELTRAMI: But pre-amendment this condition applied throughout, so in and out of insolvency of course.

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: And there's no question, nobody has suggested that LBHI2 is able to pay its debts as they fall due.

MR JUSTICE MARCUS SMITH: No, no, what I mean is if I am trying to work out whether under this contractual definition of solvent the issuer is or is not solvent, I need (i) to be able to assess what debts are falling due in the short-term. Now, there's no point in applying that test in an insolvency situation because we have an acceleration of everything.

MR BELTRAMI: Well, no.

MR JUSTICE MARCUS SMITH: No?

MR BELTRAMI: I mean there's a bit -- (inaudible) context, but the debts are still due --

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: -- and they can't be paid. I mean there's a process about by which there's a distribution of assets --

MR JUSTICE MARCUS SMITH: Well, no, I mean you could have a debt that was due in 400 years time.

MR BELTRAMI: That would -- yes, it may be Lehman is going to last for 400 years, that would be interesting. I don't think that's on the facts of this case an issue. The relevant debt -- of course we're only concerned --

MR JUSTICE MARCUS SMITH: It may not be, but I'm interested in understanding how this provision works.

MR BELTRAMI: It may be the answer is we can confine it to the facts that we have here because the position is that the unsecured debts have all been paid, so they are -- otherwise we wouldn't be arguing about the subordinated debts. So they're out of the picture. There are only -- I may be oversimplifying this but there are only -- and that's why we're having this battle -- two sets of subordinated debts. The two sets of subordinated debts are the notes which were due in 2017, so they're currently due, and the debt which was -- I think it was five years, was it, but in any event it is long due, if you like. It's not outstanding, it wasn't a 400-year term.

MR JUSTICE MARCUS SMITH: Yes. No, I --

MR BELTRAMI: So the debts that are left -- put it this way. The debts which are left LBHI2 cannot pay if they fall due.

MR JUSTICE MARCUS SMITH: Yes and what you're saying is "Don't worry, they're both due now", so that's fine.

MR BELTRAMI: They're both due and can't be paid.

MR JUSTICE MARCUS SMITH: This wording is intended to be general, particularly if you're right about the broad meaning to be attached to the word "debt".

MR BELTRAMI: Yes.

MR JUSTICE MARCUS SMITH: So all I'm asking is if one has a situation where a debt was not due next week but due in a decade's time, that will be left out of account for the purposes of (i).

MR BELTRAMI: Yes.

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: That's right, yes. That's why they've got -- I suppose -- well, I say "That's why". That is covered by the balance sheet test.

MR JUSTICE MARCUS SMITH: No, that's what I'm getting at.

MR BELTRAMI: Yes exactly.

MR JUSTICE MARCUS SMITH: I want to be clear.

MR BELTRAMI: Sorry, I was so eager to get what I thought was the question answered that I don't think I followed what it was.

Your Lordship is right, in a different scenario there could be a situation even in an insolvent situation or potentially a solvent situation where LBHI2 could pay debts as they fell due in the near future but at a balance sheet deficit longer-term, in which case the solvency condition would also kick in at that point, because both have to be satisfied.

MR JUSTICE MARCUS SMITH: Yes. It is an "and" not an "or" there, I quite see that. Yes, thank you.

MR BELTRAMI: But we do say that there is no rationale for confining the word "debts" to something else which isn't even stated and there's no reason to need to do that when, as I say, it is possible and indeed we say correct to construe 3(a) and 3(b) as a composite whole and find the answer to the definition of senior creditors through the application of the solvency condition.

One of the problems for my friend is that he starts with the senior creditors, he doesn't give effect to the solvency condition, so his approach doesn't actually give effect to the language at all. It ignores the solvency condition.

So the first point is we say a composite whole gives the answer.

The second point is we say the words mean what they say they mean and there's really no basis to say the

contrary.

The third suggestion of my learned friend is if we were right, the test would be otherwise unworkable and that was stated in his skeleton without further and better particulars, but it was said in oral closing that imagine if another debt was expressed to be junior to this this one and he is right, you know, to this extent. If another debt were expressed to be junior to this one then one would have to work out what the answer was because it wouldn't be straightforward. But that isn't this situation. It doesn't mean it doesn't work, it means you have to work hard to get the answer. And also it might be thought unlikely that it ever would be the case. If the solvency condition means what we say it means, there's no suggestion that anyone would be interested in writing a debt expressly junior to this one.

So it is a rather hypothetical scenario which doesn't arise, we say would be unlikely to arise, but it doesn't really matter because one can always dream up all sorts of complicated situations in any scenario that might create a problem. It wouldn't mean it wouldn't work, it would mean you would have to have your head scratching to find the answer, but we don't have that problem.

MR JUSTICE MARCUS SMITH: No indeed, but oftentimes testing a form of wording against an admittedly hypothetical extreme counterfactual example can give you an insight into how the provision is to work. So even if the case doesn't arise on the present facts, I still find some utility in traversing them.

MR BELTRAMI: All right. In those circumstances there would be a difficult issue of construction to determine in which case two contracts would on their face create conflicting answers.

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: That doesn't mean that my definition wouldn't work. It would mean that there would be a difficult issue of construction.

MR JUSTICE MARCUS SMITH: Okay. So going then to the other contract you say I must look at, the one at E1.

MR BELTRAMI: Yes.

MR JUSTICE MARCUS SMITH: Now, here we have the various definitions of liabilities and we have what I think Mr Phillips called it the circularity problem as between these three instruments that we have at tabs 1, 2 and 3 which I think, do correct me if I am wrong, everyone accepts require some form of intervention.

MR BELTRAMI: Yes.

MR JUSTICE MARCUS SMITH: So presumably you would accept

that I've got to work out what sort of intervention is required before I apply the question of what ranking one gets when one contrasts let us say E1 with E5.

MR BELTRAMI: Well, yes and no now. There is an issue about the position between the three subdebts.

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: I can take it out of turn --

MR JUSTICE MARCUS SMITH: I don't want to take you out of turn if --

MR BELTRAMI: There seems to be common ground as to what the answer is. I think some -- in that inter se question, some disagreement as to how you get to the answer.

MR JUSTICE MARCUS SMITH: Well, that I think is the issue.

MR BELTRAMI: It is the issue, but we wouldn't accept that you really need -- if I'm right on this solvency condition you don't need to worry about -- or the answer to the inter se question doesn't really impact on that because if I'm right on the solvency condition and going back to, say, the first subdebt on page 7, the solvency condition operates as an expression of juniority, that's its effect. So you have -- and completely separate -- and this is not at all relevant for the inter se at all. This is why I say they work together. If the solvency condition does, as I say, operate as an expression of juniority, the subnotes are by definition within

excluded liabilities. You don't need to have any massage on this agreement at all, no implied terms required, no surgery is required, it is merely application, because the definition of excluded liabilities is liabilities expressed to be junior and we say if you look at the solvency condition and understand what it is intended to achieve, that is an expression of juniority.

MR JUSTICE MARCUS SMITH: I see.

MR BELTRAMI: So you don't need to worry about -- the inter se you need some surgery because they're the same.

MR JUSTICE MARCUS SMITH: Okay, I understand.

MR BELTRAMI: But you don't need surgery on this one.

Maybe I should just deal with the inter se point, as you have raised it.

MR JUSTICE MARCUS SMITH: Only if you are happy to do so. I'm more than happy to --

MR BELTRAMI: We can do that, my Lord.

MR JUSTICE MARCUS SMITH: Very well.

MR BELTRAMI: I say because of what I just said it doesn't matter, but there is an issue for the court as to the ranking -- or there may be an issue as to the ranking inter se because it feeds into some of the arguments. And we accept the answer is pari passu. This was described -- this is one of these points was described

by my learned friend as a concession with the introduction it was now accepted as pari passu, but we actually accept that in our position paper, so it is nothing actually new at all.

Two points arise. First of all it is by reason of process of construction and we say the process of construction has to arise because of the inherent difficulty of construing these three contracts together, because they are on the same terms, the solvency condition is the same, the referential provisions are the same. It's not a case of linguistic small differences or otherwise, they are identical, identical.

So you do have a problem applying each contract to the others because if you apply on its face and with the default of being senior liabilities, each one is junior to the other, in which case you go round in a circle forever.

So it can't work. You have to do something with the wording because the wording of each contract is the same and that's just an obvious process of construction.

Now, what we have suggested is the minimum necessary to solve that problem and the minimum necessary to solve that problem is that the definition of subordinated liabilities on page 8 means not just liabilities in respect of the loan or each advance, but includes the

other two loans. So one can deal with the problem of circularity just by expanding -- whether you call it implied term or just a matter of interpretation for sense -- the definition of subordinated liabilities and you may or may not need an implied term that those three are pari passu, although I think it would probably follow (inaudible) liabilities. But we say that's the minimum necessary to break the circle that everyone agrees must be broken.

MR JUSTICE MARCUS SMITH: But that isn't the test for an implied term, is it?

MR BELTRAMI: Well, the implied term has to be -- well, two things. It has to be necessary and we say it is necessary to break the circle but also, whether it is -- it must be part of the test, the minimum necessary to be necessary, if you like, because you don't go implying a term more than you need to. I mean the fact of necessity itself imports the idea.

MR JUSTICE MARCUS SMITH: I entirely take the point about there being a need for a change, but it seems to me that if you were to suggest to the draftsman of this particular contract that there was a problem with identically framed contracts and you say "Tell you what, I've got the answer here, we will add into this definition of subordinated liabilities not simply

advances under this particular instrument but also the advances under the instrument which you have effected on the same day", the one in tab 2, and wouldn't then the draftsman say "Well, okay, I accept that actually there's a coincidence of timing here, but I might very well execute an identical instrument three months hence"?

MR BELTRAMI: Yes.

MR JUSTICE MARCUS SMITH: And how is that going to be catered for in my implied term if we're simply referring to specific instruments in that way?

MR BELTRAMI: Well --

MR JUSTICE MARCUS SMITH: That's where I'm getting at in terms of width. I can see that one can solve the problem by saying "Let's just expand subordinated liabilities to include not merely advance under this agreement but advances under the sister agreement" and that does solve the problem, but it isn't actually a very satisfactory solution and were one to point it out to the draftsman the draftsman would say "Well actually I'm going to have to think quite hard about how I'm going to achieve commercial sense when one has got sister agreements".

MR BELTRAMI: Well, the reason I sought to suggest it is narrow is that these three agreements, same parties,

same day, same words and that would be the minimum necessary to solve that problem. Now, I think your Lordship's point is, well, it might solve that problem but it doesn't solve a broader problem about what happens if there's another agreement --

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: -- with the same characteristics.

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: Now, it is always a bit difficult hypothesising what someone might or might not think and one answer might be "Well, we will deal with that when it arises", but another answer -- I think the minimum -- the immediate answer would be "Well, all right, those agreements and any other agreements on identical terms". There's no reason at all to go wider than that because it's the identical terms that creates the circularity. So I think it would be -- one has -- I suppose one has to do the exercise of what would the reasonable person think or not think. It's a pretty flexible exercise to some extent.

I don't think it can be assumed the reasonable draftsman would want to plan ahead because one doesn't know what will happen and it could be dealt with when it does happen. So there's no necessity to plan ahead, but if one were to plan ahead then one would only plan

ahead, I would submit, for the same characteristics.

So grudgingly, I think, I could see one could expand that. I don't think it would be actually necessary or appropriate, but one could expand it to be these agreements and any other agreements executed on identical terms. I don't think there's any real harm in that but I say grudgingly -- I don't think it moves very far from where I am but the critical point is the problem arises because the wording is identical and the solution responds to that identical wording.

MR JUSTICE MARCUS SMITH: Yes I see.

MR BELTRAMI: Now, what my learned friend has suggested is a different implied term of a much broader nature.

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: And we should maybe go to it. It's Day 6, so it is bundle I, Day 6, page 21, and it is the top of page 21, the words:

"The words 'all other liabilities of the lender which rank or are expressed to rank pari passu with the liabilities of the lender under this agreement' would be included on our implied term ..."

So they want a much broader implied term which covers essentially all other types of debt which might create a subordination question and two things about that.

First, the reasonable reader confronted with the immediate problem of circularity or three identical agreements would not say "Well, I will solve this by a much broader clause that might deal with all sorts of other agreements", there's no reason to jump to that.

But secondly, your Lordship would note -- and the more one looks at it the more one can see this point comes back again -- that the implied term which has been put here has the "or" in it, the all important "or", because you remember the "or" ranks pari passu distinctively from "express", because they need that to maintain the theory. But why on earth would the reasonable draftsman insert a clause with the "or" in it when we know this clause itself, in relation to expression of juniority, is "and"? So the very document has a different sort of formulation in respect of expression of juniority.

So this is this problem I have with this great "or" point and one can see what's being sought here is, under the guise of an amendment to solve the inter se problem, they want to get an implied term to enable their "or" argument to fly.

MR JUSTICE MARCUS SMITH: I think that's why I raised this question at this point because it does seem to me -- I know you say it doesn't make any difference, but I'm

going to have to resolve the width of the implied term and reach a conclusion. Before I go to the question of applying the two provisions that I found the meaning of, it would make no sense to park the implied term until later.

MR BELTRAMI: So be it. We would say in summary then it should be the minimum necessary to solve the problem and your Lordship knows what I say about that.

It certainly can't be what is suggested because it doesn't -- it solves much more than a problem -- it solves my learned friend's problem but the reasonable drafter in 2008 wouldn't have thought about that.

But third, and more general point, we are talking about how to amend or set an implied term to an FSA standard form and one doesn't know how many times this has been used in the past or what transactions have been (inaudible) on the back of it, so it's another reason for any implication for the minimum necessary that we're concerned with because the sort of in broad term my learned friend, I don't know what the consequences would be to that, but it engages a much wider picture than we need to deal with in this case, so one has to be careful where one goes on that and in my submission the answer can be given narrowly in the context of this case because of the facts that we have.

MR JUSTICE MARCUS SMITH: So oddly enough, your -- which topic was it? Your limited relevance of regulatory background topic actually pops up and bites us here, because I think you are quite rightly saying that if one is talking about documents that have a certain currency in the market, a wide implied term which might make perfect sense in a bilateral situation is something that one must weigh carefully given the fact that these instruments have a broader currency and no doubt what will be said is that what is sauce for the goose at E tab 1 is sauce for the gander in a hypothetical identically worded agreement somewhere else in the market.

MR BELTRAMI: Yes.

MR PHILLIPS: My Lord, I don't like rising but I do want to remind my learned friend and your Lordship that that definition of subordinated liabilities is the definition that we see in all the PLC subnotes that went through the waiver application, so we do have that material and it is before your Lordship. So that's where the "or" ranks --

MR JUSTICE MARCUS SMITH: No, I understand, it is just not present in this agreement.

MR PHILLIPS: Because my learned friend was suggesting that he didn't know what was in the market, I just thought

I would remind him.

MR BELTRAMI: Well, I'm very grateful for that I'm sure.

Anyway, my Lord, so that's what we say about that. Your Lordship clearly feels that you need to address that question and if it may well be you do. I would urge you to address it with the minimum necessary surgery to get there.

MR JUSTICE MARCUS SMITH: No, I think -- well, I presently think that one needs to understand how one resolves, as it were, the narrow issue in order to construe the contract broadly because if one has a problem, even if it is a problem that doesn't arise, in terms of the wording as it stands between these two instruments, if there's a contention -- and clearly there is, because all the parties agree there's a nonsense here -- that in order to make this agreement work there is the need to imply a term that will make a difference to -- I know there is an argument there as well -- may make a difference as to how these agreements interact, then I think I have to deal with them.

MR BELTRAMI: My Lord, I think the way it probably works is this. On my case on the solvency condition, there is no problem. So you don't need to worry about implying a term to get to the answer that I say the contract takes you. So it may be of background interest but it's

not part of the analysis.

MR JUSTICE MARCUS SMITH: Yes.

MR BELTRAMI: Now, I think on my learned friend's analysis you have to imply something to get to where he wants to go, because obviously there's nothing pari passu in the subdebt at all. So it may well be that if your Lordship is with me on my construction it's not a necessary feature of the road of travel to determine the inter se problem. If your Lordship goes down Mr Phillips' route, then the inter se problem may well be a necessary part of the road.

MR JUSTICE MARCUS SMITH: That may be right. I think the provisional view I take is that one isn't going to know what difference it will make until one has worked out how the E1 instrument changes and then you may be right, it doesn't matter, but, as you say, Mr Phillips is contending for a significantly different implied term to the one that you and Deutsche Bank are contending.

MR BELTRAMI: Yes. That's right. And we also say you don't -- anyway, you have my point.

MR JUSTICE MARCUS SMITH: Yes. I know where the battle lines are.

MR BELTRAMI: Now, can I just go back to -- as your Lordship is aware, the two ways we put the construction argument is we say the solvency condition, in the way I have

explained, takes you to the answer because it informs the definition of senior creditors and excluded liabilities. So it doesn't require surgery, it just requires an application of the test and the various sets of words.

Now, it is only if Mr Phillips is right on that point and I'm wrong on that point that one has to consider separately, if you like, the rest of the wording, because if one goes back to page 55, my submission is, when taken as a composite whole, the solvency condition gives you the answer, tells you who the senior creditors are and therefore that is the solution.

If the solvency condition either means something else, or in some way is sort of downgraded in terms of relevance, and the conclusion is that the solvency condition doesn't give you the answer, then you have to sort of exclude that from the analysis and work out whether there is an answer in the rest of it and this is where we get to the referential structure bit. And I dealt with this in opening, I'm not entirely sure I can say all that much more now because nothing much has changed in the evidence. As your Lordship is aware, both documents cross-refer to the other.

Now, they don't cross-refer to the other in the same

way as the three PLC subdebts and LBHI2 subdebts cross-refer to each other because the wording is not identical. So the question is, (inaudible) solvency condition, whether the court can find sufficient differences in the wording to justify a priority argument or whether the answer is a pari argument, and as your Lordship is aware, our submission on that part of the case is that you do find a difference in the wording through the different definitions being used. So you find a difference in the wording in the LBHI2 subnotes because they expressly include as a category of potentially senior creditors, subordinated creditors subject to the qualification.

So we say that sets -- I think we said in our skeleton that gives you a default "subject to". That has to be compared with the subdebt which uses different language and we say that when the subnotes require or say "default subject to express juniority", you don't get that level of express juniority in the subdebt.

Now, as I said in opening, I accept that the contrary argument is that you can get to the same answer by the definition of senior liabilities because senior liabilities implicitly could include subordinated liabilities, so we have made it clear throughout that we're not saying that this element of the case is --

we're not saying any element of the case, but this element of the case is black and white. But the exercise for the court faced with these two forms of instruments, using we say different wording, is whether a solution can be found and there only are two options for the court. Our suggestion is that the express reference to subordinated liabilities in the subdebt, when contrasted with the absence of such an express reference in the subdebt, gives you enough of a difference to come to an answer.

That has to be compared against the alternative and the alternative involves the broad implication of terms which we have just looked at and we say it's not necessary to have such a broad implication of terms if the wording can give you an answer and we also say that it is much harder to come to a solution of pari passu sharing by reason of surgery when the LBHI2 subdebt doesn't allow for pari at all on its face and where it is my learned friend's case, as I understand it, that neither instrument expresses pari.

So you have to do a lot of work to find an answer of pari in my learned friend's case and that is probably the reason why we have all these other offshoots about the default rule and the regulatory position and all the rest of it, because the nub problem is that when one

actually approaches the language it's hard to get to an answer of pari. It doesn't allow it expressly, neither document says "pari", so how on earth do you get there? You almost get there because you can't think of anything else. "Nothing gives me the answer there, gosh, I'll have pari ... I'll do a lot of work in these agreements to get ..."

So those are the two alternative arrangements one has to approach on this alternative construction argument and we say when the alternative is that difficult and frankly at the moment still really unexplained answer how you can get there on what was being used, we say the better answer is to draw the distinction between the wording being used. So that's what we say the answer to that if the insolvency condition doesn't provide the answer and it's as simple as that and it's a construction question which your Lordship will have to determine.

MR JUSTICE MARCUS SMITH: Yes, thank you.

MR BELTRAMI: Now, just on some of those additional points -- can we maybe run to 4.30? Would that be possible, my Lord?

MR JUSTICE MARCUS SMITH: Yes of course.

MR BELTRAMI: Thank you.

Just to say something about my learned friend's same

senior creditors/symmetry argument and we said some of this in opening. A lot of energy is devoted to establishing that they have the same senior creditors, but there is an important precision required as to that word. It seems that what they mean is they have common senior creditors, ie the unsecured creditors, and if that's what it means they may well be right but it's irrelevant because it doesn't touch on the position inter se.

That must be addressed as a matter of construction. If in contrast what they mean when they say "the same creditors" are identical creditors then that's problematic because that's a conclusion not a premise. It's a conclusion from the exercise of construction.

MR JUSTICE MARCUS SMITH: You say that common is not the same as same.

MR BELTRAMI: Exactly. And you only get to same if it means identical through the exercise of construction. And if you get there that's the answer, it's not a premise to get to the answer which is the way it is being put.

So none of that we say -- that's just in a sense playing with words because it doesn't actually address the issue we have to deal with in an exhaustive scheme: what is the answer inter se.

Now, it also feeds into the argument which is also

being made, I think mainly yesterday, about symmetry and my learned friend's description of what he said was categorical symmetry, by which he seems to mean I think that each set of instruments are similar categories of creditors: above, below and equal. And that may or may not be, in the abstract -- that may not be right in the abstract, indeed it has to be right in the abstract because those are the categories of creditors any party may have. It just reflects the realities there can only be three categories: above, below and equal. For what it is worth, they're not even called the same thing, the two instruments, but the fact that each has the same three categories of debt produces, if you like, categorical symmetry but again doesn't answer the construction question we've got.

You can go round the houses a number of times about same creditors and categorical symmetry and all the rest of it, but you have to deal with the words and these are just we would say bypasses of the approach rather than addressing the approach.

Next topic, can I deal briefly with the market practice case which is also being put, because it was suggested and suggested orally yesterday that as a general rule lower tier 2 debt and tier 3 debt ranked pari passu, so there's an attempt to put in expert

evidence as to market practice and in support there are two commentaries by US bankers in the files: there's an A&O work note, there's a Basel working paper and now supposedly there's some evidence from Mr Miller. A few points on that.

First it is wrong as a matter of procedure. There is no expert evidence before the court. No permission has been granted, none has been adduced, and that is the only mechanism to adduce such evidence. You can't adduce expert evidence through a book and you can't adduce expert evidence by asking a witness of fact about his opinion, or even if anybody asks a witness of fact about the opinion. It doesn't make it expert evidence because the other side does it. Opinion evidence is not before the court. Had expert evidence properly been called, we could have examined it and explored it. We haven't had that opportunity. So as a matter of procedure, there is no opinion evidence before the court.

It is wrong in any event as a matter of substance because what has been said is not in fact evidence of market practice at all. I don't think you have been taken to the book so I don't do so but what they seem to say is nothing more than statements of fact, ie there's no regulatory requirement to layer subdebt, which we all

know. None of them say "There's a market practice to do X, Y, Z", they simply talk about the absence of any -- or the fact that it is not layered as a matter of obligation.

The evidence of Mr Miller is to the same effect. He said -- I think there was an answer to a question from your Lordship which is bundle I/3/21, he regarded a default of pari passu absent contrary provision in the instrument, which says nothing more than if you don't say anything about it then obviously pari passu will be the answer, which is no doubt correct, but that doesn't tell you anything about market practice, says nothing more than the books, says really regulations don't require it, and he then immediately qualified that by agreeing that it all depends on the terms of the contract.

He did not say -- and if he had said it would have been inadmissible and irrelevant -- that there was a strong presumption that clear wording was required or anything of the sort. That's not what he said.

Even if it somehow any of this were admissible and it were evidence of market practice, it wouldn't be of particular interest to your Lordship because no one suggests that there was an universal practice of pari passu. One has no idea how, if there was

a practice, universal it was. All the instruments we know allowed for the layering of debt and the question is what the instruments did, not what someone else might or might not have done in the market.

We specifically disagree with the way it is sought to be put -- it's something I mentioned a bit earlier -- ie that there is a default position of pari passu and the question for your Lordship is whether there is sufficient material to show an express contrary intention to disapply that default. That can't be the right approach. And whatever Mr Miller was saying, he was not laying down a primary rule of construction, which is what it has become. So apparently his expert evidence on market practice is something that affects the construction of a contract. That can't be right.

The question simply remains what the agreement says and there's no presumption either way that it means one thing or the other and one doesn't start from a position which has to be moved off from their position.

So that's I think all on expert evidence or the absence of it.

Now, I see I have I think happily reached the end of my topics on pre-amendment construction so this may be a convenient moment I think.

MR JUSTICE MARCUS SMITH: Yes, well, thank you, Mr Beltrami.

We will resume tomorrow. It seems to me I should extend the same offer at least to you as I did to Mr Phillips.

MR BELTRAMI: I think I would gratefully accept it, my Lord.

MR JUSTICE MARCUS SMITH: In that case it will be 10 o'clock tomorrow morning.

(4.25 pm)

(The hearing adjourned until 10.00 am on Thursday, 21 November 2019)

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