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Monday, 4 October 2021

(10.30 am)

Submissions by MR PHILLIPS

LORD JUSTICE LEWISON: Yes, Mr Phillips.

MR PHILLIPS: May it please your Lordships, I appear with my learned friends Mr Willson and Mr Lupi on behalf of SLP3 and LBHI.

My learned friend Mr Arden appears with Ms Foskett on behalf of LBHI2. The joint administrators of PLC are represented by my learned friends Mr Beltrami and Mr Kramer.

My learned friends Ms Tolaney, Mr Fisher and Mr Goldfarb appear on behalf of Deutsche Bank.

The joint liquidators of LB1 are represented by my learned friends Ms Hilliard and Mr Roscoe.

LADY JUSTICE ASPLIN: Thank you. I can tell you that we have read the judgment several times. We have read the skeleton arguments and the notices of appeal. I'm bound to say that before reading into this I thought that every conceivable question about insolvency had been asked and answered in the courts of the Lehman administration but I was obviously wrong.

MR PHILLIPS: My Lords and my Lady, if every question on insolvency had been answered it would be a very sorry day for my set of chambers.

1           My Lords and my Lady, thank very much for that  
2           indication.

3           Like all of the subordinated instruments in issue in  
4           these appeals, the LBHI2 Sub-Debt and the LBHI2  
5           Sub-Notes were dated subordinated instruments which were  
6           issued for regulatory capital purposes to different  
7           entities within the Lehman Group. There is no clear  
8           expression in any of these instruments that they were  
9           intended to rank anything other than pari passu as  
10          between each other. And no party has identified any  
11          regulatory or commercial reason why Claim A and Claim B  
12          should rank anything other than pari passu.

13          In our submission a pari passu result is the  
14          unsurprising and fair outcome.

15          At the outset, my Lords, my Lady, we want to remind  
16          you of the basic parameters of subordination of debt, if  
17          I may. In a winding up, or a distributing  
18          administration, rights to payment under a contract are  
19          replaced by rights of proof and distribution in the  
20          insolvency. The Insolvency Act and Rules mandate how  
21          that is approved, how they are valued, what  
22          distributions they receive and what interest is paid on  
23          the debts proved.

24          Debts will rank pari passu unless a particular debt  
25          is effectively subordinated to other debts. Those rules

1 cannot be altered by agreement between the creditors and  
2 the debtor. What may be altered is the creditors'  
3 rights. A debt may be subordinated by contract or by  
4 using a trust mechanism. Determining priorities  
5 concerns identifying the subordinated creditors' right  
6 to prove and the nature of their debt.

7 The right to prove is determined by the contract.  
8 A creditor may agree that it will not prove its debt  
9 until after other creditors, the senior creditors. The  
10 effect of such an agreement is that the senior creditors  
11 will receive distributions and statutory interest before  
12 the junior creditor is entitled to prove. The judge  
13 used the label 'simple contractual subordination', as  
14 you will have seen, to describe this.

15 It is not possible for a creditor to provide that  
16 its debt will be paid in priority to another debt unless  
17 all those who would rank junior agree, because such  
18 an agreement would infringe the principle that provable  
19 debts abate equally in share distributions *pari passu*.  
20 Since *British Eagle*, it has been recognised that this is  
21 a principle of public policy, and it is presently  
22 enshrined in Rule 14.12.

23 The nature of the debt is also determined by the  
24 contract. It may be actual, future or contingent. The  
25 rules applicable in the insolvency provide how each of

1           these different types of debt are proved and valued.

2           Turning to the relevant ranking of the LBHI2  
3           Sub-Debt and the unamended LBHI2 Sub-Notes, our  
4           submission is that the claims under these instruments  
5           rank pari passu, and the judge erred, in our submission,  
6           by concluding that Claim A ranks below Claim B.

7           As we explained in our skeleton argument, we run two  
8           alternative cases: first, what we described as  
9           ineffectiveness of subordination provision inter se,  
10          which is the learned judge's approach, and, second, same  
11          senior creditors or senior liabilities. And I will  
12          expand on these, of course. In essence either on the  
13          judge's approach --

14       LORD JUSTICE HENDERSON: What was the second one?

15       MR PHILLIPS: Sorry, my Lord. Same senior creditors or  
16          senior liabilities. I will expand on it. The  
17          proposition is relatively straightforward. Which is,  
18          where two debts have subordinated themselves to the same  
19          senior creditor, they prove at the same time and, by  
20          virtue of the rules, they rank pari passu.

21          In essence, either on the learned judge's approach  
22          to construing subordinations provisions but applied  
23          properly, we say, to the LBHI2 priority dispute or on  
24          our trial case, which is the second basis, Claim A and B  
25          prove at the same time and rank pari passu.

1           We will deal, minor diversion, we will deal with  
2 Deutsche Bank's dividend stopper in due course insofar  
3 as they have permission to run that argument but that is  
4 a debate for later on the PLC appeal. Just so that you  
5 should be aware, we do not accept that Deutsche Bank has  
6 permission to run the dividend stopper argument, as the  
7 judge specifically refused it permission and made clear  
8 that it's not an argument of construction, and the judge  
9 also specifically rejected the dividend stopper argument  
10 on the facts, as I've said. We will come back to that.

11           For the purposes of the LBHI2 appeal, there is no  
12 basis to apply the dividend stopper argument to the  
13 LBHI2 ranking dispute.

14           Just to make this additional point: dividend stopper  
15 aside, you should be aware that Deutsche Bank were  
16 joined on an undertaking that they would not duplicate  
17 Mr Beltrami's arguments. And I will just give you by  
18 way of a note, in AB3, tab 57, 18.03, paragraphs 14, 16  
19 and 17 is Mr Justice Mann's joinder decision. The  
20 reason why I make these points is that we are proceeding  
21 on the basis that Deutsche Bank will not be repeating  
22 anything that PLC -- any appeal C submissions and we are  
23 focusing primarily on PLC's submissions. I just wanted  
24 to make that clear.

25           We now turn to two topics. The first topic is the

1 judge's approach to the mechanics of subordination in  
2 the relevant instruments. He held that subordination  
3 was effected by a combination of two separate  
4 mechanisms: simple contractual subordination and  
5 contingent debt subordination.

6 PLC's case focuses on the conditionalities in the  
7 instruments, which PLC describes as the operative  
8 subordination provision, and they give primacy to the  
9 conditionalities. And in our submission both the judge  
10 and PLC's analysis is incorrect.

11 LORD JUSTICE LEWISON: I thought, reading the skeletons,  
12 that both you and Mr Beltrami agreed that chopping the  
13 subordination provisions up into bits wasn't the right  
14 approach, and that they need to be read together.

15 MR PHILLIPS: They do, and the extent to which there is  
16 agreement is something, if I may, I will respectfully  
17 develop, my Lord. But your Lordship is absolutely  
18 right, the simple proposition is there is a single  
19 subordination provision in this contract, it must be  
20 construed as a single subordination provision.

21 LORD JUSTICE LEWISON: And thus effect given to as much of  
22 it as can be given.

23 MR PHILLIPS: Absolutely, my Lord, and your Lordship will  
24 not be surprised to hear, and your Ladyship, that we  
25 will be submitting that the way in which we construe

1           these clauses does give effect to absolutely everything  
2           in those clauses. And they are consistent in that what  
3           they provide, both in the conditionalities and in the  
4           subordination provision itself, is that the debts are  
5           subordinated to the senior liabilities as defined.  
6           I will develop that, of course.

7           The second topic is the judge's approach to and  
8           construction of the simple contractual subordination.  
9           And this is the part of the subordination provision that  
10          defines or refers to which liabilities each instrument  
11          is subordinated, and we've described that as the  
12          definitional wording issues.

13          So those are the two issues. If I may turn to the  
14          conditionality issue first.

15          The key point of difference between us and PLC on  
16          the conditionality issue is that PLC argue that the  
17          subordination is effected by the conditionalities which  
18          follow, as you've seen, the definitional wording in the  
19          relevant subordination provisions, and they attach no  
20          weight to the definitional wording. And in our  
21          submission the definitional wording, in other words who  
22          are the senior creditors, is central to construing these  
23          subordination provisions. It defines the senior  
24          creditors or the senior liabilities to which the debts  
25          are subordinated.

1           The mechanics of subordination, in other words the  
2           interplay between the contractual and the contingent, is  
3           an issue that cuts across the first and second grounds  
4           of appeal. And PLC's case in relation to both is that  
5           the unamended Sub-Notes and the amended Sub-Notes turn  
6           on treating the respective conditionalities in those  
7           agreements as having a freestanding and independent  
8           effect, notwithstanding, my Lord, the point that  
9           your Lordship just put to me. And their argument is  
10          that they have a freestanding and independent effect  
11          regardless of the definitional wording.

12          In our submission, the judge erred in breaking up  
13          a single subordination provision and treating it as  
14          being comprised of two separate independent and, you  
15          will see, different mechanisms which could each dictate  
16          separate and potentially inconsistent ranking outcomes.

17          In our submission the subordination provisions in  
18          both the LBHI2 Sub-Debt and the LBHI2 Sub-Notes should  
19          be construed as a whole, producing a single ranking  
20          outcome, and the judge ought to have rejected PLC's core  
21          proposition that the conditionalities altered or even  
22          could alter the means of the definition of  
23          senior creditors.

24          And if PLC is wrong on its thesis that it is the  
25          conditionalities which effect subordinating, their case



1 on both the unamended Sub-Notes and the amended  
2 Sub-Notes doesn't get off the ground. Both cases depend  
3 on the independent primacy of the conditionalities.

4 My Lords, with that, as it were, as an overview,  
5 what we would like to do now, before turning to the  
6 detail of the subordination provisions, is to look in  
7 a little more detail at the statutory scheme. My Lord,  
8 I hope you will forgive me for what I doing. The judge  
9 in paragraph 122 -- I don't need to turn up this  
10 particular paragraph -- was right to find that the  
11 subordinated claims in this case are provable debts.  
12 I just wanted to start with the proposition these are  
13 provable debts. We don't have to get into the thorny  
14 question about non-provable debts.

15 The interplay between the statutory scheme and the  
16 subordination provisions is central to these appeals.  
17 That is because creditors' rights to payment in  
18 an insolvency can only operate within the statutory  
19 scheme. And that is a core proposition: rights to  
20 payment can only operate within the statutory scheme.  
21 If you could go to bundle A, authorities bundle 5,  
22 I just want to draw attention to some propositions that  
23 we have made in paragraphs 20 to 21 of our skeleton by  
24 reference to the rules.

25 If you would be kind enough to go to tab 80 in

1 authorities bundle 5. I will start at 2531, the  
2 numbering in the bottom corner. This is Rule 14.3(1):

3 "A creditor wishing to recover a debt must submit  
4 a proof to the officeholder ..."

5 Then there are some exceptions, which are not  
6 material. The critical point is that a creditor wishing  
7 to recover his debt -- and that's of course a very  
8 important point -- must prove their debt. They may  
9 choose not to prove or they may choose to prove late or  
10 they may choose to prove after other creditors have  
11 proved and received dividends. A very important point  
12 that I will come back to when we look at MCC.

13 Then if we could go two pages back to 2529. It  
14 deals with 14.2:

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

19 And as I said to you, these were provable debts. As  
20 my Lord, Lord Justice Lewison, will know, a contingent  
21 debt can prove at any time.

22 If we could then go to 2535. This is Rule 14.14,  
23 which deals with the estimate of value of debts:

24 "In an administration or in a winding up, the office  
25 holder must [please note that is mandatory] estimate the

1 value of a debt that does not have a certain value  
2 because it is subject to a contingency or for any other  
3 reason."

4 So it is mandatory: a contingent debt that is proved  
5 must be valued.

6 PLC seek to minimise the importance of the statutory  
7 scheme. With respect, that is misguided, because the  
8 statutory scheme is the scheme by which creditors in  
9 an insolvency can be paid and the subordination  
10 provisions are concerned, as you will see, with the  
11 right to payment. There are two ways in which my  
12 learned friends seek to minimise it. If we could take  
13 bundle C1, tab 8 is my learned friend's skeleton.  
14 I would have suggested leaving it out the whole time but  
15 I'm afraid there are a few files you will be dipping in  
16 and out of. But if we could start on page 103, they  
17 seek to challenge the centrality of the  
18 *pari passu* principle.

19 LORD JUSTICE LEWISON: Which page?

20 MR PHILLIPS: 103, my Lord, apologies. And it's in  
21 paragraph 14, in which they say that we set much store  
22 by the existence of Rule 14.12:

23 "It's main theory is the exercise of contractual  
24 interpretation necessary to determine the ranking issues  
25 eschewed by the existence of the default rule of

1        pari passu ranking."

2            And as to that, the starting point is that provable  
3        debts can prove at any time:

4            "An agreement by a creditor to subordinate their  
5        debt operates as an agreement to defer the creditor's  
6        right to prove after the senior liability has been paid  
7        in full."

8            And where it is unclear or equivocal whether two  
9        debts have agreed to defer their rights to proof  
10       vis-a-vis each other, the right to prove any time has  
11       not been displaced and the creditors continue to be  
12       entitled to prove at the same time as each other. And  
13       if they prove at the same time as each other they will  
14       rank pari passu under Rule 14.12.

15           My learned friends go on in 15 to say that the  
16        relevance -- if we look at the last sentence of  
17        paragraph 15 where this train of thought goes:

18           "The relevance of Rule 14.12 is that it is engaged  
19        in a gap-filling role if the contract runs out."

20           It does not assist in the determination of what the  
21        contract actually says. But there are really two points  
22        in relation to that. First of all, to describe a core  
23        principle of the insolvency process as a gap-filler is  
24        frankly extraordinary. Contractual subordination, as  
25        I hope I have already shown you, can only take place,

1 can only take effect, within the context of the  
2 statutory scheme.

3 And as to the significance of pari passu, could  
4 I ask you to take up authorities bundle 2, please,  
5 tab 33. That is at page 752.

6 LORD JUSTICE LEWISON: 752?

7 MR PHILLIPS: 53, I'm so sorry.

8 LORD JUSTICE LEWISON: Golden Key.

9 MR PHILLIPS: Golden Key, which, you can see, is a decision  
10 of Lord Clarke, Lady Justice Arden and  
11 Lord Justice Lloyd. I just wanted to show you two  
12 paragraphs, 5 and 6. Paragraph 5, which is on 755:

13 "Pari passu provisions are often commonly found in  
14 debentures. A provision for pari passu repayment can,  
15 however, be implied if it is clear that the debenture  
16 holders are to stand on an equal footing ..."

17 So that indicates to you, as it were, another  
18 approach to the core understanding:

19 "Accordingly, where a document on its true  
20 interpretation provides for the distribution of assets  
21 to a group of persons as between whom no distinction is  
22 to be drawn, the court will imply a requirement to make  
23 distributions proportionately even though the words  
24 'equally' or 'pari passu' are not used."

25 And I'm sure this is something that will be well

1 known to you. The pari passu principle and this sort of  
2 approach goes back to equalities, equity and a long --  
3 that's where this comes from:

4 "Such an implication is not, however, possible where  
5 the document evinces an intention that the distribution  
6 should be on some other basis.

7 Given its importance, the concept of pari passu  
8 distribution can be taken to be part of the background  
9 to the issue of the CP that would have been known [as  
10 the commercial paper] to the parties."

11 Then picking it up:

12 "The concept of pari passu distribution may also be  
13 a factor which makes one interpretation more plausible  
14 than another."

15 LORD JUSTICE LEWISON: Can I just ask you this, Mr Phillips:  
16 as you can imagine, the three of us have been discussing  
17 this case before we started, and we were all a bit  
18 puzzled by what contractual principle the judge applied  
19 in breaking the so-called race to the bottom. But  
20 I think your answer is, as you've been developing it,  
21 it's not really a contractual principle, it's the rules.

22 MR PHILLIPS: It's that the contract is ineffective in that  
23 you have two subordination instruments that say you are  
24 senior to each other. And where you have two provisions  
25 that do not subordinate one to the other, that's

1           ineffective to displace, as your Lordship says, the  
2           pari passu principle.

3           The learned judge described it as ineffectiveness.  
4           However one wants to describe it, what he's saying is  
5           there is no clear and effective subordination in one or  
6           the other as between the two of them.

7           Does that help, your Lordship?

8   LORD JUSTICE LEWISON: Yes. I think what you are really  
9           saying is that unless subordination of 1 to 2 or 2 to 1  
10          is clear, then the rule prevails.

11   MR PHILLIPS: Yes, my Lord.

12   LADY JUSTICE ASPLIN: Because they are both contractually,  
13          if you like, left in limbo, and accordingly the only way  
14          you deal with it is through the rules. If there had  
15          been some express -- sorry to be so basic; this is what  
16          you said, but if there were some express contractual  
17          term then you could see that one was over two or two was  
18          over one, but there is none, so they're all in the same  
19          boat; they're all in the same bucket. And accordingly  
20          you look to the rules. That's what you are saying?

21   MR PHILLIPS: Yes, my Lady.

22   LORD JUSTICE HENDERSON: Was another way of making the same  
23          point perhaps to be say that referring to it as default  
24          provision can be dangerous because it rather suggests  
25          it's something you rather put that the back of your

1 mind, unless and until you are driven to that, whereas  
2 rather it's both the starting point and the end point,  
3 unless you find a very clear contrary provision.

4 MR PHILLIPS: Absolutely, my Lord. Absolutely. Forget  
5 default, forget gap-filler. Those aren't helpful  
6 as labels.

7 May I go on to my second point, which is that PLC  
8 ignore the significance of proving in the context of  
9 subordination. If we could go back to core bundle 1 to  
10 paragraph 47 of their skeleton, which is at 113, tab 8,  
11 where what they --

12 LORD JUSTICE LEWISON: Sorry, which paragraph?

13 MR PHILLIPS: 47, my Lord. I'm looking at the statement  
14 five lines up from the bottom. They say:

15 "SLP3's focus on proving as a matter of insolvency  
16 process is unnecessary and potentially misleading."

17 As to that, could I go back to appeal bundle 5 and  
18 to Rule 14.3, which is at tab 80/2531, just to remind  
19 your Lordships -- or maybe you don't need to turn it up  
20 again -- a creditor wishing to recover must submit  
21 a proof.

22 It's not unnecessary and it's not misleading in any  
23 way. It's the context in which these provisions  
24 operate. A creditor cannot obtain payment through any  
25 other mechanism. That's really important. And when



1 subordinate debt agreements refer to prohibitions on  
2 payment being made on the subordinated debts, in  
3 an insolvency context that is necessarily a reference to  
4 proof, given that it is, as I've shown you, only by  
5 proving that one can be paid a dividend.

6 This is also made clear by GENPRU. If I could ask  
7 you to go to tab 81 in authorities bundle 5, and if you  
8 could go to 2552. This is the Prudential sourcebook  
9 pursuant to which the subordinated instruments have been  
10 produced. And I just wanted you to see rule 2.2, 1.159,  
11 subrule 3:

12 "To the fullest extent permitted under the laws of  
13 the relevant jurisdictions, the remedies available to  
14 the subordinated creditor in the event of non-payment or  
15 other breach of the terms of the capital instrument ...  
16 must [mandatory] be limited to petitioning for the  
17 winding-up of the firm or proving for the debt in the  
18 liquidation or administration."

19 So it's all of a piece. It's a whole structure.  
20 The remedies available to the creditors are that they  
21 can wind up or, of course, if it's in an insolvency they  
22 can prove. And you've seen that proof is necessary to  
23 receive payment.

24 In our submission, my Lords and my Lady, the core  
25 subordination question arising in an insolvency is below

1           which senior creditors do they proof? For your  
2           Lordships' note, it's in paragraph 46 of our appeal  
3           skeleton. And that question is answered by looking at  
4           how the senior creditors are defined.

5           In contrast, PLC's approach turns on having the  
6           conditionalities dictate relative ranking without any  
7           regard to the definition of the senior creditors to whom  
8           the subordinated creditor has subordinated itself.

9           We'll see later, and I will develop it later, that  
10          their submission terms the senior creditors who are as  
11          defined as to all creditors. We'll come back to that.

12          The next thing, my Lords, I would like to do --  
13          sorry, I'm dealing with a number of the building  
14          blocks -- if I may, is I want to take your Lordships  
15          through two important cases on subordination, which are  
16          the MCC case and Waterfall 1.

17          If I could turn to authorities bundle 1 at tab 17  
18          first. This is the decision of Mr Justice Vinelott in  
19          1993 in Maxwell Communications Corporation. And it is  
20          a foundational judgment in relation to subordination.  
21          In MCC, the question was whether the holders of  
22          subordinated debt could be excluded from a scheme of  
23          arrangement. If the subordination provision was  
24          effective, they could be excluded. If it was not  
25          effective, they could not be excluded.

1           And if I could first show you the subordination  
2           provision, which is on internal page -- well, in the  
3           bundle it's page 304, and it's internal page 1405H. If  
4           I can just show you the subordination provision to  
5           start with:

6           "Under the guarantee, MCC undertook to pay on first  
7           demand by SPC in summary ... (Reading to the words) ...  
8           the paid up value of the outstanding bonds with  
9           interest. It provided that the guarantee of payment of  
10          the nominal value ... (Reading to the words) ... with  
11          regard to the bonds and the paid-up value of the  
12          presents shares under this guarantee constitutes  
13          an unsecured and subordinated obligation of the  
14          guarantor in that in any case of any distribution of  
15          assets by the guarantor whether the cash or otherwise in  
16          liquidation or bankruptcy..."

17          And picking it up just above B:

18          " ... creditors of unsubordinated indebtedness of  
19          the guarantor shall be entitled to be paid in full  
20          before any payment shall be made on account of payments  
21          under the bonds or the preference shares but that  
22          payments to bondholders, coupon holders and preference  
23          shareholders shall be made before any payment shall be  
24          made in such cases to the holder of any class of stock  
25          in the guarantor."

1           Now, it was a contractual subordination provision,  
2           and the reason for that is that there is no trust law in  
3           Switzerland, and that provision was found to be  
4           effective absent some other form of conditionality. And  
5           if we can go to 4011G, which is on 310 of the bundle.

6           If I can --

7   LORD JUSTICE LEWISON: Starting "The question is"?

8   MR PHILLIPS: Yes, my Lord. One of the reasons why this was  
9           such a major question at the time is that post British  
10          Eagle there was a question as to whether or not public  
11          policy meant that you couldn't have any form of  
12          subordination. That was the big issue at the time in  
13          1993.

14          "So the question is whether this underlying question  
15          of consideration of public policy should similarly  
16          invalidate an agreement between a debtor and ...

17          (Reading to the words) ... --

18   LORD JUSTICE LEWISON: You don't need to read it aloud.

19          Just tell us what you want us to read.

20   MR PHILLIPS: G, down to the end, just above letter C on  
21          1412, please. Thank you. I apologise. I meant to do  
22          that. (Pause).

23          My Lords, my Lady, you can see that Mr  
24          Justice Vinelott's reasoning was: well, if a creditor  
25          can choose whether or not he wishes to prove his debt at

1 all, why can't he decide not to prove until some other  
2 creditors have been paid? And if he can do that, why  
3 can't he pre-agree to do that? And that was  
4 his reasoning.

5 Then if we can move forward to 470 at B. I just  
6 want to show you, if you could -- at D --

7 LADY JUSTICE ASPLIN: Where am I looking, again?

8 MR PHILLIPS: It's on page 316. It's internal number 1417.

9 I just wanted to say, at letter D he moves on to  
10 ex parte De Villiers, which is a decision in  
11 South Africa, and he was looking at the decision of  
12 Justice Goldstone. And if you could pick it up, please,  
13 at 1417F to 1418B, and if you wouldn't mind just reading  
14 that passage.

15 (Pause).

16 LORD JUSTICE LEWISON: What's the proposition --

17 MR PHILLIPS: Sorry, there are two. The first proposition  
18 is that 14.17G is PLC's argument in this case:

19 "Enforceability ... (Reading to the words) ...  
20 conditions ..."

21 And so on. At 1418 A to B it is noteworthy that  
22 Justice Goldstone said that the suggestion that a value  
23 should be put on a contingent debt, that is not correct.  
24 And you will see, my Lords, and I will point this out,  
25 that Lord Neuberger in Waterfall 1 held that you do put

1 a value on those debts.

2 Then in 1418 F to H the proposition there is that  
3 Mr Justice Vinelott expressed doubt as to whether  
4 subordination turns a debt into a contingent liability.  
5 And perhaps, rather than spend the time now, if you  
6 could just note that.

7 LORD JUSTICE LEWISON: Wouldn't that depend on the terms of  
8 the instrument creating the debt?

9 MR PHILLIPS: My Lord, of course it does. You could create  
10 a contingent liability but we'll see that that debate is  
11 picked up and run with.

12 Can we then move to Lehman Waterfall 1. I want to  
13 start, if I may, in the authorities bundle 3 at tab 51.  
14 My Lords, I hope that you will forgive me for taking you  
15 through first instance, Court of Appeal and Supreme  
16 Court, because you cannot really understand what the  
17 Supreme Court did without seeing the previous debate.  
18 And of course my Lord, Lord Justice Lewison, wrote the  
19 lead judgment in the Court of Appeal so I'm acutely  
20 conscious that you will be very familiar with this.

21 LORD JUSTICE LEWISON: Mr Justice David Richards explains  
22 the regulatory capital regime extremely clearly at first  
23 instance and I think that's particularly valuable.

24 MR PHILLIPS: He certainly does. Absolutely.

25 The first point to note is that Waterfall 1

1 addressed Sub-Debt in the same form and for the same  
2 amounts as the LBHI2 Sub-Debt in this case. Whether you  
3 describe it as one up the chain or one down the chain,  
4 it was in the same chain of regulatory capital within  
5 the Lehman companies. And that is an important point to  
6 have in mind, of course, the courts were looking at the  
7 same Sub-Debt terms.

8 PLC argues that the decisions were confined to  
9 a very narrow argument concerning Rule 2.88(7).

10 That, with respect, is incorrect. Mr Justice David  
11 Richards and the Court of Appeal and the Supreme Court  
12 were concerned more broadly with how subordination under  
13 clause 5 of FSA Standard Form 10 operated and whether it  
14 was subject to a form of contingent debt subordination.

15 So if I could ask you to cast your eyes over, on  
16 page 1463, Mr Justice David Richards' judgment. If you  
17 could cast your eyes over holding number 1 on 1464.

18 (Pause).

19 My Lords, you can see the conclusion:

20 " ... on the true construction the subordinated debt  
21 agreements had the effect that the subordinated loan  
22 credited loans were subordinating not only to provable  
23 be a debts but also to statutory interest and provable  
24 liabilities."

25 LORD JUSTICE LEWISON: "On a true construction" means on

1 a true construction of the instrument, not the rules.

2 MR PHILLIPS: Yes, but the instrument operates within  
3 the rules.

4 LORD JUSTICE LEWISON: Of course.

5 MR PHILLIPS: No, absolutely, and this is significant. As  
6 your Lordship will see, the debate develops when one  
7 then looks at what Mr Justice Marcus Smith has done with  
8 this very same instrument. And that's one of the main  
9 reasons why I'm taking your Lordships through this.

10 Could you turn to paragraphs 16 and 17 on 1480 and  
11 perhaps just note that what Mr Justice David Richards  
12 does in those paragraphs is he describes the process of  
13 proof and valuation, which, as you know, is the process  
14 that is mandated by the rules, but perhaps one that you  
15 would look at later. But then at paragraph 33 at 1484  
16 where Mr Justice David Richards explains that the  
17 subordinated loans formed part of the regulatory  
18 capital. And as your Lordship has already indicated, he  
19 then goes on to explain the capital adequacy rules  
20 regime.

21 Really, and this is for your note, in 43 through to  
22 46 there is a very helpful description of the tiers of  
23 regulatory capital, and in the present case all of the  
24 subordinated debt was lower tier 2 or possibly tier 3.  
25 And you fall into the different tiers depending upon the



1 terms of the various debt instruments, so that, for  
2 example, tier 3 is going to be shorter two-year  
3 subordinated debt, just by way of example.

4 Then if I may pick it up in 48, where  
5 Mr Justice David --

6 LORD JUSTICE LEWISON: Before you move on, do the capital  
7 adequacy rules prescribe for relevant priorities as  
8 between the three tiers of capital or the three tiers  
9 and two sub-tiers?

10 MR PHILLIPS: There is one reference that I will draw to  
11 your attention in due course which provides that tier 3  
12 ranks pari passu with lower tier 2 debt. There is one  
13 reference but otherwise, of course, my Lords, I would  
14 have taken you straight to it.

15 LORD JUSTICE LEWISON: Yes.

16 MR PHILLIPS: Then in 48, what Mr Justice David Richards  
17 notes is that each of the subordination provisions were  
18 based heavily on the templates provided by the FSA. And  
19 the significance of that is that what the court was  
20 construing was clause 5 of FSA Standard Form 10, which  
21 is clause 5 in the Sub-Debt in this case.

22 My Lords, you can see that in paragraph 53, where  
23 clause 5 is set out.

24 Then if I can move on to paragraph 60. If you could  
25 just note what Mr Justice David Richards says:

1            "In approaching the issues of construction of the  
2            subordinated facility agreements, it is clearly right to  
3            have regard to their to regulatory context."

4            And then, my Lords, again for your note, but can we  
5            then move on to 63:

6            "All of this is consistent with the concept that  
7            subordinated loan capital qualifying as part of  
8            the institution's regulatory capital is, as against  
9            creditors, to be treated as part of the 'capital' of the  
10           institution. Is it is not of course part of the share  
11           capital of the company and it ranks ahead of any share  
12           capital in terms of repayment."

13           And my Lords, your Lordships will obviously note  
14           that if it's debt it ranks ahead of capital.

15           Three points for your note, if I may just make them.  
16           At paragraph 77, Mr Justice David Richards set out the  
17           rights of contingent and future creditors. And then  
18           again for your notes, in 81 and 82 Mr Justice David  
19           Richards set out the development of how contractual  
20           subordination works. And you'll note in paragraph 82  
21           that he refers to MCC.

22           Please don't put away authorities bundle 3 but  
23           I just wanted to look at the order, Mr Justice David  
24           Richards' order, which you will find in authorities  
25           bundle 5, tab 84 at 2784.

1           And my Lords, it is important in order to  
2           understand, as it were, what happened next. The  
3           declaration that Mr Justice -- do you have 2874? That  
4           is tab 84.

5   LORD JUSTICE LEWISON: Yes.

6   MR PHILLIPS: Thank you. The declaration was -- I'm picking  
7           it up in line 3:

8           " ... are subordinated to provable debts, statutory  
9           interest and non-provable liabilities, all of which,  
10          other than the claims of LBHI2 under its subordinated  
11          loan agreement ... (Reading to the words) ... thereon,  
12          must be paid in full before LBHI2 is entitled to prove  
13          and require the LBIE administrators to admit such proof  
14          in respect of its claims under its subordinated loan  
15          agreements with LBIE."

16          So that is the declaration made by Mr Justice  
17          David Richards.

18   LORD JUSTICE HENDERSON: Sorry, which subparagraph? My  
19          fault entirely.

20   MR PHILLIPS: Sorry, it's 1, my Lord.

21   LORD JUSTICE HENDERSON: Thank you. On page 2874?

22   MR PHILLIPS: 2874. It's 1, my Lord. And you can stop  
23          before it goes on to B.

24   LORD JUSTICE HENDERSON: Thank you very much.

25   MR PHILLIPS: So against that background, could I turn to

1 the Court of Appeal decision.

2 LORD JUSTICE LEWISON: It was that declaration which the  
3 Supreme Court reinstated.

4 MR PHILLIPS: It is, my Lord. That's why I'm doing this.  
5 It's so that your Lordships can fully understand exactly  
6 what happened in relation to contingent debt analysis.

7 LORD JUSTICE LEWISON: Yes.

8 MR PHILLIPS: In order to understand what the Supreme Court  
9 did -- I appreciate, my Lord, for your Lordship that is  
10 going to be relatively straightforward because  
11 your Lordship wrote the leading judgment in the  
12 Court of Appeal.

13 LORD JUSTICE LEWISON: I was wrong on that.

14 MR PHILLIPS: My Lord, it's not for me to put any sort of  
15 subjective intention in relation to what the Supreme  
16 Court said about your Lordship's judgment. There it is.  
17 That's what the Supreme Court have said.  
18 The first point to flag in relation to the  
19 Court of Appeal --

20 LORD JUSTICE LEWISON: You are going to the Court of  
21 Appeal now?

22 MR PHILLIPS: Yes, I'm so sorry. It's in authorities 3 at  
23 tab 53. The first point to flag from the headnote is  
24 that, I respectfully submit, it is actually notable that  
25 Maxwell was not referred to in the judgment, nor in

1 argument. It had, of course, been referred to in  
2 Mr Justice David Richards' judgment, as you have seen,  
3 but it does not appear to have been referred to the  
4 Court of Appeal in argument.

5 If you could turn to holding 1, if you will forgive  
6 me for just going through this with your Lordships.

7 Holding 1 is that:

8 " ... an administrator's obligation under rule  
9 2.88(7) ... to pay interest out of the surplus was not  
10 merely a direction."

11 So you were dealing with that point.

12 And just picking it up further down where it says  
13 at C:

14 " ... the subordinated debt was thus repayable on  
15 contingencies which included payment of statutory  
16 interest and of any non-provable liabilities, and any  
17 valuation of the contingent debt had to take account of  
18 both contingencies; and that, accordingly, under the  
19 agreement the subordinated loan creditor claims were  
20 subordinated not only to provable debts but also to  
21 statutory interest and non-provable interest."

22 The point that I wanted to draw to your Lordship's  
23 attention is that the decision of the Court of Appeal  
24 was that the subordinated debt was payable on  
25 contingencies. And of course, my Lord, it's

1           your Lordship's decision, your Lordship will be well  
2           aware of that.

3   LORD JUSTICE LEWISON:   The dispute was whether it  
4           was provable.

5   MR PHILLIPS:   Absolutely.

6   LORD JUSTICE LEWISON:   And I thought it was, and the Supreme  
7           Court said it wasn't.

8   MR PHILLIPS:   That's absolutely right, my Lord.   It's  
9           interesting -- I was wondering at what point I might  
10          need to a tin hat.

11   LORD JUSTICE LEWISON:   You don't need a tin hat, I quite  
12          often get things wrong.

13   MR PHILLIPS:   The argument which was run -- this is very  
14          ironic, when you go through the Waterfall decisions  
15          there is an array of talent.   But the argument that was  
16          run which persuaded your Lordship was an argument of  
17          Mr Snowden, as he then was, but the argument that he was  
18          running was that the debt was contingent and so the  
19          subordinated debt could prove, and, having proved, when  
20          there was a surplus over the principal, the principal  
21          unsubordinated debt, the contingent would be revalued,  
22          the subordinated debt would be paid before the interest,  
23          under 288.   That was the argument.   In fact, you can see  
24          that argument on 1588.   It's at 59 C to D.   You see  
25          Mr Snowden, as he then was, his argument.

1           My Lords, that argument was then picked up, if we  
2           could go to 1603 to paragraph 38. If you would forgive  
3           me for going through this. In my Lord,  
4           Lord Justice Lewison's judgment what you said is:

5           "There are a number of different ways in which  
6           subordination agreements can be drawn."

7           And you there deal with and summarise the different  
8           methods of subordination. And then it's really just  
9           below letter F:

10          "In my judgment clause 5(1) means that the right to  
11          repayment of the subordinate debt is a contingent right,  
12          contingent on the satisfaction of clause 5(1)(b), and,  
13          if appropriate, clause 5(5)(a) as well."

14          It is that sentence, my Lord, because that is  
15          precisely what Mr Justice Marcus Smith has held.

16          And of course, my Lords, I showed you Mr Snowden's  
17          submissions. Your Lordship was picking up Mr Snowden's  
18          submission and clause 5(1)(b) is the solvency condition  
19          on which PLC places all its emphasis in this case.

20        LORD JUSTICE HENDERSON: The fact it's not correctly  
21        characterised as a condition doesn't necessarily mean  
22        it's not the right place to find the answer, is it?

23        It's a question of construction, of course --

24        MR PHILLIPS: Of course.

25        LORD JUSTICE HENDERSON: -- of the thing read as a whole.

1 MR PHILLIPS: Of course one has to construe it and one has  
2 to construe it correctly. And we will do that in due  
3 course. One of the things that your Lordships will see  
4 is that, in part, what led Mr Justice Marcus Smith into  
5 error is that he has separated out the different  
6 elements. He has decided that 5(1)(b) creates  
7 a contingent debt, and he has then applied that  
8 separately. And it led him into confusion.

9 But, my Lord, you are absolutely right, you still  
10 have to look at the clause to find the answers. And  
11 I hope I will do that.

12 LORD JUSTICE HENDERSON: I don't want to take you out of  
13 your course at all. I was perhaps just laying down  
14 a bit of a marker. Also I think there is much force in  
15 your criticism, at least it seems to me at the moment,  
16 that the judge was, as it were, over analytical in the  
17 way he divided up if clauses into little morsels when it  
18 needed a sort of synoptic view rather than an ultra  
19 salami slicing one.

20 MR PHILLIPS: My Lord, that is our submission. And the  
21 relevance of contingent debt, that is not the sole  
22 point. The relevance of contingent debt is of course it  
23 has consequences to how it fits into the statutory  
24 scheme.

25 One of the very important points is, of course,



1 your Lordship in the Supreme Court were construing the  
2 conditionalities in this case, and that is one of  
3 the reasons I'm, I hope, not labelling it too much. In  
4 paragraph 39, it starts with: there's no express  
5 prohibition on proving clause 5. But again there is,  
6 with respect, no addition of the opening part of the  
7 contractual subordination, because that is what  
8 contractual subordination does.

9 Then your Lordship picked up towards the end of 39  
10 the point that clause 7E had been relied on. And  
11 your Lordship made the point that you can't rely on 7E  
12 as prohibiting the action; you have to decide the extent  
13 of the subordination. And you say that is found in  
14 clause 5 not in clause 7. And we respectfully agree  
15 with your Lordship that subordination is not found in  
16 clause 7.

17 Then paragraph 41 --

18 LORD JUSTICE LEWISON: Sorry to hold you up. The debate, as  
19 I recall, and I think it's borne out by looking at any  
20 judgment, was whether the subordinated creditors were or  
21 weren't entitled to prove. You haven't shown us how  
22 Mr Justice David Richards dealt with that issue, on  
23 which I clearly disagreed with him. If you can give me  
24 a page reference. You don't need to turn it up now, but  
25 just to remind myself.

1 MR PHILLIPS: May we come back with the page reference for  
2 your Lordship's note?

3 LORD JUSTICE LEWISON: Yes.

4 MR PHILLIPS: You are absolutely right. But yes, and the  
5 reason why you got into contingent debt was Mr Snowden's  
6 very clever argument, which was of course contingent  
7 debt can prove throughout, and Mr Snowden's argument was  
8 this is a contingent debt, ergo they can prove  
9 throughout, ergo the decision that Mr Justice David  
10 Richards had made, which was that a contractual  
11 subordination provision means that you can't prove until  
12 after the senior creditors. Putting it very basically.  
13 That's where he ran contingent debt. And your Lordship  
14 was persuaded.

15 We'll move on. I will do that in a moment, if you  
16 will forgive me.

17 Paragraph 41, where your Lordship says:

18 "I would accept Mr Snowden QC's argument that the  
19 subordinated debt is a contingent debt. It is  
20 contingent not because of its position in the rankings  
21 in insolvency but because the subordination agreement  
22 itself provides that repayment is not due until certain  
23 conditions have been satisfied."

24 So my Lord, we respectfully submit that that is the  
25 ratio of the decision. And that is relevant

1 going forward.

2 Can I then just show you the order, which is in  
3 authorities bundle 5, just to make good so you can trace  
4 the changes. It's in tab 85, and I wanted to take you  
5 to 2882. My Lords, it's order number 2, where order 1,  
6 which we've looked at, was varied to declare that:

7 "Claims of LBHI2 under its subordinated loan  
8 agreements to LBIE are provable in the administration or  
9 liquidation of LBIE but are subordinated to provable  
10 debts ...(Reading to the words)... and are repayable  
11 only on contingencies including payment of such claims."

12 So that is the change that was made in the  
13 Court of Appeal.

14 Before turning to the Supreme Court, I just want to  
15 make two points, if I may, which we would respectfully  
16 submit are material. The first is that neither  
17 Mr Justice David Richards nor the Court of Appeal held  
18 that the same subordination provision could both operate  
19 as precluding proof until a particular point and result  
20 in the debt being a contingent debt that could be proved  
21 at any time.

22 LORD JUSTICE LEWISON: Sorry, say that again. Neither ...

23 MR PHILLIPS: Neither Mr Justice David Richards nor the  
24 Court of Appeal held that the same subordination  
25 provision, which is clause 5, could both operate as

1 precluding proof until a particular point -- which is  
2 the effect of simple contractual subordination, using  
3 the language in the judgment in this case -- and also  
4 result in the debt being a contingent debt that could be  
5 proved at any time.

6 In other words, in neither Mr Justice David  
7 Richards' judgment nor in the Court of Appeal's judgment  
8 did you get this bifurcation that we get in this case.

9 The second point, just to underline the point, is  
10 that the Court of Appeal held that the subordination  
11 took effect by way of a contingency under 5(1)(b), the  
12 solvency condition. As I've indicated to your Lordship,  
13 that was an important point in Mr Snowdon's argument,  
14 because if the debt was contingent, it was part of the  
15 debts proved and it would therefore rank for interest.  
16 That is why the argument was run.

17 I then want to turn to the Supreme Court, which is  
18 in authorities bundle 4 at tab 58, and it starts at  
19 page 189. Could you just cast your eyes over holding 1.  
20 You'll see that the appeal was allowed in part in  
21 relation to the first question. The holding records:

22 "It would not be possible ...(Reading to the  
23 words)... either the non-provable liabilities been paid  
24 in full or it's clear ...(Reading to the words)... would  
25 be met in full."

1           Then if we can go forward to 473 internal, which is  
2           1817. That's just where they note the change in the  
3           Court of Appeal.

4           Then we see -- and perhaps this is one for your  
5           notes, but Mr Miles had taken over from Mr Snowden, and  
6           Mr Miles ran the arguments that were being run by  
7           Mr Beltrami before you. You might like to look at those  
8           in due course.

9           Going on to 37, if you could cast your eyes over 37,  
10          but note that what Lord Neuberger records is that the  
11          disagreement was over whether the subordinated creditors  
12          could prove and require the administrators to admit  
13          their proofs until after the proving creditors had been  
14          paid in full.

15          So that was the issue.

16          Then in 38, which records those issues, you can see  
17          that the LBIE administrators appealed the point on  
18          proof, arguing that the subordinated debt ranked behind  
19          statutory interest and non-provable debts and they  
20          argues that Mr Justice David Richards was right and  
21          LBIH2 was not entitled to prove until the senior  
22          creditor had been paid in full.

23   LORD JUSTICE LEWISON: We said that it was subordinated, it  
24          was just a question of when you could prove.

25   MR PHILLIPS: My Lord, you said it was contingent debt.

1           Subordinated but using a contingent mechanism.

2   LORD JUSTICE LEWISON:   Yes.

3   MR PHILLIPS:   And for your notes, if we can go forward to 66  
4           on 1846, paragraph 66, between letter D to the end of  
5           the paragraph, the point that Lord Neuberger --

6   LORD JUSTICE LEWISON:   66, letter G, did you say?

7   MR PHILLIPS:   Letter D, I apologise.

8            "In agreement with all parties I can see no ..."

9            Lord Neuberger there explains the limits of  
10          subordinated debt, and he explains that you can always  
11          agree to subordinate your debt; you can't agree to  
12          improve your position, unless everybody who is being  
13          subordinated agrees.

14   LORD JUSTICE LEWISON:   Yes.

15   MR PHILLIPS:   All of which brings me to 68 through -- I'm  
16          trying not to take too long over this. At 68,  
17          Lord Neuberger sets out Mr Justice David Richards'  
18          decision and says the Court of Appeal disagreed. And  
19          picking it up above C:

20          "However, they said that, until the Senior  
21          Liabilities have all been paid in full, the subordinated  
22          debt would be a contingent debt, and because of the  
23          terms of the Loan ..."

24          Then in 69 he says:

25          "In my judgment, David Richards J's view on this

1 point is to be preferred. The Court of Appeal's view  
2 appears to me to raise a logical problem. If, at the  
3 time such a proof was lodged, there was a chance that  
4 the Senior Liabilities would be paid in full, then, as  
5 with any other debt which rests on a contingency that  
6 may occur, a valuation of that proof would not be nil."

7 That's why I refer to the point made in the  
8 South African case earlier, where it said the opposite:

9 "It would have to be a figure which discounted the  
10 sum due, in order to allow for the contingency not  
11 occurring. However, if the proof is ascribed  
12 a valuation greater than nil, it would have to be paid  
13 out on any distribution ..."

14 So in other words, you value whether or not the  
15 contingency is going to be met, you then declare  
16 dividends, and as you go the subordinated creditors are  
17 paid dividends before the senior creditors had been paid  
18 in full. That was the point.

19 LORD JUSTICE LEWISON: Yes. Lord Neuberger finds the answer  
20 to the question in clause 7, not in clause 5. What he  
21 says is that he prefers Mr Justice David Richards' view  
22 that clause 7(d) or (e) has the effect of precluding the  
23 lodging of a proof. I had said I didn't think it did.  
24 I was wrong about that. And then again at 69, just  
25 below E, he says:

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

3           So it all turns on clause 7.

4   MR PHILLIPS: With respect, my Lord, no, it turns on two  
5           things, because Lord Neuberger says that where you have  
6           the effect of a contractual subordination clause,  
7           a simple contractual -- it's in paragraph 70:

8           "It therefore follows that, in my view, it would not  
9           be open to LBHI2 to lodge a proof in respect of the  
10           subordinated debt until the non-provable liabilities  
11           have been paid in full, or at least until it is clear  
12           that, after meeting that proof in full and paying any in  
13           the voter interest due on it the non-proveable liable  
14           statutory interest due on it, the non-provable  
15           liabilities could be met in full. As soon as that has  
16           happened, there would, subject to what I say in the next  
17           paragraph, be nothing to stop LBHI2 lodging a late  
18           proof."

19           that does not depend on clause 7, my Lord, because  
20           your Lordship has seen, going right back to  
21           Mr Justice Vinelott's decision, and it's a point that  
22           Mr Justice Marcus Smith got right, which is that where  
23           you agree that you will be subordinated to a senior  
24           creditor, you cannot prove until. Clause 7, as  
25           your Lordship rightly said in your Lordship's judgment,



1 does not determine the degree of subordination or when  
2 you can prove. You have the point at which you can  
3 prove from the agreement.

4 LORD JUSTICE LEWISON: That's what I thought, but that  
5 doesn't seem to be what Lord Neuberger thought.

6 MR PHILLIPS: My Lord, there are two points running in  
7 parallel here. One is the contingent debt analysis.  
8 And that is what the Supreme Court disagreed with. The  
9 second is when under contractual subordination provision  
10 you can prove. And if you agree that you will prove  
11 after the senior creditors, you cannot prove as a matter  
12 of contract, you can't prove until after the senior  
13 creditors.

14 That is precisely what happened in MCC. And the  
15 learned judge was right here. Clause 7 is not  
16 determinative. It is, as it were, enforcing  
17 an additional right to stop someone proving. But you  
18 can't -- you see, if you take out clause 7 and ask  
19 yourself the question: could a subordinated creditor  
20 prove at any time absent clause 7? Of course not,  
21 because they have agreed to be subordinated as a matter  
22 of contract to the senior creditors, which means they  
23 have agreed not to prove until after the senior  
24 creditors have been paid.

25 LORD JUSTICE LEWISON: You presumably could do that through

1           the mechanism of a contingency provided that you  
2           undertook not to prove your contingent debt until other  
3           credits had been paid out.

4   MR PHILLIPS:   You could do it -- if your Lordship is --

5   LORD JUSTICE LEWISON:   The fact that it is contingent  
6           doesn't necessarily mean that you can or cannot prove.  
7           You have to look somewhere else in the instrument to  
8           decide whether or not you've agreed not to prove.   And  
9           as I read what Lord Neuberger said he found that in  
10          clause 7.

11   MR PHILLIPS:   Well, my Lord, if your Lordship is asking  
12          me: is it possible to have a contingent debt, and you  
13          agree you will not prove your contingent debt, of course  
14          it is.   That's a matter of contract.   You could do that.  
15          If you are putting to me that the only reason why they  
16          couldn't prove is clause 7, then I respectfully  
17          disagree --

18   LORD JUSTICE LEWISON:   Right.

19   MR PHILLIPS:   -- because once you have agreed to subordinate  
20          your debt to the senior creditors, you have agreed you  
21          shall not prove.   And that is what you get from MCC.  
22          And that is also picked up correctly by the learned  
23          judge in this case.

24                 So my Lords, the last paragraph, 72, is where  
25          Lord Neuberger restores paragraph 1 of the order made by

1 David Richards. He says:

2 " ... although I agree with the Court of Appeal that  
3 he was right as to the ranking ... I disagree with the  
4 Court of Appeal, and agree with the Judge, as to when  
5 the subordinated creditors can prove ..."

6 What you get from the Supreme Court judgment, and  
7 that run, is the ratio -- I don't need to make  
8 excuses -- the ratio of the case was clause 5(1)(b) of  
9 the agreements we're looking at here on the Sub-Debt do  
10 not create contingent debt.

11 If I can then go to the judgment, which is in volume  
12 C2 at tab 22. I just wanted to go to paragraph 121,  
13 which is on 379.

14 LORD JUSTICE LEWISON: Can I put Mr Beltrami's skeleton away  
15 or do you still want me to keep that out?

16 MR PHILLIPS: I am about to turn to it again.

17 LORD JUSTICE LEWISON: You are, all right. In that case  
18 I will keep it out.

19 MR PHILLIPS: 121. Your Lordship will see that the Supreme  
20 Court agreed with Mr Justice David Richards. And then  
21 there's a footnote and it says:

22 "The Supreme Court disagreed with the analysis of  
23 the Court of Appeal, but if I'm right the  
24 Court of Appeal viewed these provisions as amounting to  
25 contingent debt subordination. That disagreement was

1 less to do with the right to prove and more to do with  
2 the difference of view between the various instances as  
3 to the nature of the clauses before them."

4 What we would say about that is that the judge  
5 identified the problem that there were two related  
6 issues: namely the right to prove and the nature of the  
7 clause. And in that case the nature of the clause was  
8 whether it created a contingent debt.

9 But what the learned judge in our case went on to  
10 do -- and we will see this -- is he held that the same  
11 FSA form, same clause, could still include a contingent  
12 debt component. And if, as we say he did, the learned  
13 judge concluded that this clause did include contingent  
14 debt subordination, it is contrary to the Supreme  
15 Court's reasoning and it was not an analysis that was  
16 open to him.

17 If I can then take up bundle C1, tab 8, which is my  
18 learned friend's skeleton, which your Lordship has kept  
19 out, and just turn to 25B and C. My learned  
20 friend says:

21 "If, as appeared to be suggested before the judge,  
22 the submission is the Supreme Court in some way  
23 disagreed with Lord Justice Lewison's description of  
24 methods of subordination either generally or with regard  
25 to paragraph ...(Reading to the words)... in

1 Lord Justice Lewison's judgment, none of which was  
2 controversial."

3 That was your Lordship's description of the  
4 different methods of subordination:

5 "The Supreme Court did disagree with Lord Justice  
6 Lewison's subsequent views expressed as in addition as  
7 to when a ...(Reading to the words)... This was in  
8 connection with an issue on which no point runs in the  
9 present case."

10 And your Lordships have seen that the discussion  
11 about whether or not it created contingent debt was,  
12 I would respectfully submit, the ratio.

13 May I now move on, with huge apologies for having  
14 taken so long so far, to construing the LBHI2 Sub-Debt.  
15 Can we pick up volume C3 at tab 38.

16 LORD JUSTICE LEWISON: I should perhaps have said in telling  
17 you what we have read that we have read the relevant  
18 provisions of the various instruments, not only as  
19 quoted by the judge but also in their original form.

20 MR PHILLIPS: Right.

21 LORD JUSTICE LEWISON: I can't say I have read every single  
22 word but the relevant subordination provisions.

23 MR PHILLIPS: There's no need, my Lord. There's no need.

24 Your Lordship -- may I take this at a bit of a pace.

25 LORD JUSTICE LEWISON: You take it at your own speed,

1 Mr Phillips.

2 MR PHILLIPS: Your Lordships see in tabs 38, 39 and 40 there  
3 are three different Sub-Debt Agreements, all in the same  
4 terms apart from the currencies. If you look at 670 you  
5 can see the heading and then you get variable terms that  
6 start on page 671 and standard terms that start on 675.  
7 If we could go to 675, clause 1 is interpretation, which  
8 you will have seen. And the order in which I wish to  
9 take it is 676 liabilities:

10 "Liabilities is widely drawn. It's all present and  
11 future sums, liabilities, obligations ..."

12 And so on.

13 That is a widely drawn provision in relation to  
14 liabilities.

15 And then we see in 676, further down, senior  
16 liabilities. It means:

17 "All liabilities except the subordinated liabilities  
18 and excluded liabilities."

19 And the point is that anything that is not  
20 a subordinated liability or an excluded liability in  
21 this agreement is a senior liability. With respect to  
22 anyone who says otherwise, that is as plain as  
23 a pikestaff.

24 We then have subordinated liabilities. They mean:

25 "All liabilities to the lender in respect of the

1 loan or each advance made under this agreement and all  
2 interest payable thereon."

3 So, again, it is only the advances under this  
4 agreement that can be the subordinated liabilities.

5 LORD JUSTICE LEWISON: Is that an FSA standard term?

6 MR PHILLIPS: These are FSA standard terms. I think --

7 LORD JUSTICE LEWISON: Including the definition of  
8 subordinated liabilities and its restriction to: under  
9 this agreement.

10 MR PHILLIPS: Yes, absolutely. And when we come to the  
11 amended notes, when we come to -- sorry, to the notes,  
12 what you will see is, because they were in the form of  
13 notes, they had to amend it to take account of the fact  
14 that it was notes. But I'll show you that. The answer  
15 to your question is yes. There is standard form 10 and  
16 standard form 5. This is 10.

17 Then the excluded liabilities on the previous page  
18 means:

19 "Liabilities which are expressed to be and in the  
20 opinion of the insolvency officer of the borrower ..."

21 Remember that:

22 "... do rank junior to the subordinated liabilities  
23 in any insolvency of the borrower."

24 The keywords are "expressed to be and do rank junior  
25 to the subordinated liabilities".

1           So you have an expression of juniority, which you  
2           will find in the excluded liability. That's where you  
3           will find that. They express themselves to be junior.

4           Then if we can go forward to 67 --

5   LORD JUSTICE LEWISON: At this stage you don't know to what  
6           debts you have subordinated your entitlement under the  
7           loan agreement until you've looked at all the other  
8           instruments which may or may not contain expressions of  
9           juniority?

10   MR PHILLIPS: They're junior to you. As in what is cut  
11           out -- the excluded junior to this instrument.

12   LORD JUSTICE LEWISON: Yes.

13   MR PHILLIPS: Your Lordship is right --

14   LORD JUSTICE LEWISON: As far as other loans under different  
15           agreements are concerned, we can forget subordinated  
16           liabilities because that's limited to what's advanced  
17           under this agreement. So if we are looking at who else  
18           does or doesn't rank senior to this debt, you have to  
19           look at the terms of whatever instrument it was that  
20           created that other debt and ask yourself: does that  
21           other instrument express itself to be junior to this  
22           one.

23   MR PHILLIPS: Absolutely. Absolutely, my Lord. In the  
24           context of these forms your Lordships will have picked  
25           up it's regulatory capital, the point is that you are



1 subordinating yourself to the bank or the businesses, if  
2 we can call it business debts, outside debts, and the  
3 capital is there to support those debts, that's the  
4 point.

5 So if we can then look at clause 5, which is 678.  
6 My Lords, your Lordships can see this is clause 5, it's  
7 headed subordination. I don't know whether you have  
8 done the same exercise as I have but the judge broke  
9 this clause and all the other clauses down into numbered  
10 phrases. For your Lordship's note, you will find the  
11 numbers for clause at 140, which is at C220 to 385 if  
12 you wanted to.

13 Looking at 5(1), this is phrase 1:

14 "The rights of the lender in respect of the  
15 subordinated liabilities are subordinated to the senior  
16 liabilities."

17 It identifies the rights of the lender, it provides  
18 that those rights, and it is in respect of the  
19 subordinate liabilities, are subordinated to the senior  
20 liabilities. Those senior liabilities are the  
21 liabilities you have seen defined in clause 1. And in  
22 paragraph -- perhaps we should take out C2, tab 22 and  
23 just look at two paragraphs but in paragraph 140, as  
24 your Lordships will have picked up, if you go to 387 --  
25 starting on 386 you can see that he describes 5(1) and

1 then he sets out that breakdown and then says in 142:

2 "In my judgment and subject to the effective words  
3 and accordingly --"

4 Which of course we will come back to:

5 -- the effect of phase 1 is to subordinate  
6 subordinated liabilities to the senior liabilities in  
7 the Waterfall and to prevent, at least in an English  
8 insolvency, the lender from proving in that insolvency  
9 until the senior liabilities have been discharged."

10 And he refers back to his explanation in 122 of how  
11 simple contractual subordination works, and it is to the  
12 effect of the submission I've been making to your  
13 Lordships, that if you subordinate yourself to the  
14 senior creditors you cannot prove until after the senior  
15 creditors have been paid.

16 Then going back to the clause, I will just put the  
17 judgment to one side, going back to the clause phrase 2  
18 "and accordingly". And that is the first of three "and  
19 accordinglylies" throughout the clause:

20 "And accordingly payment of any amount, whether  
21 principal interest or otherwise, of the subordinated  
22 liabilities is conditional upon."

23 And that follows on from the subordination of the  
24 rights of the lender, so it is the right to payment:

25 "And accordingly payment."

1           That is what is made conditional upon two things.

2           5(1)(a) applies outside of an insolvency and you  
3 will you have picked up that the conditionalities and  
4 different inside and outside of insolvency and the  
5 reason for that is the mechanics of payment are  
6 different inside and outside of an insolvency. Inside  
7 an insolvency, as I indicated and have shown your  
8 Lordships, the only mechanism of payment is proof and  
9 dividend.

10           Then we get to 5(1)(b) which gives the condition  
11 that applies both outside and inside, which is phrase 5.  
12 So this is conditional upon the borrower being insolvent  
13 at the time of and immediately after that payment by the  
14 borrower.

15           Then you get another "and accordingly".

16           "No such amount which would otherwise fall due for  
17 payment shall be payable except to the extent that the  
18 borrower could make such payment and still be solvent."

19           So it's conditional on the borrower being solvent,  
20 which means payment can only be made if the borrower  
21 will remain solvent after making the payment.

22           That takes you to what is solvent, which you get  
23 over the page in 5(2), which is numbered phrase 6:

24           "For the purposes of 1(b) above the borrower shall  
25 be solvent if it is able to pay its Liabilities

1 [capital L] as defined other than the subordinated  
2 liabilities in full disregarding obligations which are  
3 not provable or capable of being established or  
4 determined in the insolvency of the borrower and (b) the  
5 excluded liabilities."

6 Now 5(1) and 5(1)(b) are connected by the words  
7 accordingly. The natural meaning of word is to be read,  
8 in our submission, as connecting 5(1)(b) to the  
9 subordination of the senior liabilities. For your  
10 reference, we have at AB83, 2869 the  
11 Oxford English Dictionary: accordingly meaning therefore  
12 so or as a result.

13 LORD JUSTICE LEWISON: In consequence is how I would  
14 normally --

15 MR PHILLIPS: In consequence.

16 LORD JUSTICE LEWISON: So 5(1), the first rubric tells you  
17 the general principle and then 5(1)(b) tells you one of  
18 the consequences of it, at least in an insolvency.

19 MR PHILLIPS: But not the only consequence though. But yes.  
20 And the effect of the solvency conditionality is  
21 entirely consistent with the simple contractual  
22 subordination to the senior liabilities. And the reason  
23 why I say that is that in essence LBHI2 needs to be able  
24 to pay its senior liabilities. If you look at what it  
25 is that they have to be able to pay in order to be

1 solvent, it's everything other than the subordinateds  
2 and the excludeds. It's the senior. So it's all of  
3 a piece.

4 They need to be able to pay the senior liabilities  
5 in full. And the creditor does not have the right to  
6 payment, which in an insolvency means the right to  
7 proof, until that point. And contrary to what the  
8 learned judge held, the solvency conditionality does not  
9 have an independent, let alone contrary, effect which  
10 can be decoupled from the subordination to the senior  
11 liabilities. It is a whole. It is one clause. It  
12 provides that subordinated to the senior liabilities it  
13 provides and accordingly it can't prove until you can  
14 pay the seniors.

15 LORD JUSTICE LEWISON: Yes. So the question then is: is the  
16 claim under the notes an excluded liability? That's  
17 what it boils down to, doesn't it?

18 MR PHILLIPS: So maybe turn to the unamended Sub-Notes  
19 because the next thing --

20 LORD JUSTICE LEWISON: Why don't we start with the amended  
21 ones, they are current ones.

22 MR PHILLIPS: There are all sorts of reasons I could take  
23 time explaining.

24 LORD JUSTICE LEWISON: Do it in a few minutes because  
25 looking at the instrument as it actually existed at the

1 date of the insolvency, it seems to me to be the obvious  
2 starting point.

3 MR PHILLIPS: The first really important point is that the  
4 terms of the unamended notes continue to apply after the  
5 amendments. Clauses 1 to 7 apply throughout. And they  
6 are not amended. And it's a very important point  
7 because one of our major criticisms of the judge and the  
8 judge's reasoning is that he went to what he calls  
9 phrase 8 and following and he ignored phrases one to 7,  
10 including this phrase 2 that we've just looked at, which  
11 is the contractual subordination provision. And he  
12 ignored it.

13 So we have to construe that, if I may respectfully  
14 submit, in the unamended notes first. And the other  
15 point is that the clause is not amended at all outside  
16 the winding up. So you have the definition of senior  
17 creditors not amended, the operational clause outside  
18 the winding up is not amended and the conditionalities  
19 in the Sub-Notes do not alter the legal characteristics  
20 of the senior creditors to whom the Sub-Notes are  
21 subordinated and it's important to construe the  
22 definitions and their interplay with the  
23 conditionalities both under the unamended notes and then  
24 under the amended notes, in our submission.

25 And part of the construction exercise for your

1 Lordships is going to be to compare the commercial  
2 consequences of the parties' possible interpretations,  
3 and to make that comparison your Lordships are going to  
4 need to look at what happened outside the winding up and  
5 what happened inside the winding up. Because as your  
6 Lordships will already have picked up, one of the  
7 consequences of the judgment is that outside of  
8 a winding up the Sub-Notes are senior and then inside  
9 a winding up they are junior. In our submission, we  
10 need to look at all those and then of course there's the  
11 rectification question which is going to follow on from  
12 that.

13 So if I may respectfully just turn to those  
14 unamended first.

15 LORD JUSTICE LEWISON: What the notes mean is what they  
16 would mean to the reasonable reader of the document  
17 which creates them; is that right?

18 MR PHILLIPS: Yes, of course.

19 LORD JUSTICE LEWISON: They are tradeable financial  
20 interests listed on the Channel Islands Stock Exchange.  
21 It's true that as far as the Lehman companies were  
22 concerned they didn't intend the notes to go outside the  
23 Lehman Group but that I would have thought doesn't  
24 affect the meaning of a document.

25 MR PHILLIPS: Not outside of rectification, absolutely.

1 LORD JUSTICE LEWISON: So if somebody were to buy into these  
2 notes because they are traded on the Channel Islands  
3 Stock Exchange, they would see a clean print, would they  
4 not, of the amended notes, and would not have access to  
5 what had gone before?

6 MR PHILLIPS: Yes.

7 LORD JUSTICE LEWISON: So why are we starting with the  
8 unamended notes when somebody who is looking at the  
9 notes at the date of the insolvency would only have  
10 access to the amended version?

11 MR PHILLIPS: Will you just give me one moment. Because  
12 when your Lordship says I don't want to take you out of  
13 your course, this is quite dramatic.

14 LORD JUSTICE LEWISON: As I said, I thought we should start  
15 with the amended notes. (Pause).

16 MR PHILLIPS: Forgive me, I'm just trying to --

17 LORD JUSTICE LEWISON: You don't need to answer now but I'm  
18 just trying to explain to you why I thought we should  
19 start with amended notes. But you disagree and you want  
20 to start with the unamended ones. That's fine.

21 MR PHILLIPS: My Lord, I'm absolutely not tone deaf and  
22 I will go to the amended Sub-Notes and then we will  
23 apply our minds to see whether or not any submissions  
24 that I was making in the earlier context I need to pick  
25 up again.



1           I'm afraid I'm not smart enough to be able to do  
2           that on my feet.

3           Let's turn to the relative ranking of the Sub-Debt  
4           in the amended LBHI2 Sub-Notes. My Lords, as I've  
5           already indicated to your Lordships, the learned judge  
6           held that on the unamended language of the Sub-Notes the  
7           Sub-Debt ranked below the Sub-Note. For your note that  
8           was paragraph 198 of his judgment. And he held that the  
9           amended Sub-Note ranked for distribution below the  
10          Sub-Debt, which is, for your Lordship's note, 233 and  
11          243. Which meant that the judge held that the effect of  
12          the amendments was to reverse the relative ranking,  
13          which he said at 231 was surprising. And our position,  
14          just be clear, in relation to the priority dispute  
15          between the ranking of the LBHI2 Sub-Debt and the  
16          amended Sub-Notes is that the claims under these  
17          instruments ranked *pari passu*. That is our submission  
18          throughout all of these entities.

19          The effect of the judge's conclusion, and of course  
20          we'll look at this when we turn up the documents, but  
21          the effect of the judge's conclusion is that the amended  
22          Sub-Notes have within them two distinct regimes. The  
23          first outside of a winding up, which is where Claim A,  
24          the Sub-Note, ranks below Claim B, the Sub-Debt; and the  
25          second regime in a winding up, where Claim A ranks above

1 Claim B. And that is because the further conditionality  
2 which was inserted by the amendments is only engaged, as  
3 your Lordships know, in a winding up. And again we say  
4 that is highly surprising and in our submission wrong.

5 The ratio of the judge's decision was further  
6 conditionality in the Sub-Notes had the effect of  
7 subordinating the Sub-Notes to all other subordinated  
8 debt, save for debt that utilised the preference share  
9 dealing mechanism. The judge reasoned that the LBHI2  
10 Sub-Debt did not utilise a preference share deeming  
11 mechanism, and therefore that the Sub-Notes ranked below  
12 it.

13 Your Lordships have still to answer the question in  
14 relation to the amended Sub-Note, which is WHAT is it  
15 that defines the point at which Claim B under the  
16 Sub-Notes can prove. And the ancillary question of why  
17 did it subordinate the Sub-Debt for so long that the  
18 company was outside of liquidation, but subordinate the  
19 Sub-Notes if it went into a liquidation.

20 So I would respectfully submit that on any view that  
21 is a very odd result. And the judge also held that the  
22 further conditionality operated independently, entirely  
23 independently in the amended Sub-Notes. And he held  
24 that there was no need to apply the definitional  
25 wording.

1           In our submission the judge was wrong and he failed  
2           to construe a composite subordination provision in  
3           a unitary way. He failed to apply the definitional  
4           language, which remained unchanged in the amended LBHI2  
5           Sub-Notes, and he did not have proper regard to the fact  
6           that the language of the further conditionality only  
7           addressed the position above which debts the LBHI2  
8           Sub-Notes sit in a winding up. It said nothing as to  
9           which creditors the LBHI2 Sub-Notes are subordinated  
10          below. Which continue to be a question addressed solely  
11          by the unchanged definitional wording.

12           I have been handed a note asking whether the  
13          transcribers needed a break.

14   LORD JUSTICE LEWISON: I agreed to transcribers on the  
15          understanding there would be no breaks. We have a lot  
16          to get through.

17   MR PHILLIPS: Thank you.

18           So can we turn to -- I hope you still have -- or can  
19          we turn to bundle C3.

20   LORD JUSTICE LEWISON: Yes.

21   MR PHILLIPS: Tab 42. Again, my Lords, the judge numbered  
22          the different phrases and he did that at paragraph 203.  
23          If we can turn to 741, please, and in the notes it's  
24          clause 3, which is headed "Status and subordination".  
25          The first point is that as your Lordships can see --

1 and, my Lords, your Lordships have underlining but as  
2 my Lord Lord Justice Lewison rightly pointed out, that  
3 underlining would not have appeared elsewhere but it's  
4 helpful for our purposes so we can see what the  
5 amendments were.

6 The first point is that you can see everything above  
7 the underlining is --

8 LORD JUSTICE LEWISON: You are looking at the judge's  
9 quotation of it?

10 MR PHILIPPS: Sorry --

11 LORD JUSTICE LEWISON: From the judgment?

12 MR PHILIPPS: No, my Lord. I'm doing it on page 741.

13 LORD JUSTICE LEWISON: My 741 is a clean print, without any  
14 underlining.

15 MR PHILIPPS: I do apologise.

16 LORD JUSTICE LEWISON: I can get the underlining from the  
17 way the judge quotes it, but --

18 MR PHILIPPS: Now I understand, I do apologise. I have  
19 underlining, but anyway, not a problem. The point that  
20 I was making was that everything down to what is  
21 numbered 7, but you are not looking at that, anything  
22 down to, "The conditionality referred to above will not  
23 apply ..." Everything above that is unamended.

24 LORD JUSTICE LEWISON: I thought, "... including arrears of  
25 interest as defined below" was one of the amendments.

1 MR PHILIPPS: You are quite right. Apart from, "... and  
2 interest including arrears of interest as defined below,  
3 subject as provided below ..." In the brackets in  
4 line 5.

5 Your Lordships might want to actually underline it  
6 themselves. Thank you.

7 LORD JUSTICE LEWISON: Yes.

8 MR PHILIPPS: I wanted to start if I may just go through  
9 this:

10 "The notes constitute direct unsecured subordinated  
11 obligations to the Issuer and the rights and claims of  
12 noteholders against the Issuer ranked pari passu without  
13 any preference among themselves."

14 That is dealing with pari passu ranking amongst the  
15 noteholders.

16 This is numbered clause 2, the next phrase:

17 "The rights of the noteholders against the Issuer in  
18 respect of the notes are subordinated in right of  
19 payment to the senior creditors as defined below."

20 That is phrase 2. It's being suggested by  
21 Mr Willson it would make it easier for you if you have  
22 paragraph 203 of the judgment open as well, which is  
23 C2/22 at 409. Just in case I refer to a phrase number,  
24 and you wonder what I am doing.

25 That language which is phrase 2, the rights of the

1 noteholders, is unamended language. In answering the  
2 key question: after which senior creditors is the  
3 noteholder entitled to prove? The answer is the same  
4 pre- and post- amendment. It is to be found in phrase 2  
5 and the express definitions, which I will turn to.

6 Phrase 2, that I'm now referring to, contains the  
7 only language in condition 3 which deals expressly with  
8 the question below whom the LBHI2 Sub-Notes are  
9 subordinated. You have those words there, "Are  
10 subordinated in right of payment to the senior  
11 creditors".

12 There is no other express wording which describes  
13 below whom the LBHI2 Sub-Notes rank. That wording in  
14 phrase 2 is followed by the words in brackets "as  
15 defined below". That is a reference to the definition  
16 of "senior creditors" which is found in phrases 24 to 30  
17 of the provision. The words "as defined below" cannot  
18 be a reference to the further conditionality, because  
19 that is not a definition. The further conditionality  
20 contains no definitions relevant to the senior  
21 creditors.

22 If we may turn the page to 742, do your Lordships  
23 see in (b) where it starts "for the purposes of the  
24 above provisions ..." That's numbered clause 24.  
25 Numbered clause 25 goes on:

1           "Senior creditors means creditors of the Issuer."

2           This is 26 -- tell me if me telling you the numbers  
3           is unhelpful.

4   LORD JUSTICE LEWISON: I'm looking at the clean print.

5   MR PHILIPPS: I'll take that as a yes:

6           "(1) who are unsubordinated creditors of the Issuer  
7           or (2) who are subordinated creditors of the Issuer  
8           other than ..."

9           The first point that you get in (1) is it identifies  
10          unsubordinated creditors of the Issuer. That is  
11          creditors who are not subordinated in any way.

12          The second is:

13          "... who are subordinated creditors of the Issuer  
14          other than those with whose claims the claims of  
15          the noteholders are expressed to rank *pari passu*, and  
16          those whose claims rank or are expressed to rank  
17          *pari passu* with or junior to the claims of the  
18          noteholders."

19          Can I break that down. It is subordinated  
20          creditors, in other words creditors with some  
21          subordination, other than particular creditors. These  
22          are creditors who are senior creditors but who have  
23          subordinated themselves to other senior creditors.  
24          Whether you call them "subordinated senior creditors" or  
25          "senior subordinated creditors" matters not, they rank

1           senior to the notes.

2           The "other than" then identifies those who are not  
3           senior.

4           The first is those with whose claims the claims of  
5           the noteholders are expressed to rank pari passu. That  
6           is creditors who are expressed to rank pari passu in the  
7           notes. So the expression of pari passu will be in the  
8           notes. On this construction(?) it's the noteholders,  
9           the other noteholders, they all rank pari passu amongst  
10          themselves.

11          The next is those whose claims rank or are expressed  
12          to rank pari passu. Put junior to one side for the  
13          moment if I may, I will do junior after pari passu. The  
14          first is those whose claims rank pari passu. That is  
15          a recognition of a state of fact, that they rank  
16          pari passu.

17          We have already seen that there's an expression of  
18          those whose claims are expressed to rank pari passu and  
19          we have rank, which is where they are in fact ranked.  
20          That could be as a result of either the judge's approach  
21          or if they prove after the same senior creditors, they  
22          will rank pari passu.

23          Then you move on to those that are expressed to rank  
24          pari passu. That expression of pari passu ranking will  
25          be found in the other instrument. So that there's



1 an instrument that expresses itself, "I rank junior to  
2 the same senior creditors, I rank pari passu with the  
3 Sub-Notes".

4 Then we move on to junior. Those whose claims are  
5 expressed to rank junior with the claims of the  
6 noteholders. You find the expression of juniority in  
7 the other instrument, so it's somebody --

8 LORD JUSTICE LEWISON: I must say, I read the words "or  
9 junior to" as being governed by "rank or are expressed  
10 to rank", not by "expressed to rank" alone. For what  
11 it's worth.

12 MR PHILIPPS: That, if I may respectfully say, is likely to  
13 be -- because I have thought about this -- a distinction  
14 without a difference, because in order to rank junior  
15 they have to express to rank junior and it's very hard  
16 to conceive of someone ranking junior without having  
17 subordinated themselves.

18 I'm not sure I can help you further with that point,  
19 but I understand.

20 LORD JUSTICE LEWISON: The definition of senior creditors,  
21 amongst other things, recognises that there can be  
22 relative priorities as between subordinated creditors.

23 MR PHILIPPS: It does.

24 The other point that I would just make at this stage  
25 is that what is a senior debt is defined by reference to

1 seniority and juniority, in other words where they have  
2 agreed to rank it is not defined by what type of  
3 conditionalities they have subjected their debt.

4 LORD JUSTICE LEWISON: Would you not have to construe the  
5 instrument as a whole to find out if there is  
6 an expression of juniority somewhere? There's no  
7 special form of words is there -- or perhaps there is  
8 a special form of words are you saying?

9 MR PHILIPPS: No. The point that I was making was when one  
10 looks at this definition what it is saying is it is  
11 identifying where people rank and the definition looks  
12 at seniority and juniority. What it doesn't do is it  
13 doesn't say, you know, if a debt is payable on certain  
14 conditions then it will rank as whatever. I take  
15 your Lordship's point that you still have to construe  
16 the whole clauses in each and every case and I'm not  
17 shying away from that for a moment, but I was just  
18 observing that those definitions identify seniority and  
19 juniority.

20 LORD JUSTICE HENDERSON: You accept in principle then that  
21 it's possible for subordination for these purposes to be  
22 contained in something which is phrased as a condition,  
23 if on a crude construction of the provision read as  
24 a whole that is the effect which it's intended to have?

25 MR PHILIPPS: The crucial point would be if on the clause

1 read as a whole.

2 LORD JUSTICE HENDERSON: Absolutely. You are not saying  
3 that there has to be some express reference to  
4 conditionality as such -- or rather that if there is  
5 an express reference to conditionality as such, that  
6 that somehow precludes it being taken into account or  
7 having the result of a subordination?

8 MR PHILIPPS: The circumstance in which one can imagine that  
9 is if you have pure contingent debt subordination. That  
10 was one of the three mechanisms and if you had pure  
11 contingent debt subordination it's not going -- I am  
12 saying it's not ... it will be this debt is only  
13 payable ...

14 LORD JUSTICE LEWISON: If everybody else has been paid out  
15 first?

16 MR PHILIPPS: If everybody has been paid out first, which is  
17 a different approach to the contractual subordination  
18 that we are looking at. At this point we are looking at  
19 the contractual provision, if I can put it that way, and  
20 I'm going to come on obviously to the conditionalities.  
21 But at this point I'm dealing with that.

22 The amendments to the further conditionality that  
23 we're going to come on to below this definitional  
24 wording, we will see they don't convey any intention for  
25 the notes to rank behind different senior creditors to

1 the senior creditors we see in this part of the clause,  
2 which we call the definitional wording. When we look at  
3 it, you'll see it doesn't fundamentally alter the legal  
4 characteristics or identify of the senior creditors.  
5 A point that we would make is that if the draftsman  
6 had wanted to alter below whom the Sub-Notes rank, it  
7 would have been the simplest thing to amend that  
8 definition of senior creditors. If that is what they  
9 had intended to do they could have included an amendment  
10 of that definition.

11 Moving back if I may to 3(a), I think we reached as  
12 far as:

13 "Accordingly payment of principal and interest  
14 including arrears of interest in respect of the notes  
15 subject to provided below is conditional upon the Issuer  
16 being solvent at the time of and immediately after such  
17 payment."

18 That's the first accordingly.

19 Again, that was unchanged. It makes it clear that  
20 in a winding up the further conditionality applies and  
21 outside of the winding up the conditionality that was  
22 already there applies and they both follow  
23 "accordingly".

24 Again, that should be construed in the same way.

25 We then get another "accordingly", it's phrase 6 but

1           it's seven lines down:

2           "Accordingly, no such amount which would otherwise  
3           fall due for payment [you will note that it is again the  
4           right to payment] shall be payable except to the extent  
5           that the issuer could make such payment and still be  
6           solvent immediately thereafter."

7           Pausing there, that is all unamended.

8           You should note that there is only one  
9           conditionality referred to before you get to the words  
10          "the conditionality referred to above", and the  
11          conditionality is conditional upon, which you have seen.

12       LADY JUSTICE ASPLIN: The second "and accordingly" is a way  
13          of describing the first.

14       MR PHILIPPS: Yes. Yes, no, I'm so sorry my Lady, yes.  
15          Absolutely.

16       LADY JUSTICE ASPLIN: In fact you could strike out the  
17          words, not that I'm suggesting anyone does something  
18          like that.

19       MR PHILIPPS: No, no, absolutely right. We then move on to:

20               "The conditionality referred to above shall not  
21               apply."

22               The point is that that is not saying that all of  
23               what are numbered phrases 2 to 6, what has gone before,  
24               are disapplied in a winding up. In particular the  
25               words, "The rights of the noteholders against the Issuer

1 in respect of the notes subordinated in right of payment  
2 to senior creditors" is not a conditionality. That is  
3 not disapplied by those words "the conditionality  
4 referred to above shall apply".

5 We then go into the conditionality. What you will  
6 see is that this conditionality adopts a fiction of  
7 a hypothetical class of preference share, which has  
8 certain characteristics. It does not, contrary to what  
9 the judge held, say that the notes are subordinated  
10 alongside preference shares or for that matter any other  
11 issued shares. Can we have a look at that:

12 "The conditionality referred to above shall not  
13 apply ..."

14 As I have submitted, that is only conditional upon  
15 the Issuer and so on:

16 "... where an order is made by a competent court or  
17 resolution passed for the winding up or dissolution of  
18 the Issuer, except for the purpose of reconstruction,  
19 amalgamation, reorganisation, merger or consolidation on  
20 terms previous approved in writing by an extraordinary  
21 resolution of the noteholders."

22 We then get to the new conditionality.

23 LORD JUSTICE LEWISON: Pause there, the judge held winding  
24 up included administration. As I understand it, there's  
25 no dispute now about that?

1 MR PHILIPPS: We are not appealing that point, my Lord.

2 Mr Willson rightly points out that I'm about to  
3 refer to the numbers quite a lot, so if it's not too  
4 difficult to at least have them in view. I am sorry if  
5 that was a daft way of proceeding, but that's what I've  
6 done.

7 We get to the further conditionality. That's in  
8 what is phrase 8 which is, "If any time an order is  
9 made" and we have dealt with that.

10 Then it says in 9:

11 "There shall be payable by the Issuer in respect of  
12 each note, such amount if any ..."

13 The starting point, again, is it is describing  
14 payability in an insolvency, which can only mean through  
15 the proof mechanism. Proof and distribution.

16 In brackets it says:

17 "In lieu of any other payment by the Issuer."

18 All I can say is there can't be anything outside the  
19 insolvency:

20 "Such amount, if any, as [this is 10] would have  
21 been payable to the noteholder."

22 Then you get into the fiction:

23 "As would have been payable to noteholder if on the  
24 day prior to the commencement of the winding up and  
25 thereafter such noteholder were the holder of one class

1 preference shares in the capital of the Issuer having  
2 a preferential right to a return of assets in the  
3 winding up of the Issuer over."

4 As to this language, first it makes clear that we  
5 are dealing with a hypothetical construct. The notes  
6 were dated pre-amendment, and remained dated debt  
7 post-amendment, they were dated debt throughout they did  
8 not become preference shares or any other shares.

9 The hypothetical nature of the concept is made clear  
10 as a matter of language by the use of the subjective,  
11 "If such noteholder were the holder of one of the class  
12 of preference shares", which is an indication we are not  
13 dealing with real or actual shares. I appreciate ...

14 It's also worth noting that there is no wording here  
15 which links this conditionality to phrase 2 or to the  
16 definition of "senior creditors" which could support the  
17 conclusion that this language is somehow intended to  
18 redefine the legal characteristics or identity of the  
19 senior creditors. And alter behind who the notes are  
20 subordinated.

21 That, my Lords, is significant because we are  
22 construing a single clause and this single clause has  
23 said the rights of the noteholders are subordinated in  
24 right of payment to the senior creditors, they are  
25 defined, nothing in this amendment has altered that part



1 of the clause.

2 The next point that we would make is that the  
3 further conditionality is confined to expressing over  
4 which categories the LBHI2 Sub-Notes sit, thus in the  
5 phrase we were just looking at, which is phrase 10, the  
6 notes are defined as having a right over.

7 If we then look at who they have a right over, it  
8 is:

9 "The holders of all other classes of issued shares  
10 in each case for the time being in the capital of the  
11 Issuer."

12 So over the holders or classes of issued shares and  
13 over the notional holders.

14 You then have an important phrase, which is numbered  
15 13:

16 "On the assumption that such preference share was  
17 entitled to receive and a return of assets in such  
18 winding up an amount equal to the principal amount of  
19 such note together with arrears of interest, if any, and  
20 any accrued interest."

21 That tells you that the right you are proving in  
22 relation to not only is a debt, it's the principal  
23 amount of the note plus interest. That's the debt sum.  
24 That was important to distinguish the notes from equity.

25 We looked at the notional holders who they have

1 a right over. We then go onto 741, what is clause 14,  
2 clause 14 is for the purpose of the above provisions.  
3 Then we have 15:

4 "Notional holder' means any creditor of  
5 the Issuer."

6 That therefore they have a right to prove over  
7 a particular type of creditor. Which confirms it cannot  
8 possibly be a preference share in fact:

9 "Whose claims against the Issuer on a winding up are  
10 quantified as though they held a notional share."

11 So you get another notional share, which is:

12 "means any notional and unissued shares in the  
13 capital of the Issuer which have a preferential right to  
14 return of assets in the winding up of the Issuer over  
15 [again over] the holders all other classes of issued  
16 shares for the time being in the capital of the Issuer  
17 but not further or otherwise."

18 A few points on the language.

19 First, it refers to notional and unissued shares not  
20 to issued shares. Confirming that this is not dealing  
21 with real shares, preference or otherwise.

22 Second, the right to a return is stated to be above  
23 the issued share capital of LBHI2, necessarily would  
24 include preference shares, the starting point is that it  
25 ranks above all shareholders. Of course an unissued

1 share would not in fact have any right to a return,  
2 which again confirms the notional nature of this  
3 mechanism.

4 In addition to ranking above all shares, it ranks  
5 above the notional holder. The notional holder is  
6 a type of creditor. It's a creditor of the Issuer whose  
7 claims are quantified as though they held a notional  
8 share. Those creditors rank below the notes. Those  
9 creditors would be the upper tier 2 creditors.

10 Fourth:

11 "A notional share means any notional and unissued  
12 shares with a preferential right to return of assets in  
13 the winding up [again over] over the holders all other  
14 classes of shares."

15 Again the use "over", which I think appears three  
16 times. This is really an important point, the use of  
17 over, because the further conditionality refers only to  
18 the debt over which the LBHI2 Sub-Notes sit. As you've  
19 seen, it includes the notional holders, it includes the  
20 issued shares but it says nothing about below or under  
21 which debts the notes are subordinated.

22 I see your Lordship is troubled.

23 LORD JUSTICE LEWISON: I am a bit. Because it's common  
24 ground, as I understand it, that save with the agreement  
25 of all other creditors in of the same type a creditor

1           can't promote himself further up the waterfall.

2   MR PHILIPPS:   Yes.

3   LORD JUSTICE LEWISON:  Although you are quite right in

4           saying that the note uses the word "over", it can't have

5           the effect of promoting the creditor since the whole

6           object of the subordination provisions is to demote the

7           creditor from somewhere, it must be part of a demotion.

8   MR PHILIPPS:  My Lord, that is why you have to read this as

9           a whole.

10  LORD JUSTICE LEWISON:  Yes.

11  MR PHILIPPS:  Because this clause subordinates these notes

12           to the senior creditors as defined, and the creditors

13           who appear in the conditionality do not fall within the

14           definition of "senior creditors".

15  LORD JUSTICE LEWISON:  That point I understand.  The point

16           you were just making seemed to be suggesting that in

17           some way the notes could tell you above whom they

18           ranked.  That was what was bothering me.

19  MR PHILIPPS:  No, no, I absolutely understand, my Lord.  The

20           clause is not demoting the notes, the clause is

21           describing who ranks below them.  But the clause itself,

22           that amendment is not promoting the notes.  The

23           subordination of the notes is what's dealt with in

24           phrase 2 or whatever one describes it as.  One then gets

25           a description of who it is above.

1           I don't want to tread too far onto the rectification  
2 side of things, but the concern was that the notes might  
3 qualify as equity and Mr Bahal(?) wanted to make sure  
4 that it could be clear it wasn't equity, and that is  
5 what this is doing.

6           I'm not trying to trespass.

7           That was over, yes, and we've seen it in phrase 10,  
8 phrase 16 -- but then there is an important point.  
9 Because the subordination provision, which I call  
10 phrase 2, that subordination provision, that express  
11 wording makes it clear that the LBHI2 Sub-Notes are not  
12 subordinated to all subordinated creditors. We've been  
13 through that. It doesn't subordinate it to all  
14 subordinated creditors. There are some, as you've seen,  
15 who remain senior.

16           The learned judge's reasoning is inconsistent with  
17 the definitions that we see, "other than those with  
18 whose claims the claims of the noteholders are expressed  
19 to rank pari passu, and those whose claims rank or are  
20 expressed to rank pari passu ..."

21           Because if you then go on to say that this  
22 conditionality subordinates you to every type of debt,  
23 subordinates the notes to every type of debt, other than  
24 debts that have this mechanism, that's inconsistent with  
25 the definition of the senior creditors. That's one of

1 the reasons why construing it as a whole in our  
2 submission is so important. One of the reasons why we  
3 rely on the fact that it's described in over, over, over  
4 is that that isn't promoting, but equally it's not  
5 subordinating.

6 LORD JUSTICE LEWISON: Would there be anything wrong in  
7 a loan agreement which said, "I'll lend you £1 million,  
8 but in the event that the court make an administration  
9 order you need only pay me back 400,000"? I will rank  
10 pari passu with other creditors, but I won't claim more  
11 than 400,000.

12 MR PHILIPPS: But prove for 400,000, you are not saying you  
13 will pay me 400,000 whatever the dividend?

14 LORD JUSTICE LEWISON: No, that would fall foul ...

15 MR PHILIPPS: No, there's nothing wrong with that.

16 LORD JUSTICE LEWISON: What is wrong with notes that say,  
17 "Well, I'll rank pari passu with other creditors but you  
18 only need to pay me what you would have paid  
19 a preference shareholder, or I will only prove for what  
20 a preference shareholder would have got"?

21 MR PHILIPPS: The problem on this clause with that is that  
22 it's inconsistent with 13, which is on the assumption  
23 the preference share was entitled to receive a return of  
24 assets equal to the principal amount. That's the  
25 tension your Lordship runs into on this clause.

1 LORD JUSTICE LEWISON: Right.

2 MR PHILIPPS: As we are on phrase 13, that language deals  
3 with the tax concern identified by Allen & Overy, which  
4 the learned judge refers to in paragraphs 206 and 207 of  
5 the judgment. The concern was that payments on the  
6 Sub-Notes could have been dependent on the businesses'  
7 results, and that created a risk, or so it was thought,  
8 that the Sub-Notes might be treated for tax purposes as  
9 equity rather than debt.

10 Mr Grant addresses this in his witness statement.  
11 If we could just get hold of supplemental bundle 1,  
12 tab 1, page 14. This is what the learned judge was  
13 referring to in his judgment. At internal page 14, it's  
14 paragraphs 29 and 32. Just for your note, Mr Grant was  
15 the draftsman of Allen & Overy, the solicitor of  
16 Allen & Overy who drafted the amendments. It then 29 in  
17 which he identifies the risk that the Sub-Notes may be  
18 treated for tax purposes equity rather than debt.

19 Then in 32:

20 "If the winding up of the insolvent ...(reading to  
21 the words)... albeit with the claim being on  
22 a subordinated basis."

23 My Lord, that confirms, as it were, what the  
24 intention was behind that language, which said you can  
25 prove for 100 per cent.

1           My Lords, I have shown you the amendments and from  
2           that you can see that there is a double fiction  
3           introduced by a hypothetical preference share.

4           First of all, when considering what is payable on  
5           the preference share you consider the rights are above  
6           those of the notional noteholders.

7           Secondly, you operate on the further assumption that  
8           the preference share is entitled to receive 100 per cent  
9           of principal and interest. Which, as I've indicated,  
10          was the tax part of the construct which the judge  
11          referred to.

12          The reason why I draw those to your Lordships'  
13          attention is that is far removed from an actual  
14          preference share or from ranking the notes as quasi  
15          preference shares. We've thought about this and we are  
16          unaware of any preference share entitled to 100 per cent  
17          of principal and interest in the winding up.

18          My Lords, I was about to move on, Mr Willson  
19          helpfully points out I was about to move on to  
20          confirmatory note, I just wonder if that would be  
21          a convenient.

22   LORD JUSTICE LEWISON: How long is this going to take you?

23          This is, "The notes are intended", that bit?

24   MR PHILIPPS: Yes.

25   LORD JUSTICE LEWISON: How long is that going to take you?



1 MR PHILIPPS: 10 minutes.

2 LORD JUSTICE LEWISON: A minute?

3 MR PHILIPPS: 10 minutes.

4 LORD JUSTICE LEWISON: All right, well let's do that after  
5 lunch.

6 All right 2.00. We are still on time presumably  
7 with the timetable that we have been given.

8 MR PHILIPPS: I hope so, my Lord.

9 (1.00 pm)

10 (The short adjournment)

11 (2.00 pm)

12 LORD JUSTICE LEWISON: Yes, Mr Phillips.

13 MR PHILLIPS: May I go back to bundle CB3, page 741, which  
14 is the amended notes. I was just about to turn to the  
15 confirmatory note. I don't know whether your Lordships  
16 are keeping open the numbered version, but that is  
17 a matter for your Lordships.

18 It's number --

19 LORD JUSTICE LEWISON: You suggested we should, so I have.

20 MR PHILLIPS: I'm grateful, my Lord. So at 17, the  
21 confirmatory note:

22 "The notes are intended to have a right to a return  
23 of assets in the winding up or dissolution of the  
24 ...(Reading to the words)... in priority to the rights  
25 of the holders of any securities of the issue which

1 qualify, save when non-qualification is due to  
2 ...(Reading to the words)... applicable limitation."

3 The reason for that is that in regulatory catch-all  
4 even if you have instruments that technically qualify  
5 for particular levels, there are limits for how much of  
6 each type of capital you can have. So that's what  
7 that's referring to. It says:

8 "Upper tier 2 capital or tier 1 capital with the  
9 respective meanings given in GENPRU."

10 So it explains that the notes rank above up tier 2  
11 and tier 1 capital. And they were, as you know, here  
12 tier 2 so it's identifying where in the waterfall, as it  
13 were, of regulatory capital debt you find them. And I'm  
14 going to show you a little later that one reference  
15 I've mentioned.

16 LORD JUSTICE LEWISON: I think you told us this qualified  
17 either as --

18 MR PHILLIPS: Tier 2 or 3.

19 LORD JUSTICE LEWISON: How does it rank --

20 MR PHILLIPS: That was the Sub-Debt. It is lower tier 2 or  
21 tier 3. It goes: upper tier 2, lower tier 2, tier 3.

22 LORD JUSTICE LEWISON: So it's reverse order.

23 MR PHILLIPS: Yes. It's actually -- tier 1 is  
24 shareholdings, the most permanent form of capital, and  
25 as you go up it drops in number.

1           The LBHI2 Sub-Notes stated as being:

2           "Intended to have a right of return of assets in the  
3 winding up in priority to the rights of the holders of  
4 any securities which qualifies upper tier 2 or tier 1  
5 within the meaning of GENPRU."

6           Those are the more permanent forms of capital than  
7 LT2. Of course, my Lords, your Lordships see the words  
8 "in priority" are used. They are similar to the word  
9 "over", which we saw in phrase 10 and phrase 16. And of  
10 course, my Lord, your Lordship's immediately asking "why  
11 does it go 3, upper tier 2?" shows you why in regulatory  
12 capital they do tend to count from the bottom up.  
13 That's what they do. And you can see why they've  
14 done this. The conditionality deals solely with the  
15 position over or in priority.

16           The other important point to note is that the word  
17 here is "any". So it's any. It doesn't say "some upper  
18 tier 2 securities". It plainly means all of them. And  
19 what the note envisaged, which was consistent with  
20 Mr Miller's evidence which you have references to, of  
21 market practice, was the following waterfall, which  
22 is: un-subordinated creditors, dated subordinated  
23 creditors, which is lower tier 2, tier 3, sitting above  
24 undated subordinated creditors, which is upper tier 2,  
25 including the notional holders as we have seen them set

1 out, and ordinary shares, which is tier 1 capital.

2 The notes remain lower tier 2 debt, because of the  
3 type of instrument and the subordination. And that, of  
4 course, was confirmed by Allen & Overy to Lehmans in  
5 their advice. And consistent with this waterfall it was  
6 expressly envisaged that it would all sit above the  
7 upper tier 2 debt, and all the upper tier 2 debt, not  
8 just upper tier 2 debt that used the notional mechanism,  
9 which is where the learned judge landed.

10 And we say the confirmatory note is important. PLC  
11 argues and the learned judge held that the notes are  
12 subordinated to all of tier 2 debt except the upper  
13 tier 2 debt using the preference share deeming  
14 mechanism, which is not consistent.

15 But that is not what the confirmatory note says. It  
16 plainly refers to subordination in priority to all upper  
17 tier 2 debt.

18 It's also consistent with the definition of senior  
19 creditors, which excludes claims that rank or are  
20 expressed or rank junior to the Sub-Note. And that  
21 carve-out is not just limited to subordinated debts  
22 using a preference share mechanism.

23 The confirmatory note is a very clear expression of  
24 the parties' intention that the Sub-Notes should not be  
25 treated as equity -- and my Lords, your Lordships have

1 the point as to the reasons for that -- and that they  
2 should sit above the equity. And by sitting them above  
3 the equity and introducing the assumption that  
4 100 per cent principal and interest was payable, the  
5 amendments were able to address the tax concern.

6 PLC now relies on the hypothetical preference share  
7 construct to suggest that the effect of the amendments  
8 was to subordinate the notes to the level of equity.  
9 That is the opposite of what the notes state.

10 LORD JUSTICE LEWISON: I'm not sure they go that far, do  
11 they? I think they would accept that it's above the  
12 level of equity, because it's still a debt, but it is  
13 right at the end of the queue.

14 MR PHILLIPS: Absolutely, at the end of the queue, apart  
15 from entities --

16 LORD JUSTICE LEWISON: Apart from what you might call real  
17 shareholders.

18 MR PHILLIPS: Apart from?

19 LORD JUSTICE LEWISON: Apart from real shareholders.

20 MR PHILLIPS: Yes. And that is not what that says. And it  
21 might be a convenient point for me to just take you if  
22 I may just briefly to Investors Compensation Scheme so  
23 that I can explain where we think this fits in legally.

24 It's in the authorities bundle 121. 388 in the  
25 Investors Compensation Scheme case. I'm sure it's very

1 familiar to you all. The passage that I just wanted to  
2 refer to is in 388 and it's the passage at the bottom,  
3 913H to 914A. If you would be kind yourself to refresh  
4 your memory of that then I will make a very short point.

5 LORD JUSTICE HENDERSON: Sorry, give me the reference again.

6 MR PHILLIPS: It's on page 388 and internal pages 913 --

7 LORD JUSTICE HENDERSON: Yes.

8 MR PHILLIPS: I'm grateful, my Lord. (Pause).

9 The point that we make is that in the context of  
10 that recital, what Lord Hoffmann says is that he thinks  
11 one should start with the assumption that a layman  
12 reading the provision, the explanatory note, and not  
13 venturing into the claim form, was being given  
14 an inaccurate account. And that is what we say in  
15 relation to this. In our submission, the judge should  
16 have started with the assumption that the confirmatory  
17 note was accurate and construed the confirmatory note as  
18 stating that the LBHI 2 Sub-Notes continue to rank above  
19 all securities qualifying as upper tier 2 capital, which  
20 is what it says, including all upper tier 2 debt, and he  
21 should then have noted that his conclusion was to the  
22 effect that all upper tier 2 debts rank above the  
23 Sub-Note. His conclusion was they ranked above --  
24 except those which used the preference share dealing  
25 mechanism. That was the judge's conclusion, which was

1 inconsistent.

2 And if he had started with the proposition that the  
3 explanatory note was accurate, he should have looked at  
4 the conclusion that he was reaching and considered,  
5 well, can that really be right? And in our submission,  
6 for other reasons which your Lordships have, we submit  
7 it wasn't.

8 LORD JUSTICE LEWISON: ICS was concerned with an arrangement  
9 with householders.

10 MR PHILLIPS: Yes.

11 LORD JUSTICE LEWISON: (Inaudible). This, on the other  
12 hand, is a trading(?) financial instrument, and you  
13 would expect somebody to be able to go into a high  
14 street bank and buy some. And I mean, there are also  
15 cases, are there not, involving pension schemes where  
16 an explanatory booklet is issued, and the courts have  
17 consistently said, well, that can't take priority over  
18 the rules.

19 MR PHILLIPS: No. It's a question of what you do with it.  
20 One starts with the proposition that this should be  
21 accurate. And I'm going to briefly say something about  
22 Mr Miller's evidence in due course. I don't want to go  
23 out of course on that. But we should start with the  
24 proposition: well, that should be accurate, and then  
25 test the conclusions that he had reached against it.

1           And at that point he should have realised that  
2           a conclusion that the notes were, as it were,  
3           subordinated to all debt, including all upper tier 2  
4           debt, unless it used that share mechanism, was  
5           questionable. I put it no higher than that. And then  
6           one gets into the other submissions which you  
7           already have.

8   LADY JUSTICE ASPLIN: So you would say this note is  
9           a warning device and actually no more than that?

10   MR PHILLIPS: A warning device is something that you should  
11           start -- I think that's a fair way of describing it.  
12           I'm not saying that if the language had said something  
13           clearly that was different to the explanatory statement  
14           you would overrule the clear language with the  
15           explanatory statement. Not at all. But you have  
16           a statement which you should start with the proposition  
17           that that is an accurate statement, and from there one  
18           can test the conclusions which the judge made.

19           Well, I think it's a convenient moment to turn into  
20           the judgment on the notes. If we could just get up  
21           C2/22/414.

22           It starts at 218 and you can see the first matter he  
23           turned to was the confirmatory note. And he said  
24           in 220:

25           "I will construe the provisions of condition 3A but



1 in light of the explanatory note ..."

2 And of course any other relevant background.

3 And in our submission that's not what he in fact  
4 went on to do.

5 Then picking it up at 221, so that you can see now  
6 his approach. In our submission this is where the  
7 learned judge made a key error, because what he says in  
8 221 is he refers to the amendment and says that they are  
9 significant, and he says:

10 "Speaking in the broadest of terms, I seek to  
11 construe condition 3 more narrowly in due course.  
12 Condition 3(a) contains, as a result of modifications,  
13 two regimes."

14 And this is central to the learned judge's approach  
15 regarding the subordination:

16 "One regime, that described from phrase 8  
17 onwards ..."

18 Which is the conditionality referred to above.

19 "... which applies where the following condition is  
20 satisfied."

21 He then refers to the insolvency condition, if I can  
22 put it that broadly:

23 "And another regime, that described from phrase 2  
24 onwards, which applies where this condition is  
25 not satisfied."

1           So in our submission the learned judge was wrong to  
2 hold that there were two regimes that were entirely  
3 distinct. And as we go through the judgment your  
4 Lordships will see that that is precisely what he did.  
5 And you have our submission, that to say that the one  
6 regime that applied in an insolvency was from phrase 8  
7 onwards on the conditionality was, with respect, wrong.  
8 And we say that -- and I think I've made this point --  
9 the language, the conditionality referred to "above",  
10 can't refer to what we call phrase 2, the subordination  
11 phrase and the definitions, which you have seen.

12           So moving on to 222 where he deals with the second  
13 regime, which is applicable where the conditions are not  
14 satisfied, is in all essential respects the same as that  
15 which applied in the unamended note:

16           "The first regime applicable ...(Reading to the  
17 words)... is satisfied is new(?). It will be necessary  
18 to consider the nature of the new subordination regime."

19           If we can then go over to paragraph 226 on page 416  
20 in the bundle, where it says:

21           "It is unnecessary for me to consider the second,  
22 old subordination regime applicable where the condition  
23 is not satisfied."

24           He then explains why not. And then he says this,  
25 and this is very important in the learned judge's

1 reasoning:

2 "Accordingly, this section considers only the first  
3 subordination regime, which begins at phrase 8."

4 And in our respectful submission that was a serious  
5 error, because --

6 LORD JUSTICE LEWISON: This is the so-called solvent regime?

7 MR PHILLIPS: Which begins at phrase 8. No, this is the  
8 condition. Phrase 8, just for the avoidance of any  
9 doubt, my Lord, because this is important -- phrase 8,  
10 which he's there referring to, starts with the language:

11 "If at any time an order is made by a  
12 competent court."

13 LORD JUSTICE LEWISON: So it is the insolvency regime.

14 MR PHILLIPS: Yes, my Lord. So what the learned judge did,  
15 and I am sorry, I hope I'm not putting it too  
16 forcefully -- we think this was a serious error that  
17 then runs through. What he did was, he separated out  
18 that new amended conditionality and he put aside or did  
19 not refer to the definitional language that you have in  
20 phrases 2 and the definitions.

21 The language:

22 "The rights of the noteholders against the Issuer in  
23 respect of the notes are subordinated and ...(Reading to  
24 the words)... to the senior creditors as defined below."

25 On the learned judge's analysis that is no part of

1 the regime in a liquidation or administration. And with  
2 respect to the learned judge we respectfully submit that  
3 that was wrong.

4 In our submission, the further conditionality, if  
5 I can call it that, the phrase 8 on language, cannot be  
6 construed as a stand-alone subordination provision free  
7 from the language of the other part of that clause that  
8 your Lordships have been looking at in the amended  
9 clause 3.

10 And if I could just -- forgive me if I'm going too  
11 quickly but if I can just then look at 228. This is  
12 where the learned judge went on to construe phrase 8 and  
13 following. And you can see it, when he says:

14 "The first part of the clause (phrase 8) simply  
15 reiterates the condition that serves to trigger this  
16 part of the provision, which is also found in phrase 7."

17 "The clause proper begins at phrase 9. Where the  
18 condition pertains, as I find it does here, the  
19 noteholder is entitled to payment determined by  
20 reference to what are in effect new terms."

21 And with respect, I'm sorry, but that's wrong. They  
22 are amended terms. They are not new terms.

23 And I said to your Lordships -- and forgive me for  
24 repeating it but it is such an important point -- the  
25 learned judge took no account of the fact that phrase 2,

1           that language I just read to you, is still in this  
2           clause. And it is the only language, as I hope I've  
3           shown you, that ranks the Sub-Note below other debts.  
4           That's the language. It says: you rank below these  
5           other debts.

6           And then if I can go forwards to 229(1), because the  
7           learned judge turns to the characteristics of the  
8           hypothetical preference share, and he rightly noted the  
9           further conditionality, adopted the notion of the  
10          hypothetical preference share, and he says:

11          "It ranks above all other classes of issued shares,  
12          although phrased in language alien to subordination  
13          above rather than below, all this provision does is make  
14          clear that the rights of the noteholders do not fall  
15          below those of any shareholder."

16          "In short, the provision limits the extent of  
17          subordination. I doubt very much whether it would be  
18          legally possible to subordinate the debt below shares,  
19          but in any event this provision makes clear that the  
20          right of the noteholders rank just above shares."

21          Well, we respectfully agree where he says the  
22          provision limits the extent of the subordination. We  
23          respectfully agree. We've got the subordination and now  
24          it's saying: you are not going below this level.

25          However, having correctly noted that the language of

1 "above" and "over" is alien to the language of  
2 subordinating a debt, the judge then went on to construe  
3 those words as subordinating the notes below particular  
4 debts. And if I can pick that up at 229(2) where  
5 he says:

6 "It ranks above the notional holders.  
7 Notional holders is a term defined by phrase 15 as:  
8 "Any creditor of the issuer's claim against  
9 the Issuer in a winding up quantified as though they  
10 hold a notional share."

11 Then he deals with the definitions of the notional  
12 holders. And he notes in (a) that the notional holders  
13 were creditors. But he didn't go on to consider the  
14 effect of a provision that ranks these notes above even  
15 some creditors, because that's not what he ended up  
16 concluding.

17 And of course, one effect is that if you rank above  
18 creditors you cannot rank in the level of the shares.  
19 That's trite company law.

20 Then this (b) --

21 LORD JUSTICE LEWISON: Shareholder I haven't followed that  
22 the judge's interpretation is that they rank above other  
23 creditors whose claims are quantified as if they held  
24 a notional share.

25 MR PHILLIPS: Yes. And only above those creditors. That's

1           where the learned judge ends up.

2   LORD JUSTICE LEWISON:   He's not saying that they are  
3           shareholders.

4   MR PHILLIPS:   He's not.

5   LORD JUSTICE LEWISON:   And to know whether there are any  
6           such creditors you would have to examine every single  
7           instrument that whichever company it was had issued to  
8           find out whether there were any creditors who fell  
9           within their description.

10   MR PHILLIPS:   The reason why I made that point wasn't  
11           a criticism of the judge as much as reflecting  
12           a submission that was made, which may or may not be made  
13           before your Lordships.   Sorry, I wasn't intending to say  
14           the judge made a mistake there.   But I think, my Lords,  
15           you have the chain of reasoning, that you have a note  
16           which identifies who would rank above certain creditors.  
17           So we know it can't be the shareholder.   You have the  
18           same note that identifies who ranked below certain  
19           individuals.   And that part of it doesn't change.   The  
20           judge didn't look at that part of it, he only looked at  
21           the bottom up and said, well, you've only referred to  
22           these individuals, so you must rank there.

23           And that just doesn't follow, with respect.

24   LORD JUSTICE LEWISON:   Yes.   Well, the judge in effect said,  
25           I look at the waterfall, as described in Nortel,

1 waterfall 1. I see the bottom of the list on  
2 shareholders. These notes are meant to rank above  
3 shareholders. That's all they say. And therefore they  
4 are at the bottom of the queue of creditors. That is  
5 essentially how it is.

6 MR PHILLIPS: Yes, although there is one type of debt  
7 underneath, as your Lordship knows. But that is not how  
8 this subordination clause works. This subordination  
9 provides that the rights of the notes are subordinated  
10 to the senior creditors, as with all the other  
11 instruments we're looking at. And the fact that there  
12 are some individuals below whom they can't fall doesn't  
13 affect that. And even if there was a gap, it wouldn't  
14 effect that at all. And the learned judge has just  
15 looked at the one and ignored the other, which is the  
16 operative subordination provision.

17 LADY JUSTICE ASPLIN: So what you are saying is: and he has  
18 noted the floor and then has become mesmerised by the  
19 floor and hasn't seen that there is a ceiling also.

20 MR PHILLIPS: That is precisely right, my Lady.

21 Then if I could move on to 230. He refers in 230,  
22 where he says in the second sentence:

23 "It seems to me that this provision is more  
24 naturally seen as a case of simple contractual  
25 subordination, albeit using the device of a deeming



1 provision to define the level at which the noteholders'  
2 rights are subordinated. The provision is not a form of  
3 contingent debt subordination. There is, on  
4 examination, no contingency discernible."

5 And the reason why I'm drawing that to  
6 your Lordships' attention is that one ends up with  
7 a very surprising result that, outside an insolvency,  
8 you have a hybrid provision whereby you have what he  
9 describes as simple contractual subordination in the  
10 first part, followed by contingent debt subordination in  
11 the second part.

12 And that is outside of an insolvency. But inside of  
13 an insolvency, on the learned judge's analysis you only  
14 have simple contractual subordination in that condition.  
15 And with respect, that is a surprising analysis.

16 Then if I can go to 231 because this is where one  
17 sees his critical conclusion, where he says:

18 "According to this provision, the rights of the  
19 noteholders rank above all shareholdings but below all  
20 debt, including subordinated debt, except for debt that  
21 has a subordination provision similar to the deeming  
22 provisions used by the noteholders themselves for the  
23 purposes of subordination."

24 So he says: you rank below all debt apart from the  
25 debt I can identify in what could be described as the

1 floor to the subordination provision. He says:

2 "The subordination provision thus altogether fails  
3 to qualify its relative priority in relation to claims  
4 ...(Reading to the words)... by methods other than by  
5 reference to a notional share or the holder of  
6 a notional share. It simply subordinates the rights of  
7 the noteholders in such cases to the position of  
8 a preference shareholder."

9 Which, with respect, is quite a muddled way of  
10 looking at that.

11 "With the benefit of hindsight it might be regarded  
12 as surprising."

13 And he considers it in the context of rectification:

14 "I should say, however, I regard this formulation  
15 ...(Reading to the words)... unequivocal. It does not  
16 appear to me that this meaning is gainsaid by  
17 the recital ..."

18 Well, with respect, we disagree.

19 " ... set out in phrase 17. But even if it were,  
20 I do not consider I could abandon the very clear meaning  
21 I found in the subordination provision ..."

22 And so on. The learned judge then went on to apply  
23 his three-step approach. I am sure you have picked up  
24 on the three-step approach. He applied it to the  
25 amended Sub-Notes. And the critical step is in

1 paragraph 237, when considering whether Claim B was  
2 an excluded liability in Claim A.

3 Your Lordships know that the three steps are: you  
4 look at one from the point of view of the other; you  
5 then look at the other from the point of view of that  
6 one, and then you see -- okay, you have the point.

7 And what the learned judge said is:

8 "According to new provisions governing the amended  
9 LBHI2 Sub-Notes, the ranking of the noteholders is  
10 determined by reference to the hypothetical notional  
11 holder. The subordination provisions in Claim B operate  
12 by deeming the rights of the noteholders to rank as if  
13 they were holders of hypothetical preference shares,  
14 thus ranking above all shares, but below all debt,  
15 including subordinated debt. ...(Reading to the  
16 words)... above all shareholders and also above any  
17 creditors ...(Reading to the words)... claims are  
18 quantified as though they hold a notional share but  
19 otherwise rank below all other forms of debt, including  
20 subordinated debt ...(Reading to the words)... as if a  
21 preference shareholder."

22 Then in these circumstances:

23 "The liabilities of LBHI2 under Claim B are  
24 expressed to be in my judgment ...(Reading to the  
25 words)... junior to the liabilities of LBHI2 under the

1 Sub-Debt Agreement. ...(Reading to the words)...  
2 because they rank junior to the subordinated liabilities  
3 in any insolvency of the borrower."

4 And the reasoning is that because of that amendment  
5 which identifies that notional shareholder mechanism,  
6 they've expressed themselves to be junior to the  
7 Sub-Debts.

8 And that's the learned judge's reasoning. And with  
9 respect, that's not right.

10 So if I may draw this together and make six points.  
11 In fact it's five, because I've already made one of  
12 them. First, my Lords --

13 LORD JUSTICE LEWISON: Sorry, before you go on, you  
14 criticise the judge for not paying attention to the  
15 non-insolvent regime, or the non-solvent provisions.  
16 You haven't looked at them either yet, have you? And  
17 I wondered what, if anything, you wanted to say about  
18 definition of solvent in (b):

19 "For the purposes of condition 3A above, the Issuer  
20 shall be solvent if it is able to pay its debts as they  
21 fall due."

22 Is there anything you want to say about that?

23 MR PHILLIPS: We are going to come to that in a second.

24 I dealt with it in my unamended notes but I was going to  
25 come back to it. But if it would help your Lordship --

1 LORD JUSTICE LEWISON: No, you come to it when you want to.

2 As long as you cover it.

3 MR PHILLIPS: I'm told it's better, so forgive me.

4 So if I may just make the six points for your  
5 Lordships' notes. First, my Lords, we say that the  
6 learned judge was wrong to distinguish between the old  
7 and the new regime. Secondly, the conditionality that  
8 we have been looking at does not alter the identity of  
9 the senior creditors. The correct starting point is the  
10 identification of below which senior creditors each  
11 instrument is subordinated. The amended conditionality  
12 in the note does not, construed properly, alter the  
13 legal characteristics of the defined class of senior  
14 creditors. And you don't discover who your senior  
15 creditors are by applying the conditionality. You look  
16 at the defined terms. Of course, the defined terms  
17 might take you into the conditionality, but they don't  
18 in this case.

19 Third, the further conditionality does not impose a  
20 ceiling, only a floor. And the judge's central  
21 conclusion that the rights of the noteholders rank below  
22 all debt, including the subordinate debt, was  
23 unsupported by any reasoning at any stage. As the judge  
24 said, the hypothetical preference share concept made  
25 reference to the Sub-Note ranking above, notional

1 holders and issue shares. He provided no explanation as  
2 to how this language could result in subordination below  
3 all debt. And a conclusion that debt described as  
4 ranking above some specified other debts cannot be  
5 construed as an agreement that will rank below.

6 Below all other debt is a logical leap that the  
7 learned judge didn't explain, in our submission. And  
8 that is particularly so where the very same  
9 subordination provision identifies the debts below which  
10 the Sub-Notes will rank. And in the present case the  
11 debts below which the Sub-Notes agreed to rank was the  
12 senior creditors, as defined.

13 And the judge's conclusion is inconsistent with the  
14 definition of senior creditors, which does not  
15 subordinate the Sub-Notes to all subordinated debt, as  
16 you have seen. And in our submission, ignoring the  
17 definitions altogether was an error.

18 And fourth, the learned judge was wrong to find  
19 subordination at the preference share level. And we  
20 have discussed that particular point.

21 And finally, the learned judge failed to give proper  
22 consideration to the surprising commercial consequences  
23 of his findings, which, as you know, are that outside of  
24 winding up the LBHI2 sub-notes rank above the sub-debt,  
25 and then the company goes into liquidation or

1 administration, when subordination might be thought to  
2 be its most important, and the opposite position  
3 pertains. And absolutely no one has thought of any  
4 rational reason why that should be the case.

5 Can I just pick up a point on the effectiveness,  
6 which was one of the points I was going to deal with  
7 earlier, which is the proper approach. If I could  
8 then -- I'm switching from this part of the discussion  
9 into the proper approach, which is the ineffective  
10 principle, because I didn't address you on it earlier,  
11 and which I would have done otherwise.

12 So if we can go back to paragraph 152. This is  
13 where the learned judge accepted as regards the Sub-Debt  
14 that it was engaged in an infinite, never-ending race to  
15 the bottom. Personally, I can't say that I am too  
16 bothered about races or pushing up and pushing down or  
17 any of the above, you have two provisions each of them  
18 say the other is senior debt. And that creates  
19 a problem.

20 Then if we could just pick up PLC's skeleton at C1,  
21 tab 8, at page 123. I just want to pick up this point.  
22 In paragraph 68, in that paragraph PLC also appears to  
23 agree that on a textual analysis the Sub-Debt is  
24 involved in a race to the bottom as a result of the  
25 narrow definition of subordinated liabilities. It

1 contends, however, that by virtue of the solvency  
2 conditionality the Sub-Notes somehow fall even further  
3 behind.

4 So we have acceptance that you have this race to the  
5 bottom, in other words Sub-Debt can't prove. But then  
6 you come into a question of whether or not Sub-Notes  
7 fall further down.

8 We would just draw your attention to the curiosity  
9 of such an argument because, as we pointed out at  
10 trial -- and I can give you the note; paragraph 234 of  
11 our submissions -- if each of the three Sub-Debts is  
12 engaged in an infinite race to the bottom such that none  
13 of them are able to prove at all, because that's the  
14 consequence, until the other two have been paid, and it  
15 cannot be right that Sub-Notes somehow rank behind the  
16 Sub-Debt. Rather, the Sub-Debt and the Sub-Note both  
17 fall to the bottom and none of them can prove on that  
18 analysis. So if the Sub-Debts go, in the judge's words,  
19 to the bottom of the waterfall, it doesn't follow that  
20 they are senior to the Sub-Notes. I just wanted to make  
21 that point.

22 I now just want to move on to the importance of  
23 independent construction, which is in the judgment,  
24 which is in C2/23/98 -- just paragraph 175, which is  
25 where he deals with this:



1           "Where the rival creditors have both subordinated  
2 themselves ...(Reading to the words)... complex."

3           And he says it's impermissible:

4           "An impermissible approach would be to read the  
5 subordination provisions in some way conjunctively.

6           And that methodology is then repeated when he deals  
7 with the three-step approach. So the judge's view, with  
8 which we respectfully agree, is that you have to  
9 construe them independently and what you can't do is you  
10 cannot look at the one in order to construe the other;  
11 you have to turn from one to the other.

12 LORD JUSTICE LEWISON: So you agree with his subparagraph 1?

13 MR PHILLIPS: It's impermissible, yes.

14 LORD JUSTICE LEWISON: Do you agree with his subparagraph 2?

15           "He may seek to rank himself by reference to other  
16 obligations"?

17 MR PHILLIPS: No. I don't.

18 LORD JUSTICE LEWISON: That, you say, is wrong.

19 MR PHILLIPS: Yes.

20 LORD JUSTICE LEWISON: And what about 3? Possible for two,  
21 subordination provisions different instruments to reach  
22 inconsistent outcomes.

23 MR PHILLIPS: I agree.

24 LORD JUSTICE LEWISON: You agree with that.

25 MR PHILLIPS: Yes.

1 LORD JUSTICE LEWISON: So the floor, you say, is in his  
2 subparagraph 2.

3 MR PHILLIPS: Yes, and particularly the way the learned  
4 judge applies it. You should look at each instrument  
5 independently and answer the question from that  
6 instrument: is there an expression of juniority in that  
7 instrument when you then turn to the next instrument?

8 But what you can't do, and what the learned judge  
9 did, and you have probably seen it on a couple of  
10 occasions is that he flipped from one to the other. But  
11 I don't want to expand on this too much because this is  
12 relevant in the unamended.

13 Just to explain what an independent three-step  
14 construction looks like, you take the first instrument  
15 and you take the second instrument, and you read them  
16 side by side. Step 1 considers the ranking of the  
17 second instrument in the first instrument, assessing it  
18 against the different defined levels in the first  
19 instrument to see where it ranks.

20 Step 2 considers the ranking of the first instrument  
21 in the second instrument, assessing it against the  
22 different defined levels in the second instrument to see  
23 where it ranks. And step 3 considers common outcome or  
24 resolves any security. That, in our submission, is how  
25 it should be.

1           That was ineffectiveness and independent  
2           construction.

3           What we submit is that if the judge had construed  
4           the amended notes correctly as being subordinated to the  
5           senior creditors as defined but sitting above the  
6           notional holders and issued shares, the exercise he  
7           would have carried out would have been as follows.

8           So we take the two agreements. You take the one  
9           agreement and you see how the other relates to it. And  
10          Claim A and the amended Claim B do not cross-refer to  
11          each other in any way. They simply do not talk to each  
12          other. Both instruments are in place to further the  
13          same regulatory purpose, and are lower tier 2 or tier 3  
14          capital. And although the starting point is not  
15          significant -- say you start with Claim A. You ask  
16          yourself whether the amended notes are an excluded  
17          liability in Claim A. And on a proper analysis there is  
18          nothing in Claim B which suggest it is junior to  
19          Claim A. The further conditionality, as you've heard,  
20          only addresses the position over certain obligations,  
21          which do not encompass the LBHI2 Sub-Debt. The senior  
22          creditors' definition is in substance materially the  
23          same as that in Claim A.

24          Next, Claim B is not a subordinated liability in  
25          Claim A. Claim B therefore rises to top of Claim A as

1 a senior liability. You then look at Claim B, and you  
2 look at where Claim A falls within Claim B, again there  
3 is nothing in Claim A which suggests that it is  
4 expressed or ranked junior to Claim B. It does not  
5 express itself to rank pari passu with Claim B, in fact  
6 it doesn't refer -- cross-refer to Claim B at all.  
7 Therefore it does not fall into any of the carve outs  
8 from the definition of senior creditor. It is therefore  
9 a subordinated debt that doesn't fall into the carve-out  
10 and Claim A rises to the top of Claim B, as a senior  
11 creditor. And that --

12 LORD JUSTICE LEWISON: Sorry, say that last bit again.

13 Nothing in Claim A says it is junior to or pari passu to  
14 Claim B. It's not within --

15 MR PHILLIPS: It's not within any of the carve-outs that we  
16 see in Claim B in the definition of subordinated  
17 creditor. The carve-out is carve-out of senior  
18 creditor, and it's subordinated. Apologies.

19 LORD JUSTICE LEWISON: Therefore it's a senior creditor.

20 MR PHILLIPS: Therefore it's a senior creditor. So you have  
21 each one of --

22 LADY JUSTICE ASPLIN: Sorry, just a minute. So that means  
23 that, looked at in terms of Claim B, Claim A is a senior  
24 creditor.

25 MR PHILLIPS: Yes. And looked at --

1 LORD JUSTICE LEWISON: And therefore Claim B should be  
2 subordinate Claim A.

3 MR PHILLIPS: Sorry, no, no, they're both senior creditors  
4 from the perspective of each other.

5 LORD JUSTICE LEWISON: Yes, but I thought you said claim B  
6 rose to the top and that's where I lost you.

7 MR PHILLIPS: Sorry, when I say -- I'm so sorry. I was  
8 doing it independently. So I was analysing Claim A  
9 first of all and saying Claim B rises to the top. I was  
10 then doing the same with Claim B and saying Claim A  
11 rises to the top.

12 LORD JUSTICE LEWISON: Ah. I thought you said Claim B rose  
13 to top second time round.

14 MR PHILLIPS: I'm so sorry, if I did say that, I misspoke.

15 LORD JUSTICE LEWISON: So each in terms of the other is a  
16 senior creditor, and the tie-breaker is the rule.

17 MR PHILLIPS: No, the tie-breaker is, neither of them  
18 effectively subordinates one to the other. The learned  
19 judge describes it as ineffective as between the two  
20 of them.

21 LORD JUSTICE LEWISON: I understand if the rule breaks the  
22 tie, but what is the contractual principle that  
23 you apply?

24 MR PHILLIPS: They do not contractually subordinate to the  
25 other. In order to subordinate a debt, the creditor has

1 to express themselves as subordinating themselves to  
2 another debt. Otherwise, they will prove at the same  
3 time and they will rank pari passu.

4 So whether one wants to describe that as the  
5 tie-breaker being the rule or whether one wants to say  
6 that is because they do not effectively subordinate one  
7 to the other, neither of them subordinate, you are in  
8 the same position as A1, A2, A3. The judge described  
9 that as ineffectiveness. Ineffective subordination is  
10 the way I understand it.

11 And we also have an alternative case, which, if  
12 I may, you may have picked up from our respondent's  
13 notice that we have the alternative case, which is what  
14 I would describe as insolvency-centric, perhaps, as  
15 opposed to contractual centric. I'm not sure, my Lord,  
16 that you will find much favour with it. But let me  
17 please explain it --

18 LORD JUSTICE LEWISON: I don't know. The trouble is, on  
19 your analysis both Claim A and Claim B do effectively  
20 subordinate themselves to the other claim.

21 MR PHILLIPS: To the other --

22 LORD JUSTICE LEWISON: That's the problem.

23 MR PHILLIPS: Which they can't.

24 LORD JUSTICE LEWISON: Quite. So --

25 MR PHILLIPS: That's why.

1 LORD JUSTICE LEWISON: So you have to get out of the impasse  
2 somewhere. Either you do it because there is some  
3 contractual principle that you can apply -- I am not  
4 sure at the moment that I understand what it is or it's  
5 the rule that says that unless you've done this very  
6 clearly you simply have to apply a pari passu  
7 distribution.

8 That bit I can understand. But I'm struggling a bit  
9 with the contractual principle to apply if, as you say,  
10 each of the two claims does, looked at in its own terms,  
11 effectively subordinate itself to the other claim.

12 MR PHILLIPS: Which is an impossibility.

13 LORD JUSTICE LEWISON: If you can find a contractual  
14 principle I would be very happy.

15 MR PHILLIPS: Well, the learned judge did it on the basis of  
16 ineffectiveness, which you see, which is that you cannot  
17 have subordination between two instruments where each  
18 purports to subordinate themselves to each other. That  
19 is just not possible.

20 The alternative case, which for your notes is at  
21 pages 46 to 49 of our skeleton, our alternative case is  
22 a simple case. But the fact is that these instruments  
23 do not talk to each other. They have materially the  
24 same definitional structure. They identify the same  
25 senior creditors, the same category of junior and

1           subordinated. But it's the senior that matter.

2           If a serious of debts -- because the one thing you  
3           can't realistically expect, particularly in the real  
4           world, is that there will be a complete contractual  
5           regime across all debts. And so what you have is you  
6           have debt that subordinates itself to the same senior  
7           creditors, that entitles each of those creditors to  
8           prove in the liquidation at the same time. And they  
9           will therefore rank pari passu. And that is how we  
10          developed it at trial. That is our respondent's notice  
11          case. That is our alternative case. I have explained  
12          it quickly but it's relatively simple. 46 to 54 and 58  
13          to 68.

14       LORD JUSTICE LEWISON: Sorry.

15       MR PHILLIPS: 46 to 54 is the unamended. We deal with it in  
16          the context of the unamended note. And 58 to 68 is in  
17          the context of the amended note.

18       LORD JUSTICE LEWISON: This is in your skeleton?

19       MR PHILLIPS: Yes.

20       LORD JUSTICE LEWISON: You are giving me paragraph numbers,  
21          are you?

22       MR PHILLIPS: I'm giving you paragraph numbers, my Lord.

23          Looking at the time, I think I would be very hard pushed  
24          to actually expand on this in great detail now --

25       LORD JUSTICE LEWISON: Yes, all right.



1 MR PHILLIPS: -- and also deal with rectification, which  
2 I still have to deal with. So if you will accept my  
3 apologies. The point is before your Lordship and  
4 your Lordship may come up with a better answer. I don't  
5 know. You have the judge's solution, which is: that  
6 can't be right, therefore I will go with what you  
7 describe as the ineffectiveness principle, where you  
8 don't have effective subordination one to the other  
9 because you have got them going like that. And you have  
10 our alternative case, which is, if they have  
11 subordinated themselves structurally to the same group  
12 of senior debts, senior creditors, they will prove at  
13 the same time. And of course that involves your  
14 concluding that they did not treat the other as one of  
15 those senior creditors.

16 LORD JUSTICE LEWISON: Yes.

17 MR PHILLIPS: That's the problem. I acknowledge that's  
18 the problem.

19 LORD JUSTICE LEWISON: I am always a little bit suspicious  
20 of 'with one bound he was free' type solutions.

21 MR PHILLIPS: The problem is, my Lord, that unless there is  
22 a leap and they are made free, it's a real conundrum.

23 LORD JUSTICE LEWISON: I agree.

24 MR PHILLIPS: And many of the greatest minds, if you don't  
25 mind my pointing to my learned friends, they have all

1           been addressing this. But we can all see what the right  
2           answer is.

3   LORD JUSTICE HENDERSON: Is there perhaps some mileage in  
4           the principle -- I forget quite where it comes from in  
5           wider scheme of things -- where the parties have failed  
6           to provide for a certain contingency and where then  
7           objectively the task is to work out what they would have  
8           done had they so to speak thought about it? Here, they  
9           thought very hard about subordination but they have just  
10          failed to realise in the particular circumstances it  
11          leads to an impasse, so effectively they have left that  
12          part of the analysis incomplete.

13                 And looking at it objectively you would say the only  
14          sensible solution in that circumstance is *pari passu* and  
15          that must be objectively the intention one (inaudible  
16          word) to them.

17   MR PHILLIPS: My Lord, not for now, but there is something  
18          along those lines in the PLC debate.

19   LORD JUSTICE HENDERSON: Yes, and I know it's --

20   MR PHILLIPS: I don't want to take it out of course if

21          I may --

22   LORD JUSTICE HENDERSON: -- (inaudible) elsewhere. I just  
23          wondered whether it might have ended up here.

24   MR PHILLIPS: There were just -- sorry, I apologise. This  
25          is slightly bitty at this point, but I just wanted to

1 tell your Lordships about two things. And it's  
2 interesting, because when your Lords have been asking,  
3 "Well, what would anyone have thought about it?" there  
4 are two points, and that is that when you are asking --  
5 your Lordships incidentally have already seen Golden Key  
6 and you have seen that one would if necessary imply  
7 a term into a contract.

8         There are two other things. The first is, there was  
9 the evidence of Mr Miller. And we accept he was not  
10 giving expert evidence. Before anyone gets upset about  
11 it, he was not giving expert evidence, but he was  
12 a senior capital markets lawyer stating his belief,  
13 under cross-examination incidentally, and repeating the  
14 advice of A&O to its clients set out for example in  
15 a briefing document, which we dealt with in our trial  
16 skeleton. And whilst PLC are dismissive of Mr Miller's  
17 evidence they do say in paragraph 9 that they accept  
18 that what Mr Miller said, sensibly enough, was what he  
19 would expect instruments with lower tier 2 and tier 3 to  
20 rank. So he would expect them to rank *pari passu* by  
21 default, which was his evidence thus.

22         And we, of course, don't disagree that rank  
23 ultimately depends on what the contract says. But the  
24 fact that *pari passu* was regarded as the default for LT2  
25 and tier 3 is material background.

1           If I could take you to authorities bundle 5.

2   LORD JUSTICE LEWISON:  Authorities bundle 5.

3   MR PHILLIPS:  Tab 78A.

4   LORD JUSTICE LEWISON:  Working paper number 12.

5   MR PHILLIPS:  Yes.  This is the BAL(?) Committee working  
6       paper number 12.  I referred to it in answer to one of  
7       your Lordship's questions earlier and I should show it  
8       to you.  If I could show you 2521.

9           "Tier 3 capital consists of fixed maturity SMD [that  
10       is subordinated debt] with a minimum maturity of  
11       two years.  Tier 3 debt is not amortised and it ranks  
12       pari passu with lower tier 2 debt.  Tier 2 and tier 3  
13       capital does not exceed tier 1 overall."

14           So remember I told your Lordships that there were  
15       different -- you could have certain proportions of  
16       different types of debt, but the important point is that  
17       in the BAL(?) working paper tier 3 debt is described as  
18       ranking pari passu with lower tier 2 debt.  And you will  
19       see that lower tier 2 is described generically, and of  
20       course, my Lords, the sub-debt instruments that you have  
21       been looking at are the standard forms that are produced  
22       by BAL(?).  And they certainly have recorded there what  
23       they think the ranking is of lower tier 2 and tier 3.  
24       So it all lends support to a pari passu construction.

25           I'm going to move on to rectification.  Before I go

1           into rectification, we have to just think about the  
2           starting point, because either there was a change, if we  
3           were right, from a pari passu construction to the notes  
4           being junior -- having been pari passu, they go to  
5           junior -- or, if the learned judge was right, they go  
6           from senior to junior. And my learned friend  
7           Mr Beltrami in his respondents' notice is running a case  
8           that the notes were junior in their unamended form.

9           Now, I haven't dealt with that, because that was  
10          part of the unamended notes. But if it's not  
11          inappropriate may I offer to deal with that now,  
12          notwithstanding it is in the --

13       LORD JUSTICE LEWISON: Just to clarify the rectification,  
14          the sequence of events is that Allen & Overy make some  
15          amendments to the terms to the unamended notes.  
16          Somebody then spots a tax problem. The notes are  
17          further amended to deal with the tax problem, which then  
18          goes through all the various people in the Lehmans, who  
19          sign it off. And the rectification sought is not to  
20          tweak the provisions in dealing with the tax problem,  
21          it's to remove them completely.

22       MR PHILLIPS: Absolutely.

23       LORD JUSTICE LEWISON: That, I'm bound to say, goes far  
24          beyond any rectification case I know about. But it's  
25          not a question of changing what you deliberately

1           inserted, it's a question of removing everything that  
2           you have deliberately inserted to deal with a particular  
3           problem, leaving that particular problem now unresolved.

4   MR PHILLIPS:   There wasn't a problem.

5   LORD JUSTICE LEWISON:   Well, I don't think the judges found  
6           it was all illusory and there really wasn't a problem.

7   MR PHILLIPS:   There are a number of steps in that  
8           description which, with respect, I will deal with,  
9           starting with deliberate --

10   LORD JUSTICE LEWISON:   It does raise one's eyebrows to see  
11           the extent of the rectification that you are pursuing.

12   MR PHILLIPS:   Yes.   Well, it's a number of things that were  
13           done in order to deal with a particular problem, and  
14           nobody intended to do any of it.   So let me deal  
15           with it.

16   LADY JUSTICE ASPLIN:   Nobody intended to do any of it?

17   MR PHILLIPS:   Nobody intended to deal with the tax point.  
18           I need to develop this properly, if you don't mind.

19   LADY JUSTICE ASPLIN:   Okay.

20   MR PHILLIPS:   And one of the things that of course you won't  
21           necessarily yet be aware of is that this is very similar  
22           to the pensions cases because there is a mechanism for  
23           amendment.   But please let me deal with that.

24   LORD JUSTICE LEWISON:   Sorry.

25   MR PHILLIPS:   Can I deal with the point that I referred to,

1           which is my learned friend's point that the solvency  
2           conditionality, which I think is the point your Lordship  
3           raised a few minutes ago and I promised to come back to,  
4           which I'm now doing.

5           In their respondents' notice they argue that the  
6           judge ought to have concluded that Claim A had priority  
7           over unamended Claim B. And the case centres on the  
8           contention that the solvency conditionality in the  
9           amended Claim B modifies the definition of senior  
10          liabilities subordinating the Sub-Notes to all debts,  
11          without exception, including Claim A.

12          And just so that you know the history, that didn't  
13          make an appearance in the original position paper, but  
14          at trial, somewhat surprisingly, it was my learned  
15          friend's only case.

16          The core proposition is that the conditionalities on  
17          these agreements have a freestanding effect to the  
18          definitional part of the provision. And having heard  
19          that that is how the case was put, one can understand  
20          why the judge made an error.

21          If I can start with bundle C1, tab 8, at 106. It's  
22          paragraph 22 which is the nub of the point, where  
23          they say:

24                 "Whilst the first element, namely the statement that  
25                 the rights of the lender are subordinated to senior

1 liabilities ...(Reading to the words)... the loan might  
2 well operate to effect subordination when it is coupled  
3 with the detailed subordination mechanism comprising the  
4 solvency condition in paragraph 5(1), that first element  
5 may properly be regarded as a statement of introductory  
6 or general intent, the second element is the critical  
7 and implementing provision which creates and defines the  
8 subordination of the debt, and it is through the  
9 mechanism of the solvency condition that the  
10 subordination is given effect."

11 Now, that's the nub of the submission. And if you  
12 note paragraph 39, just looking at the third line from  
13 the bottom, where they say:

14 "The distinct and operational cash flow condition in  
15 the LBHI2 Sub-Notes as an expression of juniority  
16 enables both agreements to reach the same outcome under  
17 both ...(Reading to the words)... subordination and  
18 senior debt subordination."

19 Now, PLC are not reading the subordination  
20 provisions -- in other words the whole of clause 3 or  
21 clause 5, but in this instance clause 3 -- in a unified  
22 way. The case on the respondents' note depends on  
23 reading the conditionalities as modifying not unifying  
24 the subordination definitions.

25 And if I can just take you through to paragraphs --



1           just looking at 38 and 39. First it is said that the  
2           cash flow condition dictates subordination to all other  
3           debt, because it says "lower than any other debt". If  
4           you look in 38, four lines down, that's what they are  
5           saying: lower than any other debt, as opposed to the  
6           senior creditors.

7           And second, it's said that cash flow condition  
8           subordination is and of itself an expression of  
9           juniority, which you have seen.

10           Now, there are seven reasons why this is wrong, and  
11           this is the point that I wanted to get to. First -- and  
12           I think it would be useful for us to get up -- I will  
13           work from the amended -- the Sub-Notes, which as  
14           your Lordships know is CB3, page 741. There are  
15           seven reasons.

16   LORD JUSTICE LEWISON: Wait a minute. You are going to  
17           bundle 3. Do you want the judges' numbered phrases or  
18           working from the --

19   MR PHILLIPS: I'm just working from the neutral one.

20   LORD JUSTICE LEWISON: From the unamended ones?

21   MR PHILLIPS: No, I'll do it in the amended because --

22           I understand the point your Lordship has made in  
23           relation to amended and unamended. It's fine. For  
24           these purposes it's absolutely fine.

25           So the first point is conditions 3A, which start on

1           741, and 3B, which starts on 742, should be construed  
2           together. Condition 3A identifies to whom the debt was  
3           agreed to subordinate its rights. And you've seen that  
4           SLP has agreed only to subordinate its rights to senior  
5           creditors as defined below. And the subordination  
6           cannot be to both the senior creditors but also to all  
7           creditors. It can't be on the same clause. And PLC's  
8           construction ignores this key inconsistency.

9           Secondly, it flows from the use of the word  
10          "accordingly", which makes it very clear that the  
11          solvency conditionality in 3B, which is the solvency  
12          conditionality is part of the overall mechanism or means  
13          for implementing the subordination to the senior  
14          creditors. Of course, your Lordships have seen  
15          accordingly. Accordingly, accordingly. It is not doing  
16          something different, introducing a new and further  
17          subordination provision.

18          If it was doing something different, the notes would  
19          not have used the link word "accordingly".

20          Third, if we go over the page to 742 to look at  
21          condition B, and if we look at the first six words up to  
22          the comma in condition 3B, "for the purposes of  
23          condition 3A above", they refer back to condition 3A.  
24          They make it plain that the solvency conditionality that  
25          follows is intended to give effect to the subordination

1 provision in 3A.

2 Fourth, you can see that the language used is:

3 "The Issuer shall be solvent if (1) it is able to  
4 pay its debts as they fall due and (2) it's assets  
5 exceed its liabilities each as defined below."

6 And then in brackets:

7 "(other than its liabilities to persons who are not  
8 senior creditors)."

9 The fourth point we make is that debt with a small D  
10 is undefined. It is not used elsewhere in the notes.  
11 But it can only -- I don't want to misspeak -- only mean  
12 debts to senior creditors against the backdrop to  
13 condition 3A.

14 Fifth, the words in parenthesis, which you see in  
15 the end of line 2 "(other than its liabilities to  
16 persons who are not senior creditors)" make it clear  
17 that solvency in 3B only concerned with all debts and  
18 liabilities other than to persons who are not senior  
19 creditors, which of course makes absolute sense in the  
20 context of this provision.

21 Sixth, our construction renders condition 3B(i),  
22 which is the cash flow element, is able to pay its debts  
23 as they fall due, and condition 3B(ii), which is the  
24 balance sheet element, which is its assets exceed its  
25 liabilities, consistent, so that neither takes into

1 account liabilities or debts that are not owed to senior  
2 creditors. Otherwise, the two aspects of the solvency  
3 condition would themselves be inconsistent.

4 And what I mean by that is that LBHI2 would need to  
5 show that it could pay all of its debts on a cash flow  
6 basis, including all senior and non-senior liabilities,  
7 to be solvent in accordance with 3B1, but it would only  
8 need to show that on the balance sheet basis the  
9 Issuer's assets exceeded its senior liabilities to be  
10 solvent for 3B(ii).

11 LORD JUSTICE LEWISON: Is that necessarily surprising?

12 I mean, the application of a cash flow test and  
13 a balance sheet test in ordinary solvency can produce  
14 different results.

15 MR PHILIPPS: It's not a problem that the cash flow and the  
16 balance sheet test produced different results in terms  
17 of "can you pay your debts as they fall due?" as you  
18 know from Euro Sales, that is in the near future, and  
19 "do your assets exceed your liabilities?"

20 Where it is a problem is in the debts or the  
21 liabilities that you take account in the context of both  
22 of those, what they produce as an answer. And if one of  
23 them refers to all debts and the other one only refers  
24 to senior liabilities, that is a tension that, with  
25 respect, I do think that is a problem.

1 LORD JUSTICE LEWISON: Yes.

2 MR PHILLIPS: And one has to read this in the context of  
3 a provision which is subordinating the notes to the  
4 senior debts or the senior liabilities, and one has to  
5 ask: what debts or liabilities are you expected to be  
6 able to pay before you are able to pay the subordinated  
7 debt? And the answer to that must be the senior  
8 creditors or senior liabilities that you have agreed to  
9 prove after.

10 And that's the context in which this provision  
11 arises. And that's why we say "debts" in this context  
12 can only mean debts due to senior creditors. So.

13 There is just one more point, which is that if debts  
14 included both senior and non-senior liabilities, then in  
15 our submission the solvency condition would be  
16 unworkable, not least because even if a debt was  
17 expressed to rank junior to the Sub-Note, so you have  
18 an express juniority in the Sub-Note, it would need to  
19 be paid before the Sub-Notes became payable, because  
20 it's a debt.

21 So you would have another debt that ranked junior to  
22 the Sub-Note. And under this condition if debts means  
23 all debts, that has to be paid before you could pay the  
24 subordinated debts, which by definition are senior to  
25 that junior debt. And what that means is that it would

1 alter the identity of the debt to which the Sub-Notes  
2 were expressly subordinated, because you would have to  
3 pay the junior debt first.

4 So those were our submissions on the solvency  
5 condition and as to why -- and the reason why I did this  
6 at the beginning of the rectification case, it's as to  
7 why, the Sub-Notes were not junior to the Sub-Debt.  
8 That was the point I was dealing with.

9 So turning to rectification, I have heard everything  
10 that your Lordships have said and I hope I will deal  
11 with all of them. We have on the judge's analysis this  
12 difference as to how the Sub-Notes rank before and after  
13 insolvency, and you also have that outside of  
14 an insolvency they were senior and then inside  
15 an insolvency they were junior. All of which are, if  
16 I may respectfully say, surprising conclusions.

17 And we have referred to that as the ranking  
18 alteration. But the reason why it's important is that  
19 on the judge's analysis, and if we are right and they  
20 ranked pari passu prior to amendment, the amendments  
21 that were made -- and we'll come to the purpose of them  
22 in a moment -- but the legal effect of the amendments  
23 was to make the Sub-Notes, that had either been  
24 pari passu or senior, junior to the Sub-Debt.

25 We will show you that the reversal of priority is

1 inconsistent with the oral and documentary evidence.  
2 That shows that the sole alteration of the parties'  
3 legal rights which the amendments were intended to  
4 effect was a deferral of the payment of interest. And  
5 the parties did not think, nor were they told, that they  
6 were making any alteration to the parties' legal rights  
7 other than the deferral of the payment of interest.

8 There was no need to alter the ranking of the  
9 Sub-Notes to achieve the deferral of the payment of  
10 interest and to deal with the potential tax issue  
11 identified by Allen & Overy.

12 Now, PLC seek to downplay the significance of the  
13 deferral of the payment of interest, and they refer to  
14 it variously as the origin of the amendment or the core  
15 commercial purpose of the amendment, the implication  
16 being that the parties intended to make other  
17 fundamental changes to their legal rights and  
18 obligations.

19 But as we shall show your Lordships, whilst it is  
20 correct that the parties intended the amendments should  
21 protect as opposed to make changes to the LT2 regulatory  
22 status and the tax status of the Sub-Notes, the only  
23 fundamental change to the legal rights and obligations  
24 intended by the parties and needed to address Ms Dolby's  
25 tax purpose was the change to the interest payment date.

1           And that, incidentally, we would leave. We do not  
2           intend to change that.

3   LORD JUSTICE LEWISON: No, I understand that. But I just  
4           find it's quite difficult to follow on the facts. When  
5           the process of amending the documents started, the  
6           purpose was to defer interest. It's difficult for you  
7           to say that remained the only purpose, given that  
8           Allen & Overy spotted the tax problem and Lehmans were  
9           content to accept whatever it was that Allen & Overy  
10          drafted to deal with the problem.

11                 They didn't say, "Hang on a minute, all we want to  
12          do is defer interest; what are you doing mucking about  
13          with the terms of the notes?" That wasn't their  
14          reaction. So you have to accept, I would have thought,  
15          that there was a deliberate intention -- well, not  
16          necessarily intention -- there was a deliberate  
17          acceptance of the words of Allen & Overy inserted in  
18          order to deal with the perceived tax problem, and those  
19          are the very words you now want to take out  
20          by rectification.

21   MR PHILLIPS: They wanted -- I will show you the material.  
22                 They did not simply say, "Allen & Overy, whatever you  
23          want to do". And they were very clear about the  
24          purpose. And they wanted to protect the subordination  
25          status. So we'll look at it. This is absolutely not



1 a case -- and I put it to Ms Dolby -- in which they  
2 said, "Allen & Overy, do what you like".

3 It's absolutely not that case. So I understand  
4 your Lordship's point. I understand. And we're seeking  
5 to take out a lot of words, but there are a lot of words  
6 that just shouldn't have been put in. And there's no  
7 principle why you can't -- if 20 words are used to do  
8 one particular thing --

9 LORD JUSTICE LEWISON: No, I'm not saying it's the number of  
10 words that matter. It's the fact they were deliberately  
11 inserted for a particular purpose and, if they are  
12 removed, that purpose will no longer have been served.

13 MR PHILLIPS: Oh, no, it will, because there are -- the  
14 deferral of interest is all dealt with and there was no  
15 need for anything else. But we'll see that.

16 LORD JUSTICE LEWISON: The tax problem. The judge made no  
17 findings about that, did he? This tax problem  
18 was illusory?

19 MR PHILLIPS: There are two different tax problems. Do you  
20 want me to explain it now or ...?

21 LORD JUSTICE LEWISON: Take it in your own time.

22 MR PHILLIPS: No, no, let's ...

23 I'll come back to the tax problems in a moment. No,  
24 I won't. I'm so sorry. There were two. It's very  
25 important to distinguish between two different tax

1 concerns. Dolby and the tax team's objective was to  
2 amend the Sub-Notes to provide the ability to defer the  
3 payment of interest. And that would lead to tax  
4 optimisation and that was the sole intention behind the  
5 amendments by a relevant decision-maker. That was the  
6 tax question that had given rise to the instructions and  
7 the need to amend.

8 In contrast to that, Allen & Overy, who did not know  
9 that Lehmans had received extensive tax advice from PwC  
10 at the time the Sub-Notes were issued, had a separate  
11 concern with regard to the solvency condition, which  
12 they never shared specifically with Lehmans.

13 Mr Dehal believed that the solvency condition  
14 appeared to make the payment on the notes conditional on  
15 LBHI2's results and thus that HMRC might view the  
16 Sub-Notes as being more like equity than debt in  
17 a winding up, which was a completely different concern,  
18 and that might jeopardise LBHI2's ability to use the  
19 Sub-Notes' interest expense as a tax deduction.

20 A&O's internal solution was to replace the solvency  
21 condition with the preference share conditionality which  
22 we have been looking at, which included the specific  
23 assumption as to the notes and interest being payable  
24 in full.

25 So as we go through this, please just have in mind

1           that there are two distinct -- although they are both  
2           tax problems, two distinct tax problems.

3           We say that there are five grounds, which we have  
4           advanced, and they are in C1A3, 27 to 28. What I want  
5           to do, if I may, is to start with the legal principles,  
6           which I'm sure you are very familiar with, and then  
7           proceed into the judge's findings of fact and some other  
8           fact material.

9           So can we start with what the judge said about the  
10          law, which is in C2/20/425. In paragraph 258 and in  
11          particular -- he deals with the rules of common mistake,  
12          and in particular in paragraphs 3A and B where he says  
13          on page 426:

14          "As regards the provision or aspect of the  
15          instrument to be rectified, there was a common  
16          continuing intention with regard to that particular  
17          provision or aspect, and secondly there was some outward  
18          expression of accord."

19          Just going back to 257(3), the learned judge  
20          acknowledged that some instruments -- and the rules of  
21          employer pension schemes are an excellent example --  
22          contain specific provisions regarding their own  
23          amendment, as the terms of the notes do here. Such  
24          provisions can affect the rules  
25          regarding rectification."

1           The point that we make, and I will expand on it, is  
2           that the learned judge did not then apply that principle  
3           to the particular facts of the case. The logical  
4           starting point is that it is more likely that parties  
5           who make a specific amendment to an existing contractual  
6           arrangement will have the requisite actual common  
7           intention not to alter the rest of a pre-existing  
8           contract save in the specific respect in which it is  
9           intended to amend it.

10           So that's the logical starting point. And that is  
11           because, prior to the amendment, the parties to  
12           an existing contract intend that their rights and  
13           obligations are those set out in the existing contract.

14           After an amendment, the parties intend that their  
15           rights and obligations continue as set out in the  
16           contract save for any changes to those rights that they  
17           intend to make.

18           And two closely related principles can be derived  
19           from the case law. In some respects they are different  
20           sides of the same coin. For your Lordships' note we  
21           have them in paragraph 93 of our skeleton. The  
22           first is:

23           "Where an existing contract is amended, if it can be  
24           shown that the relevant decision-makers had an intention  
25           only to make a specific and limited change to

1 an existing contractual arrangement ..."

2 If we call that Change X.

3 "Then it is convincing proof that the  
4 decision-makers did not actually intend to make  
5 a further legal change, Change Y."

6 The second proposition is that where Change X had  
7 been the subject of extensive preparation, discussion  
8 and advice, but Change Y has never been discussed at  
9 all, the absence of any discussion about Y is likely to  
10 be compelling evidence that the parties did not  
11 subjectively intend it."

12 Can I take you to AMP v Barker, which is in  
13 authorities bundle 1, tab 24 at 455, please. If you  
14 could turn to page 568 in the judgment of  
15 Lord Justice Collins, as he then was. And if you could  
16 cast your eyes over paragraph 1, please.

17 LORD JUSTICE LEWISON: Paragraph.

18 MR PHILLIPS: Paragraph 1. There are a handful of  
19 paragraphs.

20 LORD JUSTICE LEWISON: Yes.

21 MR PHILLIPS: The point of this is, just so your Lordships  
22 are aware, it related to a pension scheme of a company  
23 called MP1 and it involved an amendment to increase  
24 incapacity benefits. I may as well explain that early  
25 leavers were treated as if they were leaving due to

1           incapacity, and so when they increased the rights of  
2           people with incapacity it accidentally increased the  
3           right to early leavers as well.

4           If you could look at paragraph 3, please, where it  
5           explains that the trustees and members of the board who  
6           approved the rule changes, they had overlooked that  
7           fact. So that was the mistake.

8           Then if I may take you to page 470, paragraph 66,  
9           I will just read the first sentence:

10           "There must therefore be cogent evidence of the  
11           intentions both of the trustees of MPI(?) but not  
12           necessarily their agreement or accord."

13           And if you could --

14   LORD JUSTICE LEWISON:   Sorry, 66.

15   MR PHILLIPS:   66, first sentence, my Lord.

16   LORD JUSTICE LEWISON:   Yes.

17   MR PHILLIPS:   And then that's picked up in 67, which, if  
18           I may, I will just read:

19           "Consequently, what AMP has to show convincingly is  
20           a continuing common intention by the trustees in the MPI  
21           to affect only incapacity benefits. It's clear from the  
22           factual findings that there is overwhelming evidence  
23           that their intentions were limited to improving the  
24           benefits for those leaving on account of incapacity.  
25           And they had not the slightest intention to benefit

1 early leavers in general."

2 So that is what they were intending.

3 Then paragraph 71 on page 471, again if you could  
4 cast your eyes over that paragraph. My Lords, please  
5 note where Mr Justice Lawrence Collins says:

6 "It is quite unreal to contend that the intention of  
7 the trustees in MPI was simply to pass a resolution  
8 containing the words which it did in fact contain."

9 "Nor can it be said that they intended simply to  
10 sign anything which was put before them. The resolution  
11 was subject to preparation, advice and discussion. It  
12 was not the result of a rubber-stamping exercise."

13 LORD JUSTICE LEWISON: Could you help me about this,  
14 Mr Phillips? What is the rectification that was being  
15 sought in this case?

16 MR PHILLIPS: It is very lax of me. Can I come back with  
17 that? I do apologise. I should have thought ...

18 LORD JUSTICE LEWISON: On one view, if one applies this to  
19 your case, or rather if one applies what you want to do  
20 to this case, Mr Justice Lawrence Collins would have  
21 struck out the increase in benefits for the  
22 incapacitated. But I don't suppose he did.

23 MR PHILLIPS: No. I mean, not if you did what we are  
24 talking about.

25 LORD JUSTICE LEWISON: He's not saying, well, you didn't

1           intend this amendment to have this side effect and  
2           therefore we will remove the amendment.

3   MR PHILLIPS:  No, sorry, my Lord, there is some confusion.  
4           We're not intending to remove all of the amendments.

5   LORD JUSTICE LEWISON:  No --

6   MR PHILLIPS:  Just conditionality.

7   LORD JUSTICE LEWISON:  The one dealing with the tax problem.

8   MR PHILLIPS:  No, the one that is dealing with Mr Dehal's  
9           tax problem.  The amendments that deal with the deferral  
10          of interest --

11   LORD JUSTICE LEWISON:  I follow.  I understand.

12   MR PHILLIPS:  So it's specific to that.  So in this  
13          particular case one would expect that they were taking  
14          out the amendment that -- or they would have been  
15          dealing with the amendment that meant that --

16   LORD JUSTICE LEWISON:  Linking incapacity to early leavers.  
17          Something like that.

18   MR PHILLIPS:  Yes, something like that.

19                Can I return on that.  But the point is, in the  
20          context of an amendment to a pre-existing scheme it was  
21          sufficient to show common continuing intention only to  
22          effect a change to incapacity benefits.  And the  
23          decision-maker did not need to advertently apply their  
24          mind to the benefit to early leavers in general and  
25          positively consider that it was not the change that



1           they intended.

2           And my Lords, the same principle was applied by  
3           Mr Justice Trower, which is in authorities bundle 4.  
4           It's tab 66. I can do this relatively quickly. Can  
5           I just show your Lordships two or three paragraphs.

6   LORD JUSTICE LEWISON: Bundle 4.

7   MR PHILLIPS: Bundle 4, tab 66.

8   LORD JUSTICE LEWISON: Univar, yes.

9   MR PHILLIPS: Page 2156. Just picking up paragraph 213,  
10          first line:

11                 "The present case is one in which the company relied  
12                 on the decision-makers' subjective intention as being to  
13                 maintain the status quo, save and insofar as specific  
14                 changes were necessary as a result of legislation or to  
15                 reflect existing practice or otherwise  
16                 specifically agree."

17                 So your Lordships can see the point. And then if we  
18                 can go on to 2161, it's in 239, four lines up from the  
19                 bottom, where he says --

20   LORD JUSTICE LEWISON: Which paragraph?

21   MR PHILLIPS: 239, my Lord.

22   LORD JUSTICE LEWISON: Yes.

23   MR PHILLIPS: And perhaps if you cast your eyes over that  
24                 and just cast your eyes over to 240 to the sentence:

25                 "The trustees proceeded on the basis that there were

1 to be no changes of substance unless they were included  
2 in the schedule of changes."

3 So that, my Lords, was the first principle, which is  
4 where an existing contract is amended. If it can be  
5 shown that the relevant decision-makers only intended to  
6 make change X then they didn't intend to make change Y.  
7 The second proposition, which is:

8 "Where X is the subject of extensive preparation and  
9 discussion and advice, change Y is likely to be -- the  
10 absence of discussion about the other change is likely  
11 to be compelling evidence."

12 So it's the absence of discussion point. And if  
13 I can pick that up from AB3/55, which I get from  
14 FSHC v GLAS. That's at tab 55.

15 LADY JUSTICE ASPLIN: I'm sorry, which authorities bundle  
16 was that? I've just put it away.

17 MR PHILLIPS: I'm sorry, this is authorities bundle 3,  
18 my Lady.

19 LADY JUSTICE ASPLIN: Thank you.

20 MR PHILLIPS: I'm sorry.

21 LADY JUSTICE ASPLIN: No, it's my fault.

22 MR PHILLIPS: My Lord, the answer to your Lordship's  
23 question in relation to AMP you will find in  
24 paragraph 5.

25 And the rectification sought was "of the rule

1 changes to remove the link between ill-health benefits  
2 and early leaver benefits". It's in paragraph 5,  
3 my Lord. I do apologise for not having that at  
4 my fingertips.

5 LORD JUSTICE HENDERSON: As far as I can see, it's spelt out  
6 at that level of generality. We don't see the  
7 actual text --

8 MR PHILLIPS: Even so.

9 LORD JUSTICE HENDERSON: That obviously was the principle  
10 which was applied in making the necessary changes.

11 MR PHILLIPS: Yes. May I move on to FSHC?

12 LORD JUSTICE LEWISON: Yes.

13 MR PHILLIPS: This is in authorities bundle 3, tab 55.

14 LORD JUSTICE LEWISON: Which is the first instance, is it?

15 MR PHILLIPS: This is the late Mr Justice Henry Carr. And  
16 I just want to pick up a few points. If I could take  
17 you to paragraph 44, which was at 1676, which is the  
18 start of the discussion about the absence of discussion  
19 being evidence of intention.

20 This sets out the submission by Mr Wolfson, again as  
21 he then was, where the very absence of any discussion  
22 can itself be the evidence that the parties didn't  
23 intend it.

24 And if you pick it up at 45, Mr Wolfson submitted:

25 "The more unexpected result ...(Reading to the

1 words)... is the more likely the court will find the  
2 common accord that it was not intended even where it is  
3 not expressly discussed."

4 I pause there. We are talking about the accidental  
5 subordination of 6 billion worth of Sub-Notes.  
6 Mr Howard then sought to distinguish the cases and he  
7 submitted that in determining whether a change was  
8 intended to be made to a pension scheme the  
9 circumstances may justify starting with an assumption  
10 that the parties intended the existing version was going  
11 to be preserved."

12 Then he said:

13 "The change in question was never discussed at all.  
14 The absence of discussion may itself support the  
15 conclusion that the parties did not intend to make  
16 a change."

17 And Mr Howard tried to limit the principle to the  
18 pensions cases. And Mr Justice Henry Carr said:

19 "I accept the amendments to pension schemes raised  
20 the particular issues identified by Mr Howard. I do not  
21 accept that the principle is confined to pension cases.  
22 In my judgment, the authorities illustrate the  
23 proposition that where an important change is made to an  
24 existing arrangement between the parties, the absence of  
25 any discussion of that change may itself be evidence

1           that the parties did not intend it. Whether that is  
2           true in any case depends on all the circumstances."

3           So what the cases show is that as a matter of  
4           evidence to establish convincing proof of the parties  
5           intention it can suffice to show that the parties did  
6           not intend to affect Change Y by showing that there was  
7           no mention of Change Y whatsoever, particularly when  
8           Change Y is a significant change.

9           And of course, my Lords, we completely accept that  
10          the weight attaching to the absence of discussion will  
11          depend on the facts of the case. However, the principle  
12          is apposite in the case of a specific amendment to  
13          a pre-existing contract.

14          If I may just say something about PLC's position on  
15          the law. Our submission at first instance was that the  
16          absence of any discussion of the relevant change is  
17          convincing proof that there was no intention to make  
18          that change. Since the trial, my learned friends'  
19          position has moved somewhat. At trial, their position  
20          was that only a positive intention not to effect the  
21          specific Change Y would suffice. But they now appear to  
22          accept that a positive intention not to effect other  
23          legal changes suffices.

24          And if I can just give you the references. You will  
25          find that in paragraphs 75 to 84 of their skeleton

1 argument. And if we could perhaps turn up C18/126,  
2 paragraph 77, which is where the point is pulled  
3 together:

4 "It is important to avoid the ...(Reading to the  
5 words)... between two possibilities. The first is a  
6 positive intention to effect Change X coupled with  
7 either a positive intention not to effect Change Y or  
8 a positive intention not to effect any other changes  
9 [which categories of course will include Y]. This is  
10 required for rectification. The second possibility, of  
11 only having a positive intention to change X and having  
12 no intention either way as to Y, ie being unaware of  
13 ...(Reading to the words)... both, is not the position  
14 in this case but is in any event insufficient for  
15 rectification."

16 So they set out a number of categories. The first  
17 category is: positive intention to effect legal change X  
18 coupled with either a positive intention not to effect Y  
19 or a positive intention not to effect other changes.  
20 And the second category being unaware or indifferent.

21 And in our submission on the facts of this case we  
22 are in the first category, or a positive intention not  
23 to effect any other legal changes.

24 My learned friends place a lot of reliance on  
25 Lloyd v Stanbury. That is in authorities bundle 1.

1           What I'll do is, looking at the time, if I may give you  
2           the reference and make the proposition that I --

3   LORD JUSTICE LEWISON:   Is this the boundary dispute case?

4   MR PHILLIPS:   Yes, absolutely.   This was Mr Stanbury and  
5           Mr Lloyd and plot 1428.

6   LADY JUSTICE ASPLIN:   So sorry, Mr Phillips, could you give  
7           me the reference again in the authorities?

8   MR PHILLIPS:   It's authorities bundle 1, tab 6.

9   LADY JUSTICE ASPLIN:   Thank you.

10   MR PHILLIPS:   So if you in forgive me I won't go through the  
11           references but I will give you the propositions.   It is  
12           not a case where there was a pre-existing framework  
13           which was being amended and there was a specific and  
14           limited purpose to the amendment.   That's the first  
15           proposition, because this is an important difference  
16           between that case and this.

17           The second point is that it was a case where the  
18           rectification claim failed on the facts because of lack  
19           of evidence from the conveyancing solicitors.   In our  
20           case, the draftsman of the amended Sub-Notes gave  
21           evidence and his instructions are recorded in  
22           documentary evidence.   PLC doubtless make a lot of the  
23           finding Mr Lloyd was indifferent or not interested.   And  
24           by analogy they will be submitting, I'm sure, that the  
25           Lehman Group was indifferent about subordination and

1 relative ranking.

2 The current case is not an indifference case. And  
3 I will come on to the 'so what' point that the judge  
4 made in due course.

5 Can I then take you to core bundle 3, CB3, at 41 at  
6 728, please. If I just start at 718, which is the  
7 beginning of 41. This is the Sub-Notes. I'm taking you  
8 to the Sub-Notes for a completely different reason.  
9 Could we go to page 728, please. This is clause 12 of  
10 the Sub-Notes and it deals with modification and waiver.

11 The relevant parts of clause 12(a) are as follows.  
12 If you can go seven lines down on the left-hand side  
13 there is a word "represented" and then a semicolon. And  
14 you then have the words "provided, however, that":

15 "Provided, however, that certain proposals ..."

16 Then you need to see what it includes:

17 "... including any proposal to change any date fixed  
18 for payment of [skip over principle] interest, in  
19 respect of the notes."

20 Then there are some more reserved matters. And then  
21 if you pick it up after the definition reserved matter:

22 "... may only be sanctioned."

23 And note the word "sanction", and I will come back  
24 to it:

25 "... by an extraordinary resolution passed at a



1 meeting of the noteholders at which one or more persons  
2 holding or representing not less than two-thirds or at  
3 an adjourned meeting representing any or in certain  
4 circumstances specified in the procedures memorandum not  
5 less than one-third of the aggregate principal amount of  
6 the outstanding note form a quorum."

7 Then it says this, because this is the mechanism:

8 "Any extraordinary resolution duly passed at any  
9 such meeting shall be binding on all the noteholders  
10 whether present or not."

11 Then there is an additional provision, which is:

12 "In addition, a resolution in writing signed by or  
13 on behalf of all the noteholders who for the time being  
14 are entitled to receive notice [and so on] will take  
15 effect as if it were an extraordinary resolution."

16 So what you have when it comes to amending the date,  
17 any change to the dates fixed for payment of interest,  
18 there is a procedure for amending by extraordinary  
19 resolution. And that extraordinary resolution is either  
20 passed -- sorry, I should have said and it is a sanction  
21 of a proposal by extraordinary resolution.

22 So there is a procedure whereby the noteholders can  
23 sanction a proposal to amend. And that's done by  
24 extraordinary resolution, either by two-thirds or by  
25 one-third in certain circumstances, or a written

1 resolution of all the noteholders.

2 It is similar to the pension cases because it is an  
3 exercise of a power of amendment. And the statement in  
4 my learned friends' skeleton argument at paragraph 107  
5 that the Sub-Notes do not grant other party a unilateral  
6 power to amend, subject merely to the consent of  
7 the other, is wrong.

8 Now, we'll come back to this when we consider  
9 outward expression of accord.

10 LORD JUSTICE LEWISON: So just unpack that a little bit.

11 The Issuer and 100 per cent of the noteholders I would  
12 have thought could agree any change they like. It's  
13 a contract.

14 MR PHILLIPS: It's a listed contract. I'm not sure that  
15 I would like to speculate on that.

16 LORD JUSTICE LEWISON: Well, they may have to get consent  
17 from the Stock Exchange, perhaps. But as a matter of  
18 contract why can't they agree whatever they like?

19 MR PHILLIPS: With respect, my Lord, I would submit no,  
20 because there is a process. And the process -- it  
21 actually specifically provides that certain proposals  
22 are reserved matters that can be amended in a particular  
23 way, including a resolution signed on behalf of all the  
24 noteholders.

25 And if my Lord was right and said, well, as a matter

1 of contract you could simply amend it, you wouldn't have  
2 that provision there. There is in the same --

3 LORD JUSTICE LEWISON: What about something that is outside  
4 these particular matters? Like the change in ranking.

5 MR PHILLIPS: Well --

6 LORD JUSTICE LEWISON: In the present case they just can't  
7 do it, you say?

8 MR PHILLIPS: I don't think we really need to get into it  
9 because in the present case this is the procedure. And  
10 I'm about to show you it's the procedure that was  
11 applied. It's very important because what you have in  
12 the pension cases -- what you have in all sorts of  
13 different areas of our laws, for example schemes  
14 arrangements, CVAs, you have provisions which deem  
15 agreement if you go through certain procedural steps.

16 It matters not that on the facts of this case it was  
17 a resolution in writing signed by 100 per cent of  
18 the noteholders. It is still by extraordinary  
19 resolution. It is still sanction of a proposal. And  
20 that is different to agreement at large.

21 LORD JUSTICE LEWISON: The main purpose of this kind of  
22 clause is to bind people who haven't actually signed up  
23 to the amendment. It's to bind the one third who didn't  
24 vote for the extraordinary resolution. It's to bind the  
25 pensioners in payment who didn't know about whatever the

1 trustees were proposing to do, deferred pensions or  
2 whatever it was. That's what these things are  
3 basically for.

4 MR PHILLIPS: My Lord, I don't disagree. But what it means  
5 is that you don't have to have the same sort of  
6 agreement in the context of rectification.

7 LORD JUSTICE LEWISON: I see.

8 MR PHILLIPS: Just as you don't in the pension cases,  
9 because what you have is, you have an amendment which is  
10 made by a process that deems agreement. And what you  
11 had in this case was sanction of a proposal.

12 LORD JUSTICE LEWISON: Yes.

13 MR PHILLIPS: You didn't have -- I mean, this case has two  
14 features to it. One is pre-existing structure,  
15 pre-existing set of arrangements between the parties,  
16 and the second is that you then have a procedure whereby  
17 amendment takes place. And what you will see when we  
18 look at the process of amendment is you will see  
19 Allen & Overy drafting resolutions and producing the  
20 documents required for this process.

21 And we cannot, in the context of what was intended  
22 against a backdrop where you have the pensions cases,  
23 which -- albeit Mr Howard's submission that they are  
24 unique was rejected, and I respectfully agree with that  
25 because there is a principle, but it is relevant,

1           because we didn't need the sort of agreement that you  
2           would expect, for example, if there was no process.

3   LORD JUSTICE LEWISON: I understand.

4   MR PHILLIPS: I'm sorry.

5           So can I then go to supplementary bundle 2 at tab 45  
6           please. This is the written resolution that was  
7           amending the notes. And if you look at the resolution  
8           in 2:

9           "SLP3 confirms that it is a registered holder of  
10          100 per cent of the note and as such has sole power to  
11          assent ..."

12          Again you get the language of assent:

13          "... to any amendment or modification of the  
14          conditions ...(Reading to the words)... which will  
15          henceforth be in the form attached as annex A of the  
16          resolution."

17          So it's assent to the amendment. And the effect  
18          pursuant to condition 12, which we just looked at, of  
19          the note:

20          "This written resolution takes effect as if it were  
21          an extraordinary resolution as defined in the  
22          conditions."

23          And you will see that it is signed by Emily Upton of  
24          SLP3 and by Mr Rush for LBHI2.

25          Then if we could go to tab 44, please. Tab 44 is

1 the minute of the meeting of LBHI2. I just want to show  
2 you that it's attended by Mr Rush. At paragraph 1 you  
3 can see the business of the meeting. They refer to the  
4 amendment. And then if you look at the last sentence:

5 "The purpose of the amendment was to allow the  
6 company to defer cash settlement of the interest on the  
7 note at its discretion."

8 That is a formal decision of LBHI2 that led to its  
9 signing the resolution.

10 Then going forward two tabs to tab 47 at page 3502,  
11 this is the minutes of the electronic consent of LB UK H  
12 Delaware. You will see from the third recital the  
13 corporation is the sole general partner --

14 LORD JUSTICE LEWISON: Just a minute. I'm not with you. 47  
15 is an email chain.

16 MR PHILLIPS: Yes, my Lord, go forward to 3502. The emails  
17 deal with outstanding --

18 LORD JUSTICE LEWISON: 3502.

19 MR PHILIPPS: Yes. And if you look at the third recital,  
20 the corporation is the sole general partner of SLP2, it  
21 is the sole general partner of SLP3. And then, two  
22 down, whereas the proposed incorporation in its first --  
23 so approve the proposed amendment, final sentence:

24 "The purpose of the amendment is to allow the Issuer  
25 to defer cash settlement of the interest on the notes at

1           its discretion, the holder of the notes is SLP3."

2           And this is signed by Mr Triolo, the resolution is  
3           that it's approved. So those resolutions show that the  
4           purpose of the amendment was to allow the Issuer to  
5           defer cash settlement of the interest on the notes at  
6           its discretion. That is the only purpose recorded in  
7           both resolutions. And that is consistent with the  
8           evidence of subjective intention provided by Ms Dolby,  
9           her oral evidence was she shared her intention with  
10          Mr Rush and Mr Triolo. And those resolutions were  
11          passed in the context of that rule and those companies,  
12          those companies that signed the resolution, were being  
13          told what the purpose of the amendments that they were  
14          assenting to was.

15          Can I then just turn to the judge's findings of  
16          fact. We go back to C2/22, and if we can go to 428. He  
17          dealt with his findings of fact in paragraphs -- he  
18          starts at 428, 260 to 268 of the judgment. It's done in  
19          a little over five pages, and one of the things the  
20          learned judge did was incorporate the factual history  
21          that he'd used in relation to construction which you  
22          find earlier at 199 to 215. And the point that we want  
23          to make at the start is that despite PLC's criticisms of  
24          the paucity of evidence before the court there was  
25          a considerable amount of documentary evidence disclosed

1 on all sides. There was also the oral evidence of  
2 Jackie Dolby, I'm going to show you one or two passages.  
3 She was the European tax lead with overall conduct of  
4 the amendments. The judge accepted that she coordinated  
5 the issuance of the LBHI2 Sub-Notes and she was very  
6 closely involved in the amendments process. And for  
7 your Lordships' notes that is 213 at page 413. So  
8 responsibility for this process was with Jackie Dolby.

9 And as we have seen the evidence of the resolutions  
10 by which the proposed amendment was sanctioned was  
11 consistent with Ms Dolby's evidence, and there was also  
12 oral evidence from Mr Grant, and he was the solicitor at  
13 Allen & Overy who had conduct of the drafting process  
14 and who received instructions from Ms Dolby and Sarah  
15 McMorro who was in the legal department.

16 We've set out five aspects of the evidence in  
17 paragraphs 80 to 88 of our skeleton. I want to focus on  
18 three. The first is that the learned judge did not  
19 address Ms Dolby's evidence of her own intention. She  
20 was the coordinator of the team that was responsible for  
21 the unamended notes and the amended notes. She shaped  
22 and managed the transaction and headed the  
23 cross-departmental team that worked on what was  
24 ultimately an intra-Lehman Group transaction.

25 The judge's findings that there was no discernible



1 intention was not consistent with the following  
2 evidence. And if you could take up supplemental  
3 bundle 2, tab 54 -- I'm sorry to be jumping from one  
4 bundle to another, it's difficult -- I would like to  
5 start at 567 and this is Day 3, page 110, it's on the  
6 bottom left-hand quadrant. If I could take you to 13 to  
7 18. The question:

8 "Question: And the reason for that is as you have  
9 explained is that all you intended was the interest  
10 should be deferred or could be deferred to achieve the  
11 tax benefit that you very helpfully described and that's  
12 right, isn't it?

13 "Answer: Yes."

14 And then at page 570 on page 131 of the transcript  
15 and the top right-hand quadrant and it starts at  
16 line 10:

17 "And all you intended was that the interest could be  
18 deferred so that you would achieve the tax benefit that  
19 you have been describing to his Lordship; that's right,  
20 isn't it?

21 "Answer: That's correct."

22 LADY JUSTICE ASPLIN: Could you give me the page reference  
23 again for that.

24 MR PHILLIPS: I'm so sorry, it's at 570, my Lady.

25 LADY JUSTICE ASPLIN: Yes, and internally?

1 MR PHILLIPS: Internally 131, it's the top right-hand  
2 quadrant starting at number 10.

3 LADY JUSTICE ASPLIN: Thank you.

4 MR PHILLIPS: Then if I go to 571 over to 572, this is  
5 starting on page 135 of the transcript in the top  
6 right-hand quadrant at 19:

7 "And both Mr Rush and Mr Triolo, who we have seen,  
8 were tax people who were familiar with the transaction?

9 "Answer: Correct.

10 "Question: And they both understand that the  
11 intention behind the transaction was to defer interest  
12 for the tax benefit you've described, correct?

13 "Answer: Correct.

14 "Question: And both Mr Rush and Mr Triolo would  
15 known that was the purpose of the transaction, yes?

16 "Answer: Yes.

17 "Question: And all you intended was that the  
18 interest should be deferred to achieve that tax benefit.  
19 You didn't have any additional intention than that, did  
20 you?

21 "Answer: No, not from a tax perspective, no.

22 "Question: Mr Rush approved the 2008 amendments on  
23 behalf of LBHI2?

24 "Answer: Yes.

25 "Question: We have seen that and you have explained

1 to his Lordship that you and he had a close working  
2 relationship in which you discussed all of these issues  
3 beforehand; that's right, isn't it?

4 "Answer: Correct.

5 "Question: And he shared the intention that you  
6 had which was to defer the payment of interest for that  
7 tax benefit; that's right, isn't it?

8 "Answer: Correct.

9 "Question: And you did not discuss ranking or  
10 alteration with Mr Rush, that's right?

11 "Answer: Yes.

12 "Question: And we have seen that the Delaware  
13 consent did not mention any other purpose or intention,  
14 we've seen that?

15 "Answer: Yes.

16 "Question: And Mr Triolo would have shared the  
17 same intention because he was a tax man in the US;  
18 that's right, isn't it?

19 "Answer: Correct."

20 Second, the judge said the history of the draft  
21 amendments, or any of the draft communications or  
22 discussions with the Lehman Group, were not material.  
23 And for your notes that is paragraph 211. But the  
24 history of the draft amendment shows that the only  
25 change to the parties' legal rights and obligations

1 intended by the amendment was the deferral of interest.

2 Now we set this out in our rectification chronology  
3 which if you want to look at it is at supplemental  
4 bundle 1, tab 12.

5 LORD JUSTICE LEWISON: Sorry, 211 he's dealing with the  
6 interpretation, isn't he, of the amended notes? He is  
7 not there dealing with rectification. I mean I take  
8 your point that what he should have done is gone back  
9 over what he said was or wasn't relevant. But in its  
10 own terms there is nothing wrong with 211 as regards the  
11 interpretation of the amended notes.

12 MR PHILLIPS: Yes, but -- I'm so sorry, my Lord. What the  
13 learned judge did is he incorporated these paragraphs  
14 into his rectification.

15 LORD JUSTICE LEWISON: That's your criticism, is that --

16 MR PHILLIPS: And I am only criticising this for the  
17 purposes of rectification only, my Lord, where the  
18 learned judge says, "I simply do not consider it  
19 material." And in the context of rectification we  
20 respectfully disagree. My Lord, your Lordship's  
21 absolutely right in the context of construction.

22 If you could take out supplemental bundle 2 and if  
23 I could take you to tab 29 -- I'm not going to show you  
24 all of the material -- tab 29 at page 445, this is  
25 an email of 11 June, the top email, from Jackie Dolby,

1 that is sent to, amongst others, Sarah McMorrow,  
2 Emily Upton and others and it talks about the amendments  
3 and it says:

4 "We are looking to amend the terms of the QED(?)  
5 issued by Intermediate 2 last year, currently held by  
6 SLP3. The change will give flexibility to allow the  
7 deferral of actual cash settlement of the interest  
8 though the interest would continue to accrue in both  
9 parties' accounting records and will ultimately be cash  
10 settled. My view is that the board of both companies,  
11 or the GP in the case of SLP3 should have a quick board  
12 meeting to ratify this. Thoughts?"

13 Then if we could go forward to tab 31, and at  
14 page 448, this is an email of 12 June from Mr Grant to  
15 Allen & Overy to Jackie Dolby, Sarah McMorrow and  
16 others, and he sent the second draft of the amendments  
17 to Ms Dolby and her team in the Lehman Group. He also  
18 sent a draft of the written resolution of LBHI2  
19 approving the amendments and the covering email refers  
20 to, you can see the centre:

21 "A composition showing the changes since the last  
22 draft you saw. Deferral provisions introduce tax  
23 sensitivities. The amendments are designed to ensure  
24 these sensitivities are met."

25 And so the amendment was flagged as a means of

1           preserving the subsisting tax treatment of the notes.

2           Then if I could perhaps just go to --

3   LORD JUSTICE LEWISON: This refers to the entirety of the

4           amendments?

5   MR PHILLIPS: This refers to Mr Dehal's tax concern.

6   LORD JUSTICE LEWISON: So Allen & Overy are saying to

7           Lehmans: not only have we deferred interest, we have

8           done this other thing as well, because tax sensitivities

9           are involved.

10   MR PHILLIPS: Introduced tax sensitivities. And what he

11           says is the amendments are designed to ensure these

12           sensitivities are met. And what it doesn't say is: by

13           the way, while we are at it --

14   LORD JUSTICE LEWISON: I understand that.

15   MR PHILLIPS: Absolutely. If I can just show your Lordship

16           SB1 at tab 1, page 21. This is Mr Brown's witness

17           statement.

18   LORD JUSTICE LEWISON: Sorry, SB1?

19   MR PHILLIPS: SB1, tab 1 and it's page 21. I just wanted to

20           show you paragraph 58. In paragraph 58 Mr Grant says:

21           "As part of the amendments to the Sub-Notes

22           I drafted the written resolutions to LBHI2 and SLP3.

23           I emailed drafts to Ms Dolby [so he's referring to this

24           email]. The written resolution states that the purpose

25           of the amendment was to allow ...(Reading to the

1 words)... to defer payments of interest and notes at its  
2 discretion. I did not refer to the amendments, to the  
3 subordination clauses. They were introduced solely to  
4 clarify the tax position and not to make a substantive  
5 change to the parties' rights to payment."

6 The point that you've seen from the email is the  
7 email did not flag any changes to the legal  
8 relationship.

9 Then SB2 again, tab 30, page 446. I should explain  
10 what this is. As part of the process the Lehman Group  
11 procured several documents from Allen & Overy and this  
12 included a corporate benefit note of 12 June which is  
13 this. And you can see that the subject is "Corporate  
14 Benefit".

15 LORD JUSTICE LEWISON: This was referred to in the email you  
16 just showed us, I think, wasn't it?

17 MR PHILLIPS: Absolutely right, my Lord. And you can see:

18 "The amendment involves change in the terms and  
19 conditions of the notes to all ow the Issuer to defer  
20 payment of interest on the notes. The Issuer and the  
21 sole holder of the notes, SLP3, will approve the  
22 amendment (inaudible) written resolution. The  
23 noteholder approving the amendment will be agreeing that  
24 the interest payments may not be made on the interest  
25 payment date as currently set out."

1           And there was no mention of ranking changes. And as  
2 we will show you in a moment Ms Dolby accepted in her  
3 evidence that a ranking alteration would have been to  
4 the corporate disbenefit of SLP3 and that SLP3 should  
5 have been notified of and agreed to it. But I will show  
6 you that in a minute.

7           Finally, once the drafting was finalised you've seen  
8 how the amended notes were approved and signed off. If  
9 I can just show you emails. Go forward in SB2 to  
10 tab 43, please. This is on the SLP3 side and it's Mr  
11 Parul Day(?) who was a lawyer to Mr Triolo and he says  
12 this, top paragraph:

13           "Jackie has been looking at amending the terms of  
14 the note issued by LBHI2 to SLP3. The change will allow  
15 LBHI2 to defer payment to SLP3 under the note. I attach  
16 the relevant document. I'm not sure the extent to which  
17 you've discussed it with Jackie. Happy to arrange  
18 a call."

19           And if I can then go on over to just remind you, 44  
20 is then the resolution that is signed, and you've then  
21 see the board minutes. The point that I'm making,  
22 perhaps too laboriously, is the purpose of these  
23 amendments was made clear and was understood as such by  
24 all involved, that it was just to defer the interest.  
25 And the extent to which there were other amendments to



1 deal with tax sensitivities -- I'm sorry, Mr Willson  
2 reminds me that the email we were just looking at did  
3 not attach the amended notes. Mr Triolo himself did not  
4 see the amended notes we've just looked at that.

5 So you've seen the fact that intention X, absolutely  
6 spelt out, discussed by everybody, right through the  
7 process; intention Y, the evidence we have is that if  
8 there had been such an intention ... if there had been  
9 such an intention, there is other evidence which  
10 I haven't shown you, that they would have expected it to  
11 have been raised. But what Mr Grant says in his  
12 evidence is that he was intending to maintain the  
13 status quo, he wasn't intending to make any other  
14 substantive amendment.

15 LORD JUSTICE LEWISON: I think Ms Dolby's evidence was that  
16 if the point had been flagged it would have been  
17 discussed. I don't think she said she would have been  
18 rejected, she said it would have been discussed.

19 MR PHILLIPS: She said if there had been such a change she  
20 would have expected it to have been raised with her and  
21 she would have discussed it. Mr Grant's evidence was he  
22 would have expected to raise it with her.

23 LADY JUSTICE ASPLIN: But Mr Phillips you did show us,  
24 I think it was an email or some correspondence from  
25 Mr Grant which said in effect -- and there's wording

1           which deals with the tax sensitivities which was  
2           a reference to the Mr Dehal point, let's put it that  
3           way.

4   MR PHILIPPS:   Yes.

5   LADY JUSTICE ASPLIN:   And so they were aware that there was  
6           extra wording that they were signing up to.

7   MR PHILLIPS:   They were aware there was extra wording and  
8           they were told that extra wording was there to deal with  
9           the tax sensitivity that had arisen, not to alter the  
10          subordination.   And the other thing, my Lady, that of  
11          course we've seen is the corporate benefit note.   And  
12          the fact is that if SLP3 had been subordinated by these  
13          amendments that is a significant corporate disbenefit,  
14          it was 6 million worth of notes being subordinated.   And  
15          that was not referred to in the corporate benefit note.  
16          Again all that you see in the corporate benefit note is  
17          the description of the intended amendment.

18                 And yes, in that email, my Lady, it talks about  
19                 preserving the tax position.   It's not talking about  
20                 making any other legal changes.   It's doing something to  
21                 preserve the tax position.   I can see, my Lord, that you  
22                 are --

23   LORD JUSTICE HENDERSON:   No, I'm sorry, I'm reflecting.

24                 There are very fine distinction, these areas, between  
25                 positively wishing to make no change and accepting the

1 change without having any particular feelings one way or  
2 the other as to how far it goes or what it entails.

3 MR PHILLIPS: But it's --

4 LORD JUSTICE HENDERSON: We do know here there were tax  
5 sensitivities which had to be catered for, nobody seems  
6 to have asked for chapter or verse as to precisely how  
7 that was being done, but equally they were all happy to  
8 sign up for the text that was imposed by Mr Grant with  
9 his email. Is that enough for your purposes?

10 MR PHILIPPS: Yes.

11 LORD JUSTICE HENDERSON: It's a big question (inaudible).

12 MR PHILLIPS: The reason why I say yes is this: you have  
13 got, if I may put it -- you've got clear evidence that  
14 everyone involved in this process intended amendment X.  
15 The only evidence you have in relation to amendment Y is  
16 there is some tax sensitivities but we are preserving  
17 them. What you don't have anywhere is any indication of  
18 an intention to alter the ranking, at all. And you have  
19 evidence that if they wanted to alter the ranking they  
20 would have discussed it and it would have been  
21 important.

22 When one goes back, I think it was AMP where they  
23 say the more important the amendment is more unlikely it  
24 is that it would have been intended when it's not been  
25 discussed. And the other point you get is that the more

1 amendment X is discussed the less likely it is that  
2 amendment Y is being intended.

3 LORD JUSTICE LEWISON: Leave aside amendment Y, because  
4 I understand that there are special points to it.

5 MR PHILLIPS: Yes.

6 LORD JUSTICE LEWISON: You want to rectify the contract,  
7 let's suppose. The first thing you do is to look at the  
8 contract and decide what it means. And you don't have  
9 to have evidence that parties intended it to mean that,  
10 it just means what it means. If they want to rectify it  
11 they have to show you positive evidence that they didn't  
12 want it to mean that. So to say there's no positive  
13 evidence that they wanted this change or another change,  
14 does that really help you on the question of  
15 rectification? What you need is positive evidence that  
16 they didn't want to make the change.

17 MR PHILLIPS: With respect, my Lord, you do --

18 LORD JUSTICE LEWISON: You say you got that, but I think you  
19 were answering Lord Justice Henderson in saying that  
20 there needed to be evidence that they did want to make  
21 a change but there doesn't. The change is the change,  
22 as it appears in the amended note.

23 MR PHILLIPS: I'm sorry, my Lord, we do not have to show  
24 positive evidence that they did not want to change Y.  
25 If you go back to those categories that we saw earlier

1           on in the discussion, all we need is an intention to  
2           make change X and not to make any other legal changes --  
3   LORD JUSTICE LEWISON: I'm not sure about that. The lack of  
4           evidence is material from which you can infer  
5           an intention not to make a change Y.  
6   MR PHILLIPS: But we have evidence --  
7   LORD JUSTICE LEWISON: I follow that. Then it's a question  
8           of inference from the evidence.  
9   LORD JUSTICE HENDERSON: On any view one of the things you  
10          did intend to do is to make the necessary changes to  
11          prevent the tax sensitivities which had risen. And  
12          nobody seems to have really bottomed out precisely how  
13          that was to be achieved. In that situation are you not  
14          left with the consequences of what you objectively chose  
15          to do, which was to undertake that second phase as well  
16          as the initial phase of deferment?  
17   MR PHILLIPS: My answer to that would be no, when you look  
18          at what those resolutions said. I completely  
19          understand, my Lord, where you are coming from if we  
20          were dealing with an ordinary contract. We are just not  
21          dealing with an ordinary contract, we are dealing with  
22          something that can be amended by mechanism, and --  
23   LORD JUSTICE LEWISON: Yes, all right.  
24   MR PHILLIPS: Yes.  
25   LORD JUSTICE LEWISON: I do notice the timetable purports to

1           rise till 4.30. Normally we rise at 4.15 but I think  
2           today we will allow you till 4.30, but perhaps your  
3           colleagues can bear in mind our normal rising time in  
4           the afternoon is 4.15.

5   MR PHILLIPS: My Lords, could I perhaps make the third and  
6           final point on this part, and then if I could take 15  
7           minutes from my reply submissions in due course tomorrow  
8           morning just to finish off rectification I would be very  
9           grateful.

10   LADY JUSTICE ASPLIN: As long as you and Mr Beltrami agree  
11           timetable that's fine.

12   MR PHILLIPS: If my learned friend would kindly just give me  
13           15 minutes tomorrow and I promise I'll take it off my  
14           reply.

15   MR BELTRAMI: My Lords I have taken that undertaking that it  
16           will come up as reply so I'm very happy to --

17   MR PHILLIPS: I'm obliged. If I may just do this one last  
18           point and then I will have a look at what's left this  
19           evening, if I may.

20   LORD JUSTICE LEWISON: Yes.

21   MR PHILLIPS: The third point was that the judge did not  
22           engage with the nature and scope of the instructions  
23           that were given by the Lehman Group to the drafting  
24           team. And as your Lordships know the instructions were  
25           given to Mr Grant and he agreed that the only change he

1           was asked to make related to deferral of interest and if  
2           I could take you back to SB2/51.

3   LADY JUSTICE ASPLIN: Does this really take the matter very  
4           much further forwards when you have that further email  
5           from Mr Grant later saying, "And we've also catered for  
6           this other point", and I know what that says and we have  
7           discussed that already. So what the original  
8           instructions are, does it really help a lot? Or has no  
9           more weight than you have already given them?

10   MR PHILLIPS: My Lady, yes. I don't disagree but can I just  
11           give you the references so that perhaps if you are  
12           interested you can look up what Mr Grant said in his  
13           evidence. The first reference is in SB251 at 549 which  
14           is Day 2, page 124, 10 to 21. And the second reference,  
15           which is a reference I have already referred to, is at  
16           SB2/52 at 552 that was Day 2, page 139, 8 to 11. And he  
17           agreed that if the effect of the amendments had been  
18           that the Sub-Debt took precedence over the Sub-Notes he  
19           would have told Ms McMorrow and would have needed to  
20           take instructions. And just for your note, the final  
21           reference is Ms Dolby in -- she was interviewed and she  
22           then said that that's all A&O were instructed to do, and  
23           you will find that in SB1/453, and 457, those  
24           references. And the particular point that you will find  
25           there is that she said they were not instructed in

1 relation to preserving the tax deductibility, PwC were  
2 dealing with that, PwC were dealing with the tax issues  
3 and were giving extensive tax advice, dealing with that  
4 was too loose.

5 So my Lords, if I may draw stumps at that point.  
6 I can't draw stumps? Hang on. I'm not the twelfth man.  
7 (Pause).

8 My Lord, I have until 4.30 as I understand it, so if  
9 I may.

10 LORD JUSTICE LEWISON: Yes.

11 MR PHILLIPS: The next item on the agenda is turning to the  
12 intention of LBHI2 and then I will turn to the intention  
13 of SLP3. You have seen the board resolutions, you've  
14 seen the background material, if I could take you to the  
15 judgment at C2/22/429. This is paragraph 262. If I can  
16 just pick it up in the second line where the learned  
17 judge says:

18 "I can see no evidence of any intention going beyond  
19 the objective construction of the notes as to how the  
20 notes of subordinated debt should rank as against other  
21 subordinated debt issued by LBHI2. Indeed, such  
22 evidence as there was before me strongly pointed to this  
23 being a matter that simply was not considered by LBHI2  
24 at all."

25 With respect we say that misses the point, because



1 the question wasn't what positive intention there was on  
2 relative ranking, the sole intention, as you will have  
3 seen, was to alter the payment date of the interest.  
4 And you've seen the exchange that my Lady referred to  
5 earlier in relation to, if I can call it the Dehal  
6 point. But there was no intention to make any other  
7 change. So even if we were saying: well, intention X is  
8 the tax deferral of interest plus Dehal, there was no  
9 intention to make any other legal change. That's what  
10 you can see on the evidence. If you were pushing me  
11 back on that I would still have that fundamental point,  
12 that subordination, the changing of ranking, is  
13 a fundamental change, it's a major change. And with no  
14 intention to alter the ranking, of course it's hardly  
15 surprising that there was no discussion about relative  
16 ranking of the notes or the debt at the time. And in  
17 our submission, for the reasons we have explained, the  
18 absence of discussion of relative ranking is a point  
19 that supports our case and it's certainly not a point  
20 against us.

21 There were several other flaws that I just want to  
22 draw attention to. First, the judge said, and for your  
23 note that is 262(1), that there was no evidence that  
24 anyone in the Lehman Group gave thought to subordination  
25 between different subordinated obligations because they

1 gave no thought to insolvency. So they didn't think  
2 about subordination because they gave no thought to  
3 insolvency. But with respect that doesn't follow. And  
4 you've seen subordination is relevant both in a solvent  
5 situation and an insolvent situation. You can see that  
6 from Standard Form 10 which deals with both. And the  
7 amendment to condition 3 of course itself bifurcated the  
8 subordination mechanism so that it contained separate  
9 provisions for subordination in insolvency and in  
10 solvency.

11 LORD JUSTICE LEWISON: Why do you say that? If the borrower  
12 is solvent then everybody gets paid. So why should they  
13 worry about subordination?

14 MR PHILLIPS: There are all sorts of reasons commercially  
15 why they worry about it. And I don't want to try and  
16 give expert evidence, but this debt wasn't traded. But  
17 if you can imagine, subordinated debt that is traded,  
18 where you are in the level is one of the relevant  
19 factors, my Lord. So the point that I'm making here is  
20 that the learned judge oversimplified this point by  
21 saying that the reason why they didn't think about it is  
22 that they didn't think about insolvency. And the second  
23 point --

24 LORD JUSTICE LEWISON: Nor did they think about sending the  
25 debt outside the group, did they?

1 MR PHILLIPS: No, they didn't. But your Lordship shouldn't  
2 confuse the two points because there was evidence from  
3 Mr Katz's team in relation to the dividend stopper that  
4 they did think about relative subordination in relation  
5 to that part of the structure that was sold outside. So  
6 it's wrong to say you don't think about relative  
7 subordination unless you are in an insolvency.

8 LORD JUSTICE LEWISON: Yes.

9 MR PHILLIPS: The second point was, and this is in 262(4) --  
10 and I should just make it clear of course Katz's  
11 evidence about what the discussion was was rightly  
12 rejected, but it's the fact of the discussion. In (4)  
13 he concluded that even if the relevant individuals  
14 within Lehman Group had been told about the ranking  
15 alteration they would not have cared -- they would, and  
16 this is in 264(4)(d), where he says:

17 "It is not the point. The point is that no one  
18 focused on the question of relative subordination. The  
19 point was not raised. That fact provided significant  
20 thought in what would have happened had the point been  
21 made. In my judgment, and of course the question is  
22 a hypothetical one, had the question arose it would have  
23 been met with a resounding 'so what?'"

24 And he says that it would have been a matter of  
25 indifference. But with respect, that misunderstands the

1 evidence of Ms Dolby and Mr Grant that you have seen.  
2 Because Ms Dolby said that if she'd been told the that  
3 Sub-Debt would take priority over Sub-Notes she would  
4 likely have discussed the situation with her legal and  
5 regulatory colleagues. That was her evidence. And she  
6 did not have such a discussion.

7 And in 262(4)(a) you can see that extract from  
8 Ms Dolby's witness statement. And in 262(4)(b) the  
9 judge set out an extract from Ms Dolby's  
10 cross-examination which he accepted as true, and she  
11 said she hoped she would have discussed a change in  
12 priority with colleagues, and it was unlikely she would  
13 have signed off without any discussions. And if you  
14 look to see that I ask the question:

15 "You would have discussed it with your legal and  
16 regulatory colleagues?

17 "Answer: Yes.

18 "Question: It might have created the other guys in  
19 the team in other departments a problem?

20 "Answer: I don't know.

21 "Question: Would you have discussed with them?

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

24 And so on. So it wouldn't have been met with a "So  
25 what?" And that was also confirmed in her witness

1 statement which is --

2 I'm so sorry, I don't think I should take up any  
3 more of your time this evening. That's not right. May  
4 we draw stumps, as I put it earlier?

5 LORD JUSTICE LEWISON: All right. Thank you very much,

6 Mr Phillips, we will start again at 10.30 tomorrow.

7 (4.30 pm)

8 (The hearing adjourned until  
9 the following day at 10.30 am)

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3	Submissions by MR PHILLIPS .....1
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