Friday, 8 October 2021

(10.30 am)

Submissions in reply by MS HILLIARD (continued)

LORD JUSTICE LEWISON: Yes, Ms Hilliard. You have two more points, I think.

MS HILLIARD: Yes, my Lady, my Lords, two very short points more. I was on number 6.

So number 6, Mr Phillips suggested -- and I think one sees that at pages 10 and 11 of yesterday's transcript, that it was common ground that there was no expression of juniority in Claim C as regards Claim D.

Now, in fact, whilst we agree that there was no expression in terms, we say obviously that at the end of the analysis one does find such an expression, and this is because C says it's more junior to everything save that which is expressed to be more junior still.

And D does not say, properly construed, it is more junior still because, properly construed, it doesn't subordinate itself to C.

Obviously I'm just saying the same thing that we've always said in different ways and in order to answer Mr Phillips' objections to our argument.

So what we say is that C ultimately does express itself to rank more junior, so it's not common ground that there was no expression of juniority, only that

there was no express expression of juniority.

Our seventh and final point is that Mr Phillips submitted that our treatment of British Eagle amounted to an invitation to the court to expand the principle.

We don't extend the principle. We don't say that it's an extension of the principle. Rather, we say that British Eagle is an application of the principle. And the principle is that the court will not give effect to contracts or arrangements which subvert the proper operation of the insolvency regime.

Now, that may be because the contract seeks impermissibly to evade the pari passu principle, as in British Eagle, or, we say here inadvertently but impermissibly creates a clog in the winding up of the company's affairs.

But obviously that principle only applies where there is a clog. And our case here is that there is no clog.

LORD JUSTICE LEWISON: We only get to this point if there's an impasse. And this then is the way that you break the impasse.

MS HILLIARD: Exactly. And the impasse is created because -- the impasse is there and therefore you can't finish winding up the company's affairs, so you have to break the impasse in some way. And that's what we say

is an application of the principle that the court will not give effect to contracts which subvert the proper operation of the insolvency regime which is designed to wind up the affairs of the company and ultimately dissolve the company.

But just to conclude, of course, what we say here -- although we accept that principle and we say that there's a possibility of that principle, it only applies in our case if there was a clog. And of course what we say our case is there is no clog, for the reasons that I've probably advanced too many times and repeated too many times, but I think you have our argument now.

LORD JUSTICE LEWISON: Yes, certainly.

MS HILLIARD: Thank you very much, my Lady and my Lords.

LORD JUSTICE LEWISON: Yes, Ms Tolaney.

Before you begin, there's one point. Mr Phillips yesterday placed quite a lot of stress on analysing MS Fashions on the principal debtor clause, and as I said to him I don't think we have seen the guarantee. I have assumed -- correct me if this is wrong -- that it does not contain a principal debtor clause.

MS TOLANEY: The complication, my Lord, is that it's a matter of Delaware law, and Mr Phillips has never relied on the terms of the guarantee and it's never been in the bundles, as far as I'm aware. So if he's going

to try to rely on it now, that's problematic.

I am going to come on to tell you that that makes no difference in the interpretation of the case, if he's wrong, so it may be worth revisiting the point after --

LORD JUSTICE LEWISON: I just flag it up because there did seem to be some emphasis placed on the terms of the guarantee, which we haven't seen.

MS TOLANEY: Indeed, and not in the skeleton and not taken below.

LORD JUSTICE LEWISON: Well, there we are. I just raise that point for consideration.

MS TOLANEY: We noted it, my Lord. I'm not sure there is much we could do overnight given the question arises not under English law.

Submissions in reply by MS TOLANEY

LADY JUSTICE ASPLIN: Before you begin, live-streaming is not on. I don't know if you have people in your offices who are dependent upon it. Ah, now it has been switched on. Thank you.

MS TOLANEY: My Lord, ground 3A briefly before I move to partial release. Ground 3A is set out in our skeleton at paragraph 62. And this is the argument, my Lord, and it is just worth mentioning it to your Lordships again because it was addressed on a different basis, I think, by Mr Phillips.

What he said was that this argument required us to salami-slice the clause.

Now, that's not right. What the argument involves is, if your Lordships conclude that the contractual mechanism doesn't work in order to establish the breaking of the circularity, and consequently you are driven to the conclusion that the Sub-Debt and Sub-Notes prove at the same time -- as the judge was driven to that conclusion, we say not correctly -- but if one reaches that conclusion on whatever basis, the difficulty with Mr Phillips' argument, and that's where my argument ground 3A comes in, is that one then still has to give effect to the terms of the clause, the solvency conditions, because the premise of this argument is that the contract is still valid and operational but it has been impossible to break the impasse. The conclusion is that they prove at the same time but you then have the conditionality, which is when they get paid.

If you then apply the solvency clause, which is actually clear, and that is the parties' agreement and there's no reason to disavow the entirety of the clause when that part of the clause is clear, the Sub-Notes can be paid out because the condition to payment is satisfied because in that scenario you can pay the

senior liabilities in full, but Claim C is not a senior liability because of the definition in the notes.

LORD JUSTICE LEWISON: Wouldn't Claim C be entitled to be valid as a contingent claim?

MS TOLANEY: Claim C would not be payable. You'd have(?) the C value but it wouldn't be payable because the solvency conditions wouldn't be satisfied. Because Claim D would be payable first, there wouldn't be money left. And it would be a question of payment out.

And this was what I think Mr Arden was saying. There are a number of ways that the administrators can deal with Claim D in that situation. They could refuse to deal with proof, they could reject it or they could admit it in an amount of zero.

So our point isn't that the administrators of PLC need to pay a dividend on Claim C at a different time to Claim D, but that no dividend is payable at all because the condition to payment isn't satisfied.

And I would invite your Lordships --

LORD JUSTICE LEWISON: Does that not interfere with the insolvency claim, the distribution?

MS TOLANEY: I don't believe so, my Lord. And that, I think, was what my learned friend Mr Arden was saying. The debts are admitted to proof, but the question is then when they are payable. And because of the solvency

conditions there's a clear regime that the parties agreed.

So I would invite your Lordships to look at that if that situation arises because actually it is another answer that does give effect to the parties' agreement even if there is an impasse at the earlier stage.

My Lord, may I move to partial release.

LORD JUSTICE LEWISON: Yes. Partial discharge, isn't it, rather than release? Anyway, yes, whatever you want to call it.

MS TOLANEY: Can I start by addressing five points of principle that came up different times in my learned friend's submission, and then I want to show you the cases to show you why he is wrong on interpretation.

The first point of principle is that my learned friend made a critical concession yesterday, and this was in response to my Lord Lord Justice Lewison, Day 4, pages 145 to 146, because he accepted that if a contract of guarantee contains a principal debtor clause, part-payments do discharge the debt pro tanto, and therefore do reduce the creditors' claim.

So in other words, he accepts that we're right in any case involving a guarantee with a principal debtor clause.

And he has to make that concession because it's the

only way he tries to distinguish the cases of MS Fashions and Milverton, which, as the court pointed out, are otherwise binding.

I will come on to show you why he's wrong in his construction on that. But what I would say is, actually the concession is fatal to his case, because what he's saying is that a creditor with the benefit of a simple guarantee always has the right to prove for the full debt, but a creditor with the greater benefit of a simple guarantee and a principal debtor clause is worse off because they always have to reduce.

So that leads, as a matter of policy, to the absurd situation where the stronger contract, ie the one that gives you the principal debtor and guarantee clause, puts the creditor in a worse position.

The second point was that my learned friend built his argument at the start on the basis that the bank had somehow mis-approached the question of the relationships between the parties. And he suggested that the bank hadn't properly identified the issue of competition between the creditor and the surety. That was at Day 4, page 81 lines 20 to 23.

Now, that's hard to understand as a submission because that was the heart of my submissions at Day 3, pages 140 to 141. And the key point is that the special

insolvency rule operates because otherwise -- and I place emphasis on the word "otherwise" -- there would be competition between the surety and the principal creditor. And it's the rule against double proof that prevents the competition from occurring.

And essentially our point, as your Lordship well knows, is that the release of the indemnity claim means that there can no longer be competition between the creditor and the surety, and that's why we say the special rule doesn't apply. So we obviously understand the competition aspect and it's the lack of it that is the heart of my case.

LORD JUSTICE LEWISON: Yes.

MS TOLANEY: What we also say is that unless the amount, in that scenario, for which the creditor can prove is reduced, the result subverts the pari passu rule in an insolvency situation because the creditor receives a higher percentage recovery on what is actually owed as compared to other creditors. And my learned friend accepted that. But what he said to my Lord Lord Justice Henderson was that preferential recovery is simply a function of the guarantee. That was Day 4, page 80, line 16, to page 81, line 19. And he also repeated references to the guarantee being a form of security. Day 4, page 74, lines 7 to 13.

Now, I think this was the point that my Lord Lord Justice Henderson made: it rather depends on what you mean by security because guarantees are plainly contractual arrangements, they don't confer proprietary rights, and a guarantee may be secured, like a principal claim, but they are not usually referred to as security in the real property sense.

That was my Lord's point. And in this case the claim of the creditor against the estate is a personal claim and if it's not secured it has a right to participate with other creditors. And so there's no reason why it should do better than the estate's assets.

Your Lordships will have seen I'm putting the first two points both in answer to my learned friend but also as a question of what's the right analysis in the policy, because, as you have pointed out, it's judge-made law and at the moment the argument that the guarantee confers a benefit against the rights of other creditors seems hard to justify.

The third point of principle was the question of unjust enrichment: my learned friend's 100 per cent point. My learned friend was at pains to explain that on his approach the creditor will never recover more than 100 per cent of the debt owed. And I place emphasis on the word "never".

Now, that's a difficult submission to understand because the possibility of overrecovery is the necessary consequence of my learned friend's approach. And what it turned out in the GENPRU, a new point taken yesterday, was that he meant that even if there was overrecovery on his approach, that wasn't a problem on the facts of this case, and he showed you the Settlement Agreement.

LORD JUSTICE LEWISON: Section 204.

MS TOLANEY: That's right.

But that's no answer, because as a matter of general law there should be no overpayment. The money should never come out of the estates in the first place. And therefore relying on a specific term is akin to saying: don't worry, the creditors promise to give the surplus to charity. That cannot be the way the law approaches this.

LORD JUSTICE LEWISON: Well, I think you can see that argument in a slightly different --

MS TOLANEY: I'm sorry, my Lord, I can't hear you because of the --

LORD JUSTICE LEWISON: You can see that argument in a slightly different light. Your argument is, well, the surety has released the claim against the principal debtor for indemnity. And in effect, I think the way

that Mr Phillips is putting it, though he didn't quite put it this way, is, well, no, you haven't really; what you've done is you've substituted a right of indemnity against a principal debtor by section 204, which gives you a right against the creditor in the event of a recovery. In other words, it's not a plain vanilla release of the surety's rights.

MS TOLANEY: Well --

LORD JUSTICE LEWISON: I think that's how I understand the argument.

MS TOLANEY: That's right. The reason I say -- obviously the court has to deal with the arguments before it. But obviously, as this is an entirely new point, not trailed before yesterday, but it is also inconsistent with the submission that first of all a release has no effect, and secondly the creditor, when there is a release -- and that's what his submissions were until this point -- will never recover more than 100 per cent of the debt because, as your Lordship says, he has actually re-characterised the facts of this case to say, well, there wasn't really a release at all.

LORD JUSTICE LEWISON: Yes.

MS TOLANEY: So that's why we say as a matter of law he's wrong on the analysis, irrespective of what he says the facts of this case were.

LORD JUSTICE LEWISON: So in other words, what you are addressing is: the situation would apply if there were what I've just called a plain vanilla release.

MS TOLANEY: Indeed, and that's the basis on which this point has been argued.

LORD JUSTICE LEWISON: Yes.

MS TOLANEY: My Lord, the fourth point of principle relates to the right of subrogation and the right of indemnity.

Again, I think this followed from discussions with the court, because Mr Phillips tried to attack the bank's approach by taking you back to what he said was the origin of the insolvency rule. And as I will show you, these are all cases in bankruptcy. And he was suggesting that our approach misunderstood the nature of the surety's rights. That was the Midland and In Re Rees(?) case. And I will come on to those cases.

The premise of his submissions seems to be that there was only a right of subrogation. And in response to questions from my Lord Lord Justice Lewison and Lady Justice Asplin, my learned friend said that the surety has no right to make any claim against the debtor unless the surety has paid its full liability.

That was Day 4, pages 69 to 72. And his reasoning appeared to be based on the notion that the right of the security to recover from the debtor is dependent on

being subrogated to the claim of the creditor against the debtor.

But the surety -- and it's well-established, certainly now if not then -- has a right of indemnity arising as soon as it makes and to the extent it makes any payment to the creditor. And that's clear from the cases, the Cattles case and Kaupthing decisions. They are both cited in Andrews and Millett at 13002. And that, for your Lordship's reference, is authorities bundle 4, tab 71, page 2363.

I think, as my Lord Lord Justice Henderson pointed out in this dialogue, subrogation is only one mechanism to give effect to the surety's underlying rights to claim a pro tanto indemnity from the debtor. And it's important when the principal claim is secured, because the surety is better off being subrogated to the creditor's rights.

But the right of the surety is not limited to subrogation upon payment in full of the guarantee debt. And to the extent the old cases use different language it is not clear to me that they were limiting it just to the right of subrogation. But even if they were, it's clear from the Kaupthing case that that position has moved on.

LORD JUSTICE HENDERSON: Under the law as it now stands,

what is the right juridical analysis of this indemnity entitlement that arises -- as I think you are saying -- immediately upon payment by the surety?

MS TOLANEY: I assume it's an implied contract.

LORD JUSTICE HENDERSON: Or is it perhaps another way of saying it is actually a form of subrogation and operates as you go along rather than only when the debt is discharged in full?

LORD JUSTICE LEWISON: The other possibility is it's simply restitution for unjust enrichment.

MS TOLANEY: Indeed.

LORD JUSTICE LEWISON: And that's the way the House of Lords seems to have approached it in Banque Financiere and Parc(Battersea), where I think they said you can be subrogated even though you have only paid off part.

MS TOLANEY: So it's not right to say it just arises when you pay it in full.

Then taking you then to my fifth point of principle. Really this was the key plank, I think, of my learned friend's argument, which was he was claiming that the distinction between primary and secondary liabilities was the key. And the suggestion was that we were confused as to the nature of the surety's obligation.

Now, there's no confusion on our part. The position is that the payment of the surety discharges both the

secondary guarantee obligation and the underlying guarantee debt. So if the surety pays £50 it discharges the guarantee obligation to that extent and the underlying guarantee debt. And we submit that that's absolutely clear from MS Fashions and Milverton, and is entirely logical as to where it should be as a matter of policy.

My Lord, can I start at that point, then, looking at the authorities briefly. My learned friend cited two new authorities yesterday which I would just like to address briefly and then go back to what he said in MS Fashions.

LORD JUSTICE LEWISON: Yes. Can I just ask you about your fifth point. The difficulty with the fifth point is fitting it into the rule against double proof, because, I think it was in Stotter that Mr Justice Fisher said, well, how can you prove for more than you are owed? But the cases do seem to suggest that you can.

It may be that this is a judge-made rule about who has first crack at what's left in the insolvent estate --

MS TOLANEY: Exactly.

LORD JUSTICE LEWISON: -- and that you can prove for more than you are in fact owed because of this special judge-made rule. And that's one possible explanation.

Which Mr Justice Fisher didn't really buy, but if that is the explanation it is a rather peculiar explanation.

MS TOLANEY: My Lord, I don't shy away from that. I would submit that that is the explanation. And that it is the explanation is apparent from the cases and the text, which talk about otherwise there being competition.

LORD JUSTICE LEWISON: Yes.

MS TOLANEY: So it's not suggested there's any other reason. It's the competition, is the main point, exactly as my learned friend was urging on you. And it's called a special rule, we would suggest, because it's been introduced to deal with a particular scenario in insolvency. But as my Lord Lord Justice Henderson I think has said a number of times during the hearing, it's not ideal.

LORD JUSTICE LEWISON: But you have to accept, don't you, that in this situation the creditor can prove for more than he is owed?

MS TOLANEY: Exactly. And that seems to be the essence, I'm afraid, of the rule against double proof, is that he is proving for more than he is owed because the surety can not.

LORD JUSTICE LEWISON: Yes.

MS TOLANEY: And it is judge made. It's not very satisfactory. And we say in this case the ratio for it

or the rationale is not there. So --

LORD JUSTICE HENDERSON: Sometimes in the older cases there seems to be perhaps an attempt to paper over the contradictions by a sort of rather metaphysical notion that you owe a debt in entirety until every penny of it has been paid.

MS TOLANEY: That's right.

LORD JUSTICE HENDERSON: Which makes no economic sense. As I say, it's almost a sort of philosophical point. The whole thing has to be discharged before you can say it's gone.

MS TOLANEY: Well, you see that very much from Re Sass, the Midland Bank case and Re Rees. All three of them are at pains to say that construing the guarantee, even with a limit, you are still liable for the whole debt. And they take that approach.

Now, that isn't the approach of Lord Justice Hoffmann as he then was. He obviously thought that was -- as well as Lord Justice Glidewell. They both obviously thought that that was a very strange thing to say. And as I will remind you, though you are familiar with the cases, they said it in the clearest of terms.

So even if there was a position previously, it doesn't seem to be the modern law.

LORD JUSTICE HENDERSON: It's really a species of legal

fiction and not something I want to encourage.

MS TOLANEY: No, and it's outdated now. But the point is, it's fair to say in modern guarantees may arise less frequently, and it may be that is why there is less recent law on it, given it's used for suspense(?) accounts and other things. (inaudible) the debtor committed(?). But it isn't right as matter of law, we would submit, to suggest that a payment by a guarantor doesn't discharge pro tanto the debt.

LORD JUSTICE LEWISON: Yes, well, then you are forced back to the uncomfortable position that the creditor can prove more than he is owed.

MS TOLANEY: Yes, that's right. I will check the textbooks, but I think one of them even says that in terms. I don't shy away from that. That is the special rule, and it's justified on the competition basis.

My Lord, just looking at the Midland Bank case which my learned friend handed up, I think it's at A5/89, and in the clip, and National Bank v Rees(?) is behind it. Can I go to those in moment. I will just tell you three points about those two cases and then I will look at them.

My Lady, it's at 89. There are three overarching points. The first is that they are all bankruptcy cases so they are not dealing with the position outside

insolvency, as your Lordships know. Second, and taking my Lord Lord Justice Henderson's point, the reasoning is not very clear in certain respects.

Insofar as they suggest that there's a surety's right against the principal debtor can only arise by way of subrogation -- it's not clear that they are saying that but, insofar as my learned friend suggested they were, then that would not be the correct approach anyway.

And the third and crucial point is that none of the cases involve a release of the surety's right to an indemnity from the principal debtor.

So starting, then, with the Midland Bank case. The case isn't relevant, we submit, because it simply recognises the general rule, which is not in dispute, that a guarantor who pays 100 per cent of his liability is entitled to prove in the debtor's insolvency in place of the creditor if the creditor is not proving, because he's then seen as fulfilling(?) the debt.

But in that case the surety had waived his right to prove by virtue of the terms of the guarantee. And all the court was considering was whether it was different because the guarantor had been reimbursed from the estate of the debtor. In other words, should the estate be subject to a proof in respect of which it had

indirectly discharged? And the court decided that was irrelevant.

So it's not a particularly useful authority in the context of this case.

Nevertheless, my learned friend submitted that the case was factually very similar to the release in the present case. And he said:

"Where a surety has made a part-payment and has waived his right to subrogation, there is nothing to prevent the creditor from claiming the full amount of the proof against the principal debtor."

So he relied on it as to waiver being akin(?) to the release. That was Day 4, page 89. But contrary to his suggestion, the similarity isn't there, because there was no waiver or release in favour of the principal debtor. The surety in the Chambers case covenanted with the creditor for the benefit of the creditor not to assert the creditor's claim by subrogation.

You can see that from the bottom of page 2942 of the bundle in the judgment of Lord Justice Selwyn. It starts from:

"The surety may, however, in contract agree to waive this right to the benefit of the creditor."

That's an important difference in this case. And in the Midland Bank case there was in principle the

possibility of the competing proof, albeit that might have been a breach of contract between the surety and the creditor. But all this showing is an application of the special insolvency rule, as opposed to the facts of our case where there's no possibility of a proof by the surety.

The National Bank v Rees(?) case adds nothing because it was argued on exactly the same basis. Can you see that? It's the next tab on. And if one looks at page 100 of the report, which is at page 2947. You can see that from under Bacon CJ:

"The peculiar form of bond gives the bank the right to retain their proof for the full amount."

And what you see at page 102 of the report, which is 2949, at the very bottom it starts, if your Lordships can see it, "But the proviso is perfectly clear", which is about six lines up from bottom. If you read that to just over the page. (Pause).

So again, the estate didn't have the benefit of any release.

LORD JUSTICE LEWISON: So what does Lord Justice James mean, further up the page, at page 102? He says:

"It's not that he was surety only for the £500, he was surety for the whole debt within(?) the limitation. He had no equity arising out of any reduction of the

ultimate balance if the principal debtor had paid part of the debt."

What does that mean?

MS TOLANEY: That it wouldn't affect the position with the creditor.

LORD JUSTICE LEWISON: Equity surely is to do with the rights of the surety?

MS TOLANEY: Yes, but there's no right to stand in the creditor's shoes, I think is the point.

LORD JUSTICE LEWISON: Oh, I see. So are we getting to the position where what starts as a question of construction of the guarantee turns into a rule?

MS TOLANEY: I think that's right.

LORD JUSTICE LEWISON: That's how it has evolved.

MS TOLANEY: That seems to be how it has evolved. And what is odd about it, as you see, is the peculiar form of bond is ... But it becomes a rule in solvency situations as we see from Re Sass, but possibly also in Re Sass, with respect, there seems to be the line that we looked at in the second sentence, my Lord. I can show it to you. It's at tab 1 of the bundle, where Lord Justice Vaughan Williams, in passing, says --

LORD JUSTICE LEWISON: Common law right.

MS TOLANEY: Exactly. And there just doesn't seem to be any basis for that, as your Lordship pointed out. And these

cases don't appear to divide(?) it. And they were referred to for that purpose, I think, by my learned friend. But they don't do, properly analysed.

Then --

LORD JUSTICE LEWISON: I think there is one of the cases that was cited to Mr Justice Vaughan Williams, which we haven't seen, which suggests the contrary. I don't know which one it is off hand.

MS TOLANEY: We will check, my Lord.

It's at tab 1.

LORD JUSTICE LEWISON: I think it's Commercial Bank of Australia v Wilson.

MS TOLANEY: Right. But my Lord, irrespective, we would submit, of that particular line, we say the position actually now is very clear outside an insolvency. And that comes from MS Fashions and Milverton.

And just to stand back a moment, my learned friend appears to be suggesting to the court two things: one is that the Court of Appeal decision of Lord Justices Woolf and Scott should be just ignored because it was an application for leave to commence the proceedings, and secondly that because Milverton didn't appear to have been cited very often it therefore seems to be not really worth giving much time to. That essentially seemed to be the suggestion at one point.

So the position is actually quite clear: these are authorities of the Court of Appeal; they actually make the points in very clear terms, with none of the limitations that were being read in, and one would have to disregard an awful lot of what was said in these to reach the position that my learned friend was urging on you.

So if we look first at the authority we passed up yesterday in MS Fashions, at tab 91. And if your Lordships would look at -- I think it was in fact my Lord Lord Justice Lewison who pointed out the passage, at 287H, in the judgment of Lord Justice Scott.

That passage makes it clear that Lord Justice Scott regarded it as beyond doubt that set-off, if it occurred, would operate to release not only the surety but also the principal debtor. And similarly, Lord Justice Woolf, at page 289H.

LORD JUSTICE HENDERSON: Sorry, what was the reference to the passage in Lord Justice Scott?

MS TOLANEY: It was 287, letters H to I, my Lord.

LORD JUSTICE HENDERSON: Thank you.

MS TOLANEY: The bundle references are at the bottom, 2958.

LORD JUSTICE HENDERSON: Thank you very much.

MS TOLANEY: And there's plainly weight in their dicta, particularly when you then read the main decision, which

is at tab 16, which we have looked at, I know, but if we could go back to the passage at 448D.

LADY JUSTICE ASPLIN: Sorry, where do we find that?

MS TOLANEY: Sorry, bundle 1, tab 16.

LADY JUSTICE ASPLIN: Thank you.

LORD JUSTICE LEWISON: The page you want is 448?

MS TOLANEY: It's 448 of the report and 296 of the bundle, and it's the passage at letters D to E.

So this is the passage in Lord Justice Dillon's judgment that we were debating yesterday. And our first point is that this is precisely and definitively on point:

"The discharge of a guarantor's liability to the creditor by payment or in the case of set-off reduces the guarantor's liability and also that of the principal debtor."

So the same point that we've seen from the judgments of Lord Justice Scott and Lord Justice Woolf.

Now, the argument being advanced by my learned friend is that that was only because the sureties were principal debtors.

But that's wrong. And can you see that when you look at the judgment of Lord Justice Hoffmann at page 436, D to F. And the passage starts -- and I think maybe again I'm revisiting ground that I think my Lord

Lord Justice Lewison had pointed out to me. but at letter D:

"In my judgment the principal debtor ..."

And if your Lordships could read from D to F.

LORD JUSTICE HENDERSON: So sorry, I'm finding these page references confusing.

MS TOLANEY: Would you prefer the bundle references at the bottom, my Lord?

LORD JUSTICE HENDERSON: I think, given that the print doesn't show the pages of the report at all clearly --

MS TOLANEY: I'm so sorry. It's page 284 of the bundle.

LORD JUSTICE HENDERSON: Thank you.

MS TOLANEY: It's letters D to F and it's in the judgment of Lord Justice Hoffmann at first instance.

LORD JUSTICE HENDERSON: Ah, I'm so sorry, I was looking at Milverton and that's why I was getting confused.

MS TOLANEY: Would your Lordship just look back at -- the passage I had just referred to was in Lord Justice Dillon's judgment.

LORD JUSTICE HENDERSON: Yes.

MS TOLANEY: That was at 296, d to E, which I know you are familiar with.

LORD JUSTICE HENDERSON: Yes, indeed. Thank you.

MS TOLANEY: Then I was going back to the judgment of Lord Justice Hoffmann to see how this arose.

LORD JUSTICE HENDERSON: Yes.

MS TOLANEY: And this passage is extremely important in the judgment of Lord Justice Hoffmann because he is describing the guarantor as a principal debtor. And doing that doesn't stop the court looking at, as he puts it, the underlying reality for some purposes. And crucial the surety's equitable rights and the rule against double proof.

And the only relevance in this case, as I think your Lordship pointed out, of the guarantor being a principal debtor was that the guarantor's liability wasn't contingent on demand. And so a mutual debt could be set off.

You see that in Lord Justice Dillon's judgment at 447H to 448C. Let me just give you the bundle references. That is 295H to 296C.

And crucially, when Lord Justice Dillon comes to consider the effect of set-off, he plainly regards the sureties as guarantors, and he refers to them as such, to contrast them with the principal debtor.

If he had only thought the relevance was principal debtor, then the phrase would be nonsense in the judgment, because they would all be principal debtors.

And my Lady Lady Justice Asplin put to my learned friend yesterday that the paragraph at -- it's bundle

page 296B, 448 of the report, that paragraph B to C might qualify the more general statement of principle on which I rely.

And the answer to that, my Lady, is that the former paragraph explains why there is set-off in this case. The latter paragraph is about the effect of the set-off, because it begins "If there is set-off" and then there are the two points that emerge.

And the first point is that the set-off operates as if it were payment under the guarantee. And we get that from the sentence "it operates". And that is exactly as my Lord Lord Justice Lewison put it at Day 4, page 133:

"Set-off is equivalent to payment."

And the use of the word "therefore" in that sentence makes it clear that the reason why the payment by way of set-off reduces the liability of the principal debtor is because it's treated as payment under the guarantee.

And set-off was only important because it was a method of payment, as your Lordship said. And it was treated as such -- just for your Lordship's note -- by Lord Justice Hoffmann as well. And that was at page 277 of the bundle, letters A to B, which is 429 of the report.

LORD JUSTICE LEWISON: A to B. That is just reciting the facts.

MS TOLANEY: But that's the basis on which Lord Justice Hoffmann was approaching this. It was all presented as a method of payment.

LORD JUSTICE LEWISON: Sorry, I'm not sure we are looking at the right place. 429 starts "29 June 1992 sought as against the bank."

MS TOLANEY: I'm sorry, my Lord, I will check the reference.

The other point I just wanted to make on this, while we are finding the reference, is at page 286 of the bundle, which is 438 of the report, at letter F, where Lord Justice Hoffmann specifically agrees with the analysis of Lord Justices Scott and Woolf.

LORD JUSTICE LEWISON: Yes.

MS TOLANEY: And that is, as my Lord Lord Justice Lewison pointed out, the position after Re Sass and Ulster Bank had been cited to him.

Given that the payment is treated as a payment under the guarantee, it engages the general rules stated in the penultimate sentence of the passage we were looking at of Lord Justice Dillon's judgment, which was at 296 of the report.

And the rule isn't qualified. It couldn't be stated in more general terms. Note the reference to "a guarantor" not "the guarantor".

So if Lord Justice Dillon had meant only that

a payment by a person treated as a principal debtor to a creditor reduces the principal debt, then he certainly would not have referred to the position of the guarantor throughout this paragraph.

And at page 451 of the report and 299 of the bundle he concludes by saying, at letter H, that he dismisses the appeals for substantially the same reasons as those of Lord Justice Hoffmann.

My Lord, I apologise, I gave you a bad reference. It was page 287 of the bundle, 439 of the report. Letters A to B.

LORD JUSTICE LEWISON: Yes.

MS TOLANEY: And not, with apologies, the reference I gave.

My Lord, that then takes me to the case of Milverton. That's in the bundle at tab 19.

Again, we would suggest to the court that this couldn't be clearer, despite my learned friend's submissions trying to distinguish it. There is nothing in the analysis of the court that suggests that the terms of the guarantee or the fact that it was to do with leases changed the general principle stated in this case. And one sees --

LORD JUSTICE LEWISON: Just to unpack the facts a little bit, because I think we do just need to understand it.

You have L, who grants a lease to T1. T1 assigns to

T2, who is surety S1. T2 then assigns to T3, who are sureties 2 and 3. Reversion then changes hands. T3 goes bust. Landlord sues T1. In fact the sureties then pay a sum. First of all it's S2 and S3 who pay for their release. They pay £50,000-odd.

The rent outstanding at that time was £19,500. S1 then pays a further 10,000 for his release. And the court decides the whole of it can be set off against rent then due.

MS TOLANEY: That's exactly right.

LORD JUSTICE LEWISON: That's what's decided in the case.

MS TOLANEY: It is. And that is a lot easier than if I had gone through the facts. It's very clear from page 350 of the bundle.

And the question, my Lord, is framed by Lord Justice Glidewell on page 347 of the bundle, page 3 of the report, in general terms. And you see that he answers the question at page 6 of the report, page 350 of the bundle. That's the reference I just gave your Lordship, where he clearly distinguishes the role of principal assignee and surety. And he deals with the surety on the assumption that there has been a default, ie it was a proper (inaudible) liability. And the payment by any of them discharges the guarantee, as your Lordship has just said in your summary of

the facts.

LORD JUSTICE LEWISON: Discharges the rent.

MS TOLANEY: That's right, discharges the rent.

And if one turns then to page 353 of the bundle, page 9 of the report, Lord Justice Hoffmann takes the same approach, and in particular in the paragraph that starts "Mr Bailey", which is the third on the page, halfway down, "for the purpose of", that sentence at the end of the paragraph.

LADY JUSTICE ASPLIN: I'm sorry, I can't find that. I'm on page 9 or 353 --

MS TOLANEY: It's page 9 or 353.

LORD JUSTICE LEWISON: Just above the red line.

LADY JUSTICE ASPLIN: Thank you. (Pause).

MS TOLANEY: What your Lordship will see, and I think again your Lordship pointed this out, is that on page 8 the decision in P&A Swift Investments is cited. That's 352 in the bundle. And it's relying on that decision, which you see in the penultimate paragraph, and the view of Megarry J in Hawkins, that he expressly makes the point, Lord Justice Hoffmann as he then was, that you cannot say that payment is only in respect of the release.

And the case is actually a good way of establishing the illogicality or the absurdity of saying a creditor who has been paid a debt by a guarantor can continue to

pursue the debtor for that debt. And that's very much the approach that the court took in this case.

LORD JUSTICE LEWISON: But the whole of the rule against double proof depends on characterising the two claims as two claims in respect of the same debt.

MS TOLANEY: It does.

LORD JUSTICE LEWISON: Even though they are probably different debts, properly analysed.

MS TOLANEY: Properly analysed, they are, but that's the fiction that's created by the insolvency regime. It's one of the reasons, my Lord, I did say at the beginning that -- I accepted I had to overcome the insolvency regime, not just position outside banking -- outside the insolvency regime, because of that special rule.

My learned friend also took your Lordships to Ulster Bank v Lambe and I don't propose to turn that up unless your Lordship wishes me to. We say it suggests it's inconsistent.

LORD JUSTICE LEWISON: Just remind me which tab.

MS TOLANEY: It's tab 5 of bundle 1.

And that it was discussed and not followed in Stotter and we simply say -- my Lord, actually it may be sensible if I'm going to make the point on it for your Lordship to have it in front of you.

LORD JUSTICE LEWISON: I just wanted to say one thing about

Ulster Bank. If you look at the facts it seems that the payment which the sureties made was not actually appropriated to the debt, it was put into a separate account.

MS TOLANEY: A suspense account.

LORD JUSTICE LEWISON: Into a suspense account. So it wasn't actually appropriated to the debt, so it wasn't in fact payment.

MS TOLANEY: No. And also it seems to be a decision that does turn on the terms of the guarantee as well. And Westpac simply follows this case.

Then finally may I just -- I know your Lordship has looked at it but I can just ask you to turn up Octaviar, which is at volume 2, tab 34. I'll conscious of the time but I would just invite your Lordship to read perhaps in your own time again from pages 833, paragraph 75, 833 of the bundle and 35 of the report, through to the conclusion at paragraph 92 which is page 842 of the bundle and 44 of the report. And in particular the points that arise from that passage are that the court considers the academic criticism and notes the position, but looks at the cases of Stotter, MS Fashions and Milverton, and in particular thinks that the proposition cited by the court in MS Fashions and Milverton were uncontroversial, but it was going to

reduce pro tanto.

At paragraph 91 you see the reasoning as to why it's a difficult submission to accept that the guarantor's payments do not reduce the principal debt, not least in the light of interest accruing.

LORD JUSTICE LEWISON: Yes. I think I just want you to tell me, if you won't mind, what was the issue in the case. Is Mr Justice Murdo saying that because the part-payment by the surety has reduced the debt, the creditor can only prove for the balance? If that's what's he's saying then he is not applying the rule against double proof.

MS TOLANEY: He's not saying that.

LORD JUSTICE LEWISON: I understood you to accept that even though the amount for which the creditor -- even though the amount of the balance owing to the creditor has been reduced he can still prove for the entirety of the original debt.

MS TOLANEY: Yes, I am. I was understanding him to be talking about the effect of clause 4.2(b).

LORD JUSTICE LEWISON: That's set out somewhere, isn't it.

MS TOLANEY: It is set out in paragraph 63, it starts, and it's over the page on 828.

LORD JUSTICE LEWISON: Yes.

MS TOLANEY: My Lords, two further points. I had one

correction which is that I'm told that the principal debtor basis for distinguishing Milverton was raised in a note submitted by my learned friend. I didn't see it in his skeleton but I may have missed it so I should be fair to him.

The second point is that I think he suggested yesterday that the judge could be excused because this had all come up rather late, the release point. What happens, and I will not take up the court's time --

LORD JUSTICE LEWISON: I understand you put in some written submissions after the hearing.

MS TOLANEY: As I recollect it's in our opening, my learned friend didn't respond to it in opening, he responded to it in reply. We were then given permission to put in a --

LORD JUSTICE LEWISON: I'm not terribly interested in these grumbles.

MS TOLANEY: I understand that, but I don't want it to be suggested that this was a new point in -- the fact is, with respect to the judge, it was the square point, and he didn't deal with it, but this court could do so.

LORD JUSTICE HENDERSON: And it's an important issue of law so obviously -- we want to look at it in the round but as long as nobody is taken by surprise in this court, which nobody is suggesting.

MS TOLANEY: Certainly not.
LORD JUSTICE LEWISON: Can I just find out from you where this is going. We've got to the position I think where you say well, the payment by the surety discharges the debt, pro tanto, nevertheless the creditor is entitled to prove for the whole debt. You say not in this case, the creditor must only prove for the balance. And that then turns on the release.
MS TOLANEY: Exactly. We say the general rule outside insolvency is clear, it's not what my learned friend says; it's very clear. But there is a special rule in insolvency just about proof which creates a legal fiction for proving purposes. The underpinning rationale of that strange rule is that there is a competing debt owed to the surety and that the estate must not be faced with two competing claims. Here there is no such competing claim, therefore the special rule shouldn't be applied because the rationale for it simply doesn't exist.
LORD JUSTICE LEWISON: Yes.
MS TOLANEY: My Lords, if I can assist you further.

Submissions on guarantee by MR PHILLIPS

MR PHILLIPS: My Lords, I do not rise by way of seeking to make submissions in rejoinder. Can I just make that clear from the start. But I rise in order to assist

with your Lordship's question before my learned friend started her position.

LORD JUSTICE LEWISON: The guarantee.

MR PHILLIPS: Yes. May I just very briefly make a few points. And whilst I do this could I ask the associate to hand the guarantee to your Lordships. And I know my learned friend's going to object. Please don't --

MS TOLANEY: I don't have a copy.

MR PHILLIPS: I'm so sorry.

MS TOLANEY: I do object to this I must say. It's entirely up to the court, but if this is going to be the mainstay it's a little rum.

LORD JUSTICE LEWISON: Let's just hear what Mr Phillips has to say. Either we will take it into account or we won't.

MR PHILLIPS: My Lords, I don't want your Lordships to look at it at this point. May I just explain. My Lords and my Lady, we understood throughout that it was common ground that the guarantee did not give rise to a primary liability but only to a secondary liability. And that is obvious and was obvious from all the skeleton arguments and for a reason that I will show your Lordships, I hope in a moment, that is because it would have been an impossible point to take.

I'm not going to get into when points were and were

not raised, but in relation to this one point I would make is of course this is Deutsche Bank's appeal and if they were going to take the point that this created a primary liability, rather than it being my --

LORD JUSTICE LEWISON: No. The point arose because of the way in which you explained MS Fashions.

MR PHILLIPS: Okay. My Lords, would you please turn to the second page of this and I can show you the "guarantee" language.

LORD JUSTICE LEWISON: To what is it an exhibit?

MR PHILLIPS: We don't know, but this is a resolution, this is the guarantee. Can I just show you -- the guarantee terms are at the top of the second page:

"... and it is resolved that the company hereby fully guarantees the payment of all liabilities obligation and commitments of the subsidiaries ..."

And the subsidiaries are set forth in a schedule:

"... each of which shall be a guarantee subsidiary for the purposes of the code."

LORD JUSTICE LEWISON: The code being? It's an insolvency code?

MR PHILLIPS: No, it's the --

LORD JUSTICE LEWISON: Oh, code of authorisation. That's these Articles of Association, something like that.

MR PHILLIPS: Yes, my Lord. But the short point, and it is

to assist your Lordships, and your Lordship did ask this question, the short point is it's clear on the face. Your Lordships don't need evidence of Delaware law. You are dealing with a secondary liability. And in the context of your Lordships' judgment on this matter I thought that it was appropriate that you should see what it is that my Lord your Lordship has been asking for.

LORD JUSTICE LEWISON: Yes.

MR PHILLIPS: Unless I can help further, that was the only point.

LORD JUSTICE LEWISON: No, thank you.

Ms Tolaney, do you want to say anything about this?

Reply submissions on guarantee by MS TOLANEY

MS TOLANEY: My Lord, I'm just taking instructions because I'm told it's not quite as straightforward as this, that's why I'm a little ...

LORD JUSTICE LEWISON: Do you want us to go away for a couple of minutes?

MS TOLANEY: The query we had was what then happened in the plan that compromised this guarantee, because it didn't just stop here. And then it got a lot more complicated so --

LORD JUSTICE LEWISON: What, in leading up to the Settlement Agreement you mean?

MS TOLANEY: My Lords, I don't think it's sensible to get into the stacks of documents I now have behind me. I think the query was: could this document simply be read in isolation or did it get amended or altered or interpreted differently in the context of the plan that then followed settling this guarantee, and admission of the claims?

That is all I can say. We are not taking any point on primary debtor or not -- you've understood my submission. We say that's a misreading of the cases in any event. It was really actually if my learned friend wanted to take a point and his point seems to be that this isn't a primary liability and therefore --

LORD JUSTICE LEWISON: You say it doesn't matter.

MS TOLANEY: I do.

LORD JUSTICE LEWISON: Right.

Well, thank you very much. We have had excellent submissions from everybody, if I may say so. There is an awful lot to think about. It won't surprise you to learn that we are not going to launch into judgment straight away. So we will reserve our judgments. You will receive a draft in the usual way, which will be your opportunity to correct our English and our grammar and our spelling, but not our reasoning.

We would hope that in the event of receiving the

drafts you will be able to agree an order disposing of the various appeals. If, as may well be the case, you can't, please make short submissions in writing and we will make the order we consider to be appropriate.

Thank you all very much indeed.

(11.35 am)

(The hearing concluded)

INDEX