

**OPINIONS**  
**OF THE LORDS OF APPEAL**  
**FOR JUDGMENT IN THE CAUSE**

**Sirius International Insurance Company (Publ) (Appellants)**

**v.**

**FAI General Insurance Limited and others (Respondents)**

**ON**  
**THURSDAY 2 DECEMBER 2004**

The Appellate Committee comprised:

Lord Bingham of Cornhill  
Lord Nicholls of Birkenhead  
Lord Steyn  
Lord Walker of Gestingthorpe  
Lord Brown of Eaton-under-Heywood

**HOUSE OF LORDS**

**OPINIONS OF THE LORDS OF APPEAL FOR JUDGMENT  
IN THE CAUSE**

**Sirius International Insurance Company (Publ) (Appellants) v. FAI  
General Insurance Limited and others (Respondents)**

**[2004] UKHL 54**

**LORD BINGHAM OF CORNHILL**

My Lords,

1. Left to myself, I should have accepted the interpretation put by the respondents on the Tomlin order agreed between the parties on 6 April 2001. But no issue of principle on the construction of contracts divides the parties. The Tomlin order is expressed in terms which are one-off. If the appellants' argument on construction is accepted no point of law of general public importance arises. I must acknowledge that the judge adopted the construction favoured by a majority of my noble and learned friends. My own reasons for favouring a different construction differ from those of the Court of Appeal. This being so, no purpose is served by expounding the interpretation which I myself would have put on the Tomlin order, and I am content to accept that favoured by the majority. I would accordingly agree that the appeal should be allowed.

**LORD NICHOLLS OF BIRKENHEAD**

My Lords,

2. I have had the advantage of reading in draft the speeches of my noble and learned friends Lord Steyn and Lord Walker of Gestingthorpe. For the reasons they give, with which I agree, I would allow this appeal.

## LORD STEYN

My Lords,

3. When leave to appeal was granted by an Appeal Committee, it may have appeared that important issues regarding the so-called autonomy principle applicable to letters of credit issued by banks would have to be resolved. Certainly that was the main thrust of the petition. In the result it has turned out to be unnecessary to examine the arguments about the autonomy principle. Instead it has become clear that the appeal should be decided on the basis of the correct contextual interpretation of two related documents. Those two documents are a side letter to a letter of credit, agreed between the party setting up the letter of credit and the beneficiary, and a schedule to a Tomlin order settling a dispute that had arisen between the parties. These two documents are not in standard form. The interpretation of these documents is, like the construction of all texts, a matter of law but it does not involve a question of general public importance. The House would not ordinarily have given leave to appeal in such a one-off case. But the House is now seized with it, and the issue must be resolved.

### *The commercial context.*

4. Sirius International Insurance Company (Publ) is a company incorporated under the laws of Sweden. It carries on business as an insurer and reinsurer. FAI General Insurance Limited is a company incorporated under the laws of New South Wales. It also carries on business as an insurer and reinsurer. It is part of the insolvent HIH insurance group. FAI is in provisional liquidation in Australia and in England. The second to fourth respondents are FAI's English provisional liquidators, who were appointed as such by an order made by Mr Justice Hart on 23 March 2001.

5. In early 1997 a syndicate at Lloyds, Agnew, wished to reinsure its liabilities on its onshore energy account. FAI offered to act as reinsurer but Agnew required an "A" rated reinsurer. FAI was not "A" rated. Accordingly, Agnew required the policy to be fronted by an acceptably rated reinsurer. Sirius was an "A" rated reinsurer. By its letter dated 15 October 1997, Sirius agreed to "front" the reinsurance by writing the policy for Agnew, and then retroceding it "back to back" to

FAI. For fronting the reinsurance Sirius received an annual fee of US\$65,000.

6. Sirius duly wrote the reinsurance for Agnew for two periods: 1 December 1996 to 31 December 1997 and 31 December 1997 to 31 December 1998 and FAI duly wrote the retrocessions for Sirius for the same periods. The premiums for the two years were respectively US\$2 million and US\$1.6 million. These sums went to FAI. To summarise: Agnew was the insurer; Sirius was the fronting reinsurer, and FAI was the retrocessionaire.

7. By undertaking to act as fronting reinsurer Sirius assumed the risk, in the event of the insolvency or default of FAI, of having nevertheless to pay Agnew. The fact that the FAI was not an A-rated insurance company underlined the fact of the risk. Not surprisingly, Sirius required security. Sirius insisted on a letter of credit from a bank. A side letter, dated 3 September 1999, which was negotiated between Sirius and FAI, provided:

“We [Sirius] therefore undertake that we will not agree or pay any claim presented to Sirius by [Agnew] without FAI’s prior agreement in writing, nor will we draw down under [the letter of credit], unless (1) FAI has agreed that Sirius should pay a claim but has not put Sirius in funds to do so, notwithstanding the simultaneous settlements clause in our retrocession contract (see below) or (2) [Agnew] obtains a judgment or binding arbitration award against Sirius which Sirius is obliged to pay.”

Paragraph 3 of the side letter also recorded that “FAI has already agreed to a simultaneous settlements clause which provides that FAI shall pay their share of any loss under the retrocession simultaneously with Sirius’ payment to Agnew.” Thereafter, FAI (by now acting by its parent HIH) produced a draft letter of credit. The terms of the letter of credit, which incorporated the ICC Uniform Customs and Practice for Documentary Credits (1993 Revision), were approved by Sirius. On 24 January 2000, Westpac Banking Corporation, an Australian bank, produced an irrevocable standby letter of credit for US\$5 million in the terms agreed by the parties. Westpac was not aware of the terms of the side letter.

*The dispute.*

8. By this time, Agnew had claimed against Sirius under the reinsurances, and a dispute had developed as to whether the reinsurances written by Sirius and, consequent upon that, the retrocessions written by FAI, should respond to the claims. On 23 March 2000, Lambert Fenchurch Limited (Agnew's brokers), Agnew and Sirius entered into a funding agreement whereby *inter alia* Lambert Fenchurch agreed to fund Agnew in respect of its paid losses due under the reinsurances and Sirius agreed to permit Lambert Fenchurch to commence proceedings on its behalf to enforce Sirius' rights under the retrocessions. Prior to the funding agreement, Sirius had suggested an ad hoc arbitration between Agnew and FAI. FAI refused to engage in such an arbitration. In May 2000, Sirius started arbitration proceedings against FAI claiming to be entitled to payment by FAI under the retrocessions which issue necessarily involved the question whether Sirius was liable to Agnew. On 15 March 2001, provisional liquidators were appointed in Australia over FAI. On 23 March 2001, provisional liquidators were appointed in England by Mr Justice Hart. This had the effect, under section 130(2) of the Insolvency Act 1986, of automatically staying the arbitration proceedings.

*The Tomlin order.*

9. Sirius applied to court for a lifting of the automatic stay on the arbitration, which was by then about to come to a lengthy substantive hearing. By that time the provisional liquidators were running FAI. The application to lift the automatic stay on the arbitration were compromised between Sirius and the provisional liquidators of FAI by a Tomlin order dated 6 April 2001. The material terms of the Tomlin order were as follows:

- “1. FAI General Insurance Company Limited ('FAI') is indebted to the applicant [Sirius] in the sum of US\$22,500,000 and the applicant shall be entitled to prove in the liquidation or scheme of arrangement of FAI in the said sum of US\$22,500,000.
2. [Sirius] shall draw down on Westpac Banking Corporation's Irrevocable Standby Letter of Credit No. 772 dated 3rd February 2000 ('the LOC').

3. [Sirius] shall pay the proceeds of the LOC ('the proceeds') into an escrow account to be held together with accrued interest thereon by Reynolds Porter Chamberlain pending the resolution of the parties' claims (if any) in respect of the LOC.
4. For the avoidance of doubt, the position and all arguments of the applicant and the respondents in respect of the LOC are preserved in respect of the proceeds notwithstanding the terms of this Schedule.
5. Save for the parties' rights with respect to the LOC and the agreements associated to the LOC, the terms herein shall be in full and final settlement of all claims raised by either party in the arbitration proceedings."

On about 12 June 2001, the letter of credit was drawn down in accordance with its terms and the proceeds were placed in escrow pursuant to the Tomlin order.

*The proceedings.*

10. On 31 July 2001, Reynolds Porter Chamberlain, on behalf of Sirius, demanded payment of the sums held in escrow. The demand was not acceded to and these proceedings were commenced by Sirius by application dated 19 September 2001. On 27 May 2002, Mr Registrar Baister directed that certain questions be determined as preliminary issues: namely (a) what were the conditions upon which Sirius could draw down the letter of credit and (b) whether those conditions were satisfied.

11. On 23 July 2002, Jacob J decided that the first condition of the side letter had been satisfied by the terms of paragraph 1 of the Tomlin order and gave directions for the future conduct of the application and also gave FAI permission to appeal: *Sirius International Insurance Co. (Publ) v FAI General Insurance Ltd & Others* [2002] EWHC 1611 (Ch); [2003] 1 WLR 87. In respect of the first condition of the side letter Jacob J observed, at p 94, para 26:

“ . . . [Counsel for FAI] submitted that FAI had never agreed that Sirius should pay a claim. [Counsel for Sirius] says that FAI in effect did so by clause 1 of the Tomlin schedule. By that clause FAI acknowledged an indebtedness of US\$22.5m to Sirius. Everyone knew that there was a back-to-back arrangement in place, that the US\$22.5m would inure for Agnew’s benefit. So in substance, submitted [counsel for Sirius], FAI agreed to payment by Sirius. They knew exactly who was really getting the benefit of clause 1 of the settlement agreement. I think that is right. No one ever thought that the right to the US\$22.5m was really that of Sirius. The commercial substance is that FAI had agreed that Sirius should pay a claim.”

12. On 4 April 2003, the Court of Appeal reversed the decision of the judge. The Court of Appeal held that the first condition of the side letter had not been satisfied and decided that FAI was entitled to the proceeds of the letter of credit: *Sirius International Insurance Co (Publ) v FAI General Insurance Ltd & Others* [2003] EWCA Civ 470; [2003] 1 WLR 2214. On the point of interpretation May LJ concluded, at pp 2222-2223, para 21:

“[Counsel for Sirius] accepted that the second condition of the 3 September 1999 agreement was not and is not fulfilled. He accepted that the first condition was not fulfilled before the Tomlin order. He accepted that the literal words of paragraph 1 do not express an agreement by FAI that Sirius should pay Agnew’s claim. Creative construction or implication is required to interpret it as doing so. He accepted, I think, that an award in contested arbitration proceedings would not have fulfilled the first condition. But the Tomlin order, he said, embodied an agreement not an award, and the agreement that Sirius should be entitled to prove in FAI’s liquidation or administration for US\$22.5m necessarily carried with it an agreement by FAI that Sirius should pay Agnew’s claim. I do not think so.”

Carnwath LJ agreed, at p 2227, para 34, and Wall J came to the same conclusion, at p 2228, para 39. The Court of Appeal held that FAI were entitled to the proceeds of the letter of credit in the escrow account. The effect was Sirius became an unsecured creditor in the insolvency of FAI.

13. Sirius now appeals to the House of Lords.

*The issues.*

14. The statement of issues agreed between the parties reads as follows:

“(1) Whether paragraph 1 of the Tomlin order, on its true construction, constituted an agreement by FAI that [Sirius] should pay Agnew and thereby satisfied the first of the conditions for draw down set out in the agreement.

(2) Whether, having regard to paragraphs 4 and 5 of the Tomlin order, any of the provisions of that order can be construed as taking away FAI’s argument that it was entitled to the proceeds of the letter of credit as a result of non-compliance with the conditions of draw down in the agreement.

(3) Whether, in the event that [Sirius] could not establish that the agreed conditions for draw down were satisfied, it follows that draw down in breach of the agreement gave rise to an entitlement on the part of FAI to the proceeds of the letter of credit, as opposed to a claim in damages. This question raises the following issues:

- (a) Whether the effect of the autonomy principle, which is applicable to letters of credit and all other documentary credits, is such as to give [Sirius] the right to the proceeds, leaving FAI with its claim in damages; or
- (b) Whether, in the circumstances of this case, FAI is entitled to the proceeds.

*The point of construction.*

15. The principal question is whether the first condition of the side letter was satisfied by the terms of paragraph 1 of the Tomlin order.

16. The judge ended his trenchant judgment by saying, at p 94, para 28:

“I reach this conclusion without regret. The truth is that FAI got the benefit of Sirius fronting the deal. The price of that was the provision of the letter of credit. The letter of credit was properly drawn down. It was there to meet just the eventualities that happened.”

This was a reference to the merits of the underlying dispute. In the construction of commercial documents a hard-headed approach is necessary. The merits of the underlying dispute, predating the Tomlin order, were as such entirely irrelevant to the determination of the question of construction. But the *matrix* of the Tomlin order may cast light on its meaning.

17. Turning now to the two documents to be considered, the meaning of the first condition of the side letter is not in doubt. It stipulates as a pre-condition for draw down under the letter of credit that:

“FAI has agreed that Sirius should pay [to Agnew] a claim but has not put Sirius in funds to do so, notwithstanding the simultaneous settlements clause . . .”

(Words in square brackets inserted)

No dispute about the meaning of this pre-condition emerged during the oral hearing of the appeal. The critical question is whether the terms of paragraph 1 of the Tomlin order satisfied this condition.

18. The settlement contained in the Tomlin order must be construed as a commercial instrument. The aim of the inquiry is not to probe the real intentions of the parties but to ascertain the contextual meaning of the relevant contractual language. The inquiry is objective: the question is what a reasonable person, circumstanced as the actual parties were, would have understood the parties to have meant by the use of specific language. The answer to that question is to be gathered from the text under consideration and its relevant contextual scene.

19. There has been a shift from literal methods of interpretation towards a more commercial approach. In *Antaios Compania Naviera SA v Salen Rederierna AB* [1985] AC 191, Lord Diplock, in an opinion concurred in by his fellow Law Lords, observed (at 201):

“if detailed semantic and syntactical analysis of a word in a commercial contract is going to lead to a conclusion that flouts business common sense, it must be made to yield to business common sense.”

In *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749, I explained the rationale of this approach as follows (771A-B):

“In determining the meaning of the language of a commercial contract . . . the law . . . generally favours a commercially sensible construction. The reason for this approach is that a commercial construction is more likely to give effect to the intention of the parties. Words are therefore interpreted in the way in which a reasonable commercial person would construe them. And the standard of the reasonable commercial person is hostile to technical interpretations and undue emphasis on niceties of language.”

The tendency should therefore generally speaking be against literalism. What is literalism? It will depend on the context. But an example is given in *The Works of William Paley* (1838 ed), Vol III, 60. The moral philosophy of Paley influenced thinking on contract in the 19th century. The example is as follows: The tyrant Temures promised the garrison of Sebastia that no blood would be shed if they surrendered to him. They surrendered. He shed no blood. He buried them all alive. This is literalism. If possible it should be resisted in the interpretative process. This approach was affirmed by the decisions of the House in *Mannai Investment Co Limited v Eagle Star Life Assurance Co Limited* [1997] AC 749, at 775 E-G, per Lord Hoffmann and in *Investors Compensation Scheme Limited v West Bromwich Building Society* [1998] 1 WLR 896, at 913D-E, per Lord Hoffmann.

20. From the surrounding circumstances preceding the making of the Tomlin order, and the text of the Tomlin order, it can be inferred that the parties had two major immediate objectives. First, they desired to

compromise an arbitration that would have been long and costly. This objective was achieved by paragraph 5 of the Tomlin order. Secondly, the letter of credit had been extended but was due to expire on 15 November 2001. Both parties wanted to obtain a draw down of the letter of credit on terms which left open the issue of the entitlement of the proceeds of the draw down. Paragraph 2 of the Tomlin order provided for the draw down.

21. That brings me directly to the effect of paragraph 1 of the Tomlin order read in context of the remainder of the paragraphs of the schedule to it. At first glance there are countervailing indications. Counsel for Sirius emphasised the unqualified acknowledgement of indebtedness in a specific sum in paragraph 1. While literally paragraph 1 recorded the indebtedness of FAI to Sirius, counsel for Sirius argued that by reason of the back to back fronting arrangement, and the simultaneous settlement clause referred to in the side letter itself, paragraph 1 necessarily meant that FAI acknowledged the indebtedness of Sirius to Agnew in the same sum. At the very least, he argued, it meant that FAI accepted that the insured events had occurred and that liability in the sum of \$22,500,000 had been incurred under the matching reinsurances and retrocessions. As against this counsel for FAI relied heavily on the words in paragraph 4 that “*all* arguments of [Sirius] and [FAI] are preserved in respect of the proceeds notwithstanding the terms of this schedule.” His primary argument was that paragraph 1 must be read as entirely subordinate to paragraph 4. He submitted that the very fact that it was agreed that the proceeds would be paid into an escrow account, rather than be paid over to Sirius, supported this argument.

22. If this argument of FAI is accepted, it follows inexorably that by virtue of the terms of the settlement in the Tomlin order Sirius abandoned the chance of ever fulfilling either condition of the side letter. That must be so since the arbitration proceedings were compromised. In his judgment the judge trenchantly commented on such an outcome, at p 93, paras 21-22:

“If one follows the logic of [the] argument through, its effect is that the letter of credit was agreed at the time to be unenforceable. It might as well have been torn up by the agreement . . . . This is such a bizarre conclusion that it cannot be right.”

On this point May LJ came to the same conclusion. He said, at p 2222, para 19:

“In my judgment, the judge was correct to reject FAI’s extreme submissions based on paragraphs 4 and 5 of the schedule to the Tomlin order. The short point is that paragraphs 4 and 5 cannot, in my view, be read as leaving open for future contention that which paragraph 1 compromised. Paragraph 1 compromised the arbitration proceedings. It did not purport to determine questions arising out of the letter of credit. Available arguments as to the letter of credit were preserved, but the indebtedness of FAI to Sirius under the retrocessions was determined.”

Carnwath LJ agreed with the judgment of May LJ and in a separate judgment Wall J took the same view. In my view the outcome contemplated by the argument of counsel for FAI is so extraordinary as to be commercially implausible.

23. I would accept the argument of counsel for Sirius and reject the argument of counsel for FAI. It does not follow from this conclusion that the reservation of rights under paragraph 4, and the payment of the proceeds into the escrow account, is to be given no meaning. These features of the settlement were intended to enable the English provisional liquidators to decide whether, and if so, in what manner, they might wish to challenge Sirius’ right to the proceeds of the letter of credit. One must bear in mind that the provisional liquidators took office only thirteen days before the Tomlin order and probably knew very little about the background. The reservation of rights would, for example, have entitled them to rely, for example, on dishonesty in the underlying transaction if that could be established. Only in such an attenuated sense were rights reserved. Given this reservation of rights, the arrangement to pay the proceeds into an escrow account was not surprising.

24. For all these reasons I would reject the primary argument of counsel for FAI.

25. That leaves the reasoning of the Court of Appeal to the effect “that the literal words of paragraph 1 do not express an agreement by FAI that Sirius should pay Agnew’s claim”: p 2223, para 21, per May

LJ and p 2228, para 39, per Wall J. It is indeed true that literally paragraph 1 did not so provide. But it is also clear that the words of paragraph 1 necessarily meant that FAI agreed that, under the back to back reinsurances, and the simultaneous settlements procedure, that Sirius should pay Agnew. If it were necessary I would reach this conclusion on the basis of a constructional implication. I do not, however, think that it is necessary to resort to an implication. In my view the judge was right to conclude that on a correct interpretation of paragraph 1 of the Tomlin order the first condition of the side letter was satisfied. With due respect to the members of the Court of Appeal their interpretation was uncommercial and literalistic.

26. Given this conclusion it is common ground that all remaining issues fall away.

27. For these reasons, as well as the reasons given by my noble and learned friend Lord Walker of Gestingthorpe, I would allow the appeal against the order of the Court of Appeal and restore the order of Jacob J.

## **LORD WALKER OF GESTINGTHORPE**

My Lords,

28. I have had the advantage of reading in draft the speech of my noble and learned friend Lord Steyn. I agree with it, and for the reasons which he gives I would allow this appeal. But because of the differences of opinion between your Lordships on the first issue, the issue of construction, I wish to add a few observations in my own words.

29. The House has to construe two contractual documents which interact on each other. One is a letter dated 3 September 1999 written by Ms Monica Cramer Manhem, a senior vice president of the principal company in the group which includes the appellant, Sirius. The letter is part of an exchange of correspondence between reinsurance executives, and none of the correspondence appears to have been drafted by lawyers. The other document is the schedule to a Tomlin order made on 6 April 2001. The order was made on what had originally been an application to lift a stay of arbitration proceedings between Srius and

the first respondent, FAI. It had the effect of bringing the arbitration proceedings to an abrupt end. What further effect it had is a matter of acute controversy, on which Jacob J and the Court of Appeal reached different conclusions.

30. The Tomlin order was drafted by competent and experienced lawyers (the House was not told its exact provenance, but both sides had solicitors and counsel of high standing). But it seems to have been produced under severe time constraints, and at a time when (because of the recent appointment of provisional liquidators with solicitors and counsel who were new to the matter) one side at least was by no means well informed about the tangled history of these reinsurances. Sirius (and the brokers, Lambert Fenchurch, who were in substance conducting the arbitration in the name of Sirius) had much more opportunity to become acquainted with the complexities of the position but for them too FAI's dramatic plunge into insolvency was a new factor calling for specialised advice.

31. When a commercial dispute arises it is sometimes convenient to both sides to reach a limited agreement involving some immediate action, but to leave other issues unresolved, to be compromised or litigated at some future time. In the present case it is reasonably clear—whatever other difficulties there are about the construction and effect of the schedule to the Tomlin order—that both sides wanted to achieve two immediate objectives. One was to put an end to the arbitration proceedings, in which a long and expensive hearing was due to start very soon. The other was to obtain draw-down on the letter of credit (which had been extended but was to expire on 15 November 2001) while leaving open the issue of entitlement to the proceeds of the draw-down.

32. When parties are under severe time pressure, and one or both of them have inadequate information, such a limited agreement may be all that the parties can achieve. But in such difficult circumstances they may have to accept that the immediate action on which they do agree inevitably alters the context of the issues which remain unresolved. For instance, a consent order for sale of equipment subject to a finance lease may raise the question whether relief from forfeiture, which the lessee was seeking from the court, is still available (see the decision of this House in *On Demand Information Plc v Michael Gerson (Finance) Plc* [2003] 1AC 368, especially in the speech of Lord Millett, at p 381, paras 36-39).

33. So in this case the two important points on which the parties did agree inevitably had an effect on the issues which were not resolved. Paragraphs 1 and 5 of the schedule had the effect of putting a final end to the arbitration. It was no longer possible for Sirius to obtain declaratory relief (sought, in addition to a money award, in the arbitration) to the effect that Sirius was bound to pay Agnew and FAI was bound to pay Sirius. Moreover, paragraphs 2 and 3 of the schedule had the effect that Westpac, the issuer of the letter of credit, dropped out of the picture. The escrow account was a sort of substitute for the letter of credit but it was of a different kind, as the element of “the great and fundamentally important separation” (the expression used by Sir John Donaldson MR in *Bolivinter Oil SA v Chase Manhattan Bank* [1984] 1 Lloyd’s Rep 251, 256) between banker and re-insurers was no longer there. The deceptively simple language of para 4 of the schedule must in my view be approached with these points in mind.

34. The terms in the schedule, and paragraph 4 in particular, must also be viewed, like any other contractual document, in their commercial context. In this House there was not much common ground between counsel as to how the commercial context of the Tomlin order should be characterised. The courts below saw much more of the extensive documentary evidence than has been placed before your Lordships. But the limited evidence before the House discloses some uncontroversial facts which may be material.

- (a) The order of Mr Registrar Baister made on 27 May 2002 (that is, more than a year after the Tomlin order) shows that there was still no agreement as to what the basic contractual documents were. Between August 1999 and January 2000 there had been a lengthy exchange of correspondence (identified in the affidavit dated 18 September 2001 of Mr Timothy Brown of Reynolds Porter Chamberlain and the witness statement dated 2 November 2001 of Ms Kathryn Carr of Ince & Co) from which the effective contractual terms had to be identified and extracted.
- (b) In an affidavit made on 5 April 2001 (that is, the day before the Tomlin order) Mr Timothy Bull of Reynolds Porter Chamberlain deposed (in relation to the letter of 3 September 1999) to his belief that:

“The agreement does not say so however the intention is that FAI’s written agreement would not be unreasonably withheld.”

Whether or not this was admissible or cogent on the issue of construction of the letter, it appears to have been the only clear instance of an argument about the letter of credit put forward openly before the making of the Tomlin order.

- (c) There is mention (in a letter dated 31 July 2001 from Reynolds Porter Chamberlain to Freshfields Bruckhaus Deringer, and also in an affidavit of Mr Timothy Brown of Reynolds Porter Chamberlain sworn on 18 September 2001) of a suggestion put forward on behalf of the provisional liquidators that (in the words of the letter) “the security given by the LOC must be ‘downgraded’ as a result of FAI’s insolvency to security for any distribution in the estate of FAI.” This suggestion was evidently put forward after the appointment of the provisional liquidators but before the Tomlin order.
- (d) However, it does not seem to have been a considered view, since on 7 August 2001 Freshfields (for the provisional liquidators) stated that their clients had still not had an opportunity to acquaint themselves with the facts and take a view as to the merits of Sirius’s claim. In order to do so they would need (among other things) to contact Ince & Co (who had acted for FAI at the time). Freshfields’ state of knowledge on 6 April 2001 must have been even more deficient.
- (e) In her witness statement of 2 November 2001 Ms Carr put forward further arguments (based on allegations of champerty and misrepresentation) on behalf of the provisional liquidators but there is no suggestion that these arguments were live at the date of the Tomlin order.

35. Against that background I turn to paragraph 4 of the schedule to the Tomlin order:

“For the avoidance of doubt, the position and all arguments of [Sirius] and [FAI and the provisional liquidators] in respect of the LOC are preserved in respect of the proceeds notwithstanding the terms of this Schedule.”

Meticulous verbal analysis of this paragraph is not appropriate, at any rate not to the exclusion of common sense, or its commercial context. Nevertheless I make three short verbal points. First, the words “For the avoidance of doubt,” although sometimes loosely used, suggest that the paragraph is going to spell out what is fairly obvious (or at any rate unsurprising) rather than subverting the other provisions of the Schedule. Second, the reference to arguments being “preserved” cannot in the circumstances sensibly restrict the parties to arguments which had already been articulated and advanced (compare the mirror-image issue of the release of unknown claims considered by this House in *Bank of Credit and Commerce International SA v Ali* [2001] UKHL 18; [2002] 1 AC 251); at the time when the Tomlin order was made there seems to have been doubt even as to the identity of the relevant contractual documents. Any arguments, whether or not already canvassed, could be put forward (the parenthesis “(if any)” in paragraph 3 is consistent with that). Third, the repetition of “in respect of” (“the arguments . . . in respect of the LOC are preserved in respect of the proceeds”) is not careless drafting but serves to emphasise the intended parallel between the letter of credit before draw-down and the proceeds after draw-down.

36. Then there are the most controversial words in paragraph 4, “notwithstanding the terms of this Schedule.” Plainly they are intended to have some sort of overriding effect: in particular, since the issues left unresolved centre on the letter of credit, to require entitlement to the letter of credit to be determined as if there had been no draw-down. That hypothetical approach may give rise to more difficulties than the parties had fully thought through, but it is consistent with their commercial objectives.

37. Does the Schedule intend the hypothesis to be stretched further, so as to require the apparently unqualified acknowledgement in paragraph 1 of FAI’s liability to be disregarded in determining entitlement to the proceeds of the letter of credit? The judge thought that that would be an extraordinary result. He said, at p 93, paras 21-22:

“If one follows the logic of [the] argument through, its effect is that the letter of credit was agreed at the time to be unenforceable. It might as well have been torn up by the agreement . . . This is such a bizarre conclusion that it cannot be right.”

38. In the Court of Appeal May LJ took the same view. He said, at p 2222, para 19:

“In my judgement, the judge was correct to reject FAI’s extreme submissions based on paragraphs 4 and 5 of the Schedule to the Tomlin order. The short point is that paragraphs 4 and 5 cannot, in my view, be read as leaving open for future contention that which paragraph 1 compromised. Paragraph 1 compromised the arbitration proceedings. It did not purport to determine questions arising out of the letter of credit. Available arguments as to the letter of credit were preserved, but the indebtedness of FIA to Sirius under the retrocessions was determined.”

Carnwath LJ agreed with May LJ; and Wall J expressed similar views.

39. The ground on which the Court of Appeal disagreed with the judge was not as to a far-reaching counterfactual hypothesis introduced by paragraph 4, but as to the proper meaning of paragraph 1, construed in its commercial context. On that point, for all the reasons given by Lord Steyn, I respectfully prefer the reasoning of the judge to that of the Court of Appeal. As the judge said, at p 94, para 26:

“The commercial substance is that FAI had agreed that Sirius should pay a claim”.

For these reasons I would allow the appeal.

#### **LORD BROWN OF EATON-UNDER-HEYWOOD**

My Lords,

40. I find myself in precisely the same position as my noble and learned friend, Lord Bingham of Cornhill. I too was inclined to the construction of the Tomlin order contended for by the respondents. For the reasons given by Lord Bingham, however, I too am content to agree that the appeal should be allowed.