IN THE ROYAL COURT OF GUERNSEY

(ORDINARY DIVISION)

CIVIL ACTION NO. 1510

BETWEEN:

(1) CARLYLE CAPITAL CORPORATION LIMITED (IN LIQUIDATION)

(2) ALAN JOHN ROBERTS, NEIL MATHER, ADRIAN JOHN DENIS RABET, solely in their capacity as Joint Liquidators of Carlyle Capital Corporation Limited (In Liquidation)

Plaintiffs

-AND-

(1) WILLIAM ELIAS CONWAY JR
(2) JAMES H. HANCE JR
(3) JOHN CRUMPTON STOMBER
(4) MICHAEL J. ZUPON
(5) ROBERT BARCLAY ALLARDICE III
(6) HARVEY JAY SARLES
(7) JOHN LEONARD LOVERIDGE
(8) CARLYLE INVESTMENT MANAGEMENT LLC
(9) TC GROUP LLC
(10) TCG HOLDINGS LLC

Defendants

Before: Her Hon Hazel Marshall QC, Lieutenant Bailiff

Counsel for the Plaintiffs: **Advocates J M Wessels & Abel R Lyall**
Counsel for the First to Fourth Defendants: **Advocates I C Swan, Anna Guggenheim & Bryan de Verneuil-Smith**
Counsel for the Fifth to Seventh Defendants: **Advocate Gareth Bell**
Counsel for the Eight to Tenth Defendants: **Advocate Simon Davies**

Dates of hearing: 20th – 24th and 27th – 30th June,
4th – 7th, 11th – 14th, 18th – 21st and 25th – 28th July,

1st, 8th – 11th, 15th – 18th, 22nd – 24th and 30th August,
12th – 15th, 19th – 22nd, 26th, 27th and 30th September,
3rd – 5th, 10th – 12th, 26th and 27th October,
9th and 28th – 30th November,
1st, 2nd, and 6th – 9th December 2016.

Judgment handed down on: 4th September 2017

Cases, Texts and Legislation referred to:

1. Legislation

(a) Guernsey

The Companies (Guernsey) Law 1994, ss 67b 67C, 67F, 94, 95, 106, 117
The Companies (Amendment) (Guernsey) Law 1996
The Royal Court (Reform) (Guernsey) Law 2008 s 113
The Companies (Guernsey) Law 2008, ss 131, 132, 157, 407, 422, 434, 522, 527
The Evidence in Civil Proceedings (Guernsey and Alderney) Law 2009, ss 1-4

The Royal Court Civil Rules 2007, r 10
The Companies (Transitional Provisions) Regulations 2008. reg 10
The Evidence in Civil Proceedings (Guernsey and Alderney) Rules 2011, rr 2, 8

(b) England and Wales

Companies Act 1862 s 80
Companies Act 1907 s 28
Companies Act 1948 ss 333, 455
Companies Act 1985 ss 518, 741
Insolvency Act 1986 ss 123, 214, 212
Companies Act 2006 s 250

2. Cases

(a) Guernsey

Carlyle Capital Corpn Ltd (in Liq) v Conway and others (Guernsey Judgment 29/2011)
Carlyle Capital Corpn Ltd (in Liq) v Conway (2011-12) GLR 562 (CA)
Emerald Bay Worldwide Ltd v Barclays Wealth Directors (Guernsey) Limited (2014) (CA. No 02/2014)
Flightlease Holdings (Guernsey) Ltd v Flightlease (Ireland) Limited [2009-2010] GLR 38
In re Montenegro Investments Limited (in administration) 2013 GLR 345
Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd (2015)(CA. No 35/2015)
Perpetual Media Capital Ltd v Enevoldsen (2014) GLR 57 (CA)
Romain Zaleski v GM Trustees Ltd (2015) (Guernsey Judgment 42/2015)
Savile AD4 Limited v Marlborough Trust Company Limited (2016) (Guernsey Judgment 3/2016)

(b) England and Wales

*Aberdeen Railway Co v Blaikie Brothe*rs (1854) 17D (HL) 20
AIB Group (UK) plc v Mark Redler & Co Solicitors [2015] AC 1503
Armory v Delamirie, (1722) 93 ER 664
Bilta (UK) Ltd v Nazir (No 2) [2016] AC 1
Bishopsgate Investment Management Ltd v Maxwell (No 1) [1994] 1 All ER 261
BNY Ltd v Eurosail [2013] 1 WLR 1408

Boardman v Phipps [1967] 2 AC 46
BPE Solicitors vs Hughes-Holland [2017] UKSC 21
Brady v Brady [1988] BCLC 20
Braganza v BP Shipping [2015] UKSC 17*Bristol & West Building Society v Mothew* [1998] 1 Ch 1
Browne v Dunn (1893) 6 R 67
Browning v Brachers [2005] PNLR 44
BTI 2014 LLC v Sequana SA [2016] EWHC 1686 (Ch)
Bucci v Carman (Liquidator of Casa Estates (UK) Ltd) [2014] EWCA Civ 383
Byblos Bank SAL v Al-Khudhairy [1987] BCLC 232
Byng v London Life Associations Ltd [1990] Ch 170 (CA)
Charterbridge Corp Ltd v Lloyds Bank Ltd [1970] Ch 62
Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd [2003] 2 BCLC 153
Daniel v Tee [2016] 4 WLR 1538
Donoghue v Stevenson [1932] AC 562
Eclairs Group Ltd v JKX Oil & Gas plc [2016] BCC 79 (Sup Ct)
English v Emery Reimbold & Strick Ltd [2002] EWCA 605
Equitable Life Assurance v Hyman [2002] 1 AC 408
Extrasure Travel Insurances Ltd v Scattergood [2003] 1 BCLC 598 (ChD)
Facia Footwear Ltd v Hinchliffe [1998] 1 BCLC 218 (ChD)
Farstad Supply AS v Enviroco Ltd [2010] UKSC 18
Galoo Ltd v Bright Grahame Murray [1994] 2 BCLC 492
Gestmin SGPS SA v Credit Suisse (UK) Ltd [2013] EWHC 3560 Comm
Holland v HMRC [2010] UKSC 51
Howard Smith v Ampol Petroleum Ltd [1974] AC 821
Hutton v West Cork Ry Co (1883) 23 Ch D 654
Item Software (UK) Ltd v Fassihi [2005] 2 BCLC 91 (CA)
Kuwait Asia Bank EC v National Mutual Life Nominees Ltd [1991] 1 AC 187 (PC)
Libyan Investment Authority v Goldman Sachs International [2016] EWHC 1538 (Ch)
McQueen v Great Western Railway Company (1875) LR 10 QB 569
Madoff Securities International Limited (in liquidation) v Raven [2014] Lloyd's Rep F C 95 (Comm)
Nationwide Building Society v Balmer Radmore (a firm) [1999] Lloyds Rep PN 241
Optaglio Ltd v Tethal [2015] EWCA Civ 1002
Parabola Investment Ltd v Browallia Cal Ltd [2011] QB 477
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Pitt v Holt [2013] 2AC 108
Re a company (ex p. Glossop) [1988] 1 WLR 1068 (ChD)
Re B Johnson & Co Builders Ltd [1955] Ch 634
Re Barings plc; Secretary of State for Trade and Industry v Baker [1998] BCC 583
Re Barings plc (No 5) [1999] 1 BCLC 433 (ChD)
Re Bonnelli's Telegraph Co [1871] LR 12 Eq 246
Re Casa Estates Ltd [2013] EWHC 2371(Ch)
Re Cheyne Finance Plc (No 2) [2008] BCC 182
Re City Equitable Fire Insurance Co Ltd [1925] Ch 407
Re Continental Assurance Company of London Ltd (in liqn) [2001] WL 720239
Re Continental Assurance Company of London Ltd (in liqn) (No 4) [2007] 2 BCLC 287
Re CS Holidays Ltd [1997] 1 WLR 407
Re Cubelock Ltd [2001] BCC 523
Re d'Jan of London Ltd [1993] BCC 646 (Ch D)
Re Edennote Ltd [1996] BCC 718 (CA)
Re European Life Assurance Society (1869) LR 9 Eq 122
Re HLC Environmental Projects Limited (in liquidation) [2013] EWHC 2876
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Re Landhurst Leasing plc [1999] 1 BCLC 286 (ChD)
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Re Mumtaz Properties Limited: Wetton v Ahmed [2011] EWCA Civ 610
Re Pantone 485 Ltd [2002] BCLC 266 (CA)
Re Ralls Builders Limited (in liquidation) [2016] Bus LR 555
Re Smith and Fawcett Limited [1942] Ch 304 (CA)
Re Southern Counties Fresh Foods Ltd [2008] EWHC 2810 (Ch)
Re Welfab Engineers Ltd (1990) BCC 600
Re Westmid Packing Services Ltd [1998] 2 All ER 124
Regal (Hastings) Ltd v Gulliver [1967] 2AC 134
Regentcrest plc v Cohen [2001] 2 BCLC 80 (ChD)
Roberts v Frohlich [2011] EWHC 257 (Ch)
Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran [1994] 1 AC 438
Secretary of State for Industry v Deverell [2001] Ch 340
Shuttleworth v Cox Brothers & Co (Maidenhead) [1927] 2KB 9
Smith v Molyneaux and others [2016] UKPC *35* (PC)
Smithton Ltd v Naggar [2014] EWCA Civ 939
South Australia Asset Management Corporation v York Montague Ltd [1997] AC 191
Ultraframe (UK) Ltd v Fielding [2005] EWHC 1638
Vasiliou v Hajigeorgiou [2010] EWCA Civ 1475
Viscount of the Royal Court of Jersey v Shelton [1986] 1 WLR 985
Vivendi SA v Richards, [2013] EWHC 3006
Wisniewski v Central Manchester Health Authority [1998] PIQR 324
Yam Seng Pte Ltd v International Trade Corpn Ltd [2013] 1 Lloyds Rep 526

(c) Other jurisdictions

Australia:
Ampol Petroleum Ld v RW Miller (Holdings) Ltd [1972] 2 NSWLR 850
Houghton v Immer (No 155) Pty Ltd [1997] 44 NSWLR 46
Kinsela v Russell Kinsela Pty Ltd [1986] 4 NSWLR 722
Roach v Page (No 37) 2004 NSWSC 1048
The Bell Group Ltd (in liquidation) v Westpac Banking Corporation (No 9) (2008) 70 ACSR 1
Westpac Banking Corporation v The Bell Group Ltd (in liquidation) (No 3) (2012) 44 WAR 1

Cayman Islands:
Culross Global SPC Ltd v Strategic Turnaround Master Partnership Ltd 2008 CILR 447
In re Weavering Macro Fixed Income Fund Limited (in liquidation) (18th November 2016) (CICA No 2 of 2016)

Hong Kong:
Akai Holdings Ltd v Thanakharn Kasikorn Thai Chamkat [2010] 3HKC 153
Libertarian Investments Ltd v Hall (2013) HKFCAR 681
Moulin Global Eyecare Holdings Ltd v Mei (2014) HKCFAR 466

Singapore:
Ng Eng Ghee v Mamata Kapildeve Dave and others [2009] 3 SLR 109

United States:
CMMF LLC v JP Morgan Investment Management Inc 43 Misc 3d 1226(A)

3. Textbooks and other materials

Goode: *Principles of Insolvency Law* (4th Ed 2011) paras 4-16, 4-23
Gower's *Principles of Modern Company Law* 10th Ed, paras 9-13, 9.14
Hoffmann: *Causation* (2005) 123 LQR 592
Mortimore: *Company Directors; Duties Liabilities and Remedies* (3rd Ed 2017) paras 12.21-22
Palmer's *Company Law* (Rev Jan 2016) para 15.99.30

Snell's *Equity* (33rd Ed Cum Sup 201), para 20-028
Taube: *International Asset Tracing in Insolvency* (2009) para 4.88.

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Her Honour Lt Bailiff Marshall QC:

1. Introduction and overview

The case in outline

1. This is the culmination, in this jurisdiction at any rate, of a process by which the liquidators of Carlyle Capital Corporation Ltd ("**CCC**"), a company incorporated in Guernsey which has been in compulsory liquidation for the last eight years, seek to recover damages or financial contribution amounting to many millions of dollars, against its former directors and three other companies incorporated in Delaware in the United States. These were CCC's asset and investment manager, and the two corporate entities at the apex of the Carlyle Group of companies, the promoters of CCC.

2. CCC was incorporated on 29th August 2006. The Carlyle Group was a highly successful multi-billion dollar private equity enterprise, based in the United States of America. Their business was investment and financial asset management in a variety of forms and across a variety of business sectors. This description still applies today, although in the interim, in 2012, they have become a public company.

3. At the time with which I am concerned, the Carlyle Group was looking to extend the scope of their operations. CCC was incorporated at Carlyle's instigation as a closed-ended investment "yield vehicle". It was intended to acquire investments with permanent capital, and to hold these for income, so as to produce an attractive and steady return for its shareholding investors through the payment of dividends. This is a significant background point in the case, as will appear. CCC's being "closed-ended" meant that investors were not able to withdraw their investments in the enterprise directly from it, as might be the case with some investment funds. However, because the liquidity of an investment is an attractive feature, this was to be provided through investors being able to recover their funds by selling their shares. To make this easy, CCC was to become a public company, with listed shares. The Euronext Stock Exchange in Amsterdam was selected for this purpose.

4. After a private placement of shares in two tranches in late 2006 and early 2007, taken up by certain supporting investment banks and existing Carlyle investors, there was an Initial Public Offering ("**IPO**") of shares in CCC in late June 2007. This was completed on 4th July 2007, following which CCC was listed on the Euronext Exchange.

5. From its private placement and public offering, CCC had achieved capitalisation of $945Mn. It proceeded to acquire investments in accordance with the business model which had been devised for it, and which was explained in both its Private Placement Memoranda ("**PPM**") and Offering Memorandum ("**OM**"). This business model is of central importance to the case, but here it is enough to say that it depended on borrowing very substantially to buy the assets to generate the income to pay the dividends, and that those assets were to be of two broad classes, one being credit assets, principally bank loans, and the other being US Government Agency bonds whose underlying assets were residential mortgages.

6. There were some tremors in the financial markets in the spring of 2007, and CCC's intended IPO was scaled back somewhat from the original intentions, before it went ahead and closed on 4th July 2007 as mentioned. In early August 2007 there was a crisis in the financial markets, the repercussions of which resulted in the funding on which CCC depended becoming

less readily available on the kind of terms which CCC had anticipated when structuring its business model. CCC's assets had lost value and its liquidity was significantly depleted. By taking extraordinary steps – borrowing money from the main Carlyle companies and selling the bank loan sector of its portfolio – CCC survived this crisis, but the exercise had taken a toll on its liquidity and the amount of cash available as a safety net. The directors decided against actively selling the other assets in CCC's portfolio, the Agency bonds, but to retain them. They considered them to be high quality, and that they ought to recover and return cash to the company. The directors say that they hoped and expected to weather the aftermath of the August 2007 storm and to be able to put CCC back on its feet. CCC did continue to survive, even over a well-understood difficult period for borrowing over the lending banks' own year ends, when they tend to look to keeping assets on their own balance sheets. Early in the following year, the Defendants say that CCC's financial position improved, but in early March 2008 a second even more disruptive liquidity crisis hit the financial markets. This, CCC was not able to withstand.

7. Thus, on 17th March 2008, less than a year after its initial flotation, CCC was ordered to be compulsorily wound up in this court on the application of its own directors, with insufficient assets to meet its liabilities. The net deficiency of assets as regards creditors (although at the moment, in accordance with Guernsey liquidation procedure, these are merely claims awaiting ultimate confirmation as debts) has been quantified at more than $350Mn. On this basis, CCC had lost a remarkable $1.3Bn in eight months.

8. On 7th July 2010, CCC's four duly appointed liquidators brought this action in the name of CCC, and also, for procedural reasons, in their own names as joint liquidators. They do so against CCC's seven former individual directors, and against the three main corporate entities in the Carlyle Group, claiming, in essence, damages for breach of their fiduciary duties and/or gross negligence as directors of CCC and, in the case of the Eighth Defendant, for breach of contract or common law negligence as CCC's investment manager. These proceedings were in fact one of four sets of proceedings commenced simultaneously in different jurisdictions, although I believe they are the only set which currently survives. The liquidators have also been reduced to three in number since the commencement of the action, owing to the sad demise of the fourth, Mr Christopher Morris.

The parties

9. Of the seven individual director Defendants, the first four hold or held senior positions in entities within the Carlyle Group, to which I will refer as "**Carlyle**" or "**Carlyle Group**" or "**the Group**" as seems natural. They have been collectively referred to for convenience as the "**Carlyle Directors**".

10. The First Defendant, **Mr William (Bill) Conway,** was one of the three original co-founders of the Group from 1987, and was and is a major global partner. He is an executive Director of TC Group LLC ("**TCG**"), the Ninth Defendant, which is the Group's main operating vehicle. He is also the Group's informal Chief Investment Officer.

11. The Second Defendant, **Mr James Hance Jr,** was and is a consultant to the Carlyle Group with the title of Senior Adviser, but he also holds a range of other external directorships. He became one of the global partners of the Group in May 2005, shortly before the events with which I am concerned. In addition to being a director of CCC, he was the non-executive Chairman of its Board.

12. The Third Defendant, **Mr John Stombe**r, was the Chief Executive Officer, Chief Investment Officer and President of CCC. He had been especially recruited by Carlyle to take up this particular position. His functions were entirely dedicated to the affairs of CCC although not as an employee; CCC had no employees of its own. As with all the other Carlyle affiliated individuals, Mr Stomber's formal employment was with a Group company, Carlyle Group Employee Co LLC ("**CGEC**"). For formal or technical reasons, and at or shortly before the relevant time, the Group had formed CGEC to be the actual Employer of most, if not all, of the salaried employees in the Group. Nothing has been argued to turn on this structure. Under that employment, Mr Stomber's services were at the disposal of the Eighth Defendant, Carlyle Investment Management LLC ("**CIM**"), the company which supplied investment management services to entities in the Carlyle Group. Mr Stomber was then seconded to fulfil the functions required of him in relation to CCC, as mentioned.

13. The Fourth Defendant, **Mr Michael Zupon**, was already, at the material time, a Carlyle employee and global partner, and was the founder and head of its US Leveraged Finance Division. This section specialised in investment in, and management of, different species of corporate debt, which, as already mentioned, were investments intended to be included in CCC's portfolio according to its original business model. Mr Zupon was therefore involved in CCC for his expertise in this area. He too was, technically, employed by CGEC and provided his management services through CIM.

14. Mr Conway and Mr Hance were voting members of CCC's Board, although they had no official day to day executive management function in its affairs. Mr Stomber and Mr Zupon, although directors of CCC and involved in the actual running of its business affairs, were non-voting directors. Their role on the Board of CCC was thus reporting and advisory.

15. The second group of Defendants comprises the remaining three individual Defendants, who have been referred to as the "**Independent Directors**". CCC's constitution specifically required the appointment of three "Independent Directors", who were not affiliated with the Carlyle Group. These were they. They were experienced bankers or financial professionals from outside the CCC Group. They were non-executive, but voting, directors. If all of the same view, they actually formed a voting majority of the Board. CCC's Articles of Association required that certain decisions on particularly significant matters required the approval of a separate majority of these Independent Directors.

16. The Fifth Defendant, **Mr Robert (Barry) Allardice III,** was an experienced recently retired investment and commercial banker, having worked for many years for Morgan Stanley and latterly for Deutsche Bank. At Deutsche Bank he had known Mr Stomber, for whom he gave a reference. Mr Stomber had suggested that he be considered for the position of Independent Director. He was experienced in capital markets, banking and accounting, and took a particular interest in audit work regarding CCC.

17. The Sixth Defendant, **Mr Harvey (Jay) Sarles,** was a former Vice President of Bank of America and Vice President and Chief Administrative Officer of FleetBoston. He was previously known to Mr Hance. He had long and senior experience in commercial banking and capital markets.

18. The Seventh Defendant, **Mr John Loveridge**, is the only non-US Defendant. He lived and still lives in Guernsey. He was a trust professional (he has since retired) with many years' experience in the administration of off-shore funds and the financial regulatory requirements of

Guernsey. He was known to Carlyle through having previously been engaged by them to act as a director of certain other entities within the Carlyle empire, where these had vehicles operating in European jurisdictions.

19. CCC and the liquidators make their claims for breaches of duty and wrongful trading against all CCC's seven individual directors. As a matter of law, these claims are necessarily individual, although the Plaintiffs describe the alleged breaches as "collective".

20. The remaining Defendants are all corporate entities, incorporated in the State of Delaware. They have been referred to as the "**Entity Defendants"**.

21. The Eighth Defendant is **Carlyle Investment Management LLC** ("**CIM**"). It has already been mentioned and its name is self-explanatory. CIM was contractually engaged as the Investment Manager for CCC, under a contract (the Investment Management Agreement or "**IMA**") governed by Delaware Law. CIM also had no employees of its own, and provided its services through its call on the services of employees in the Carlyle Group, who were formally employed by CGEC. CCC and its liquidators claim breach of contract against CIM alleging breach of contractual or fiduciary duty, or negligence amounting to gross negligence or recklessness.

22. The Ninth and Tenth Defendants are **TC Group LLC** ("**TCG"**) and **TCG Holdings LLC** ("**Holdings**"). They were the two companies at the head of the Carlyle Group structure. TCG is the Group's principal operating company. It owned a very substantial controlling interest in CIM, if not the whole. Holdings was the sole Managing Member of TCG. The Managing Members of Holdings were the three founding members of the Carlyle Group, namely Mr Conway and Messrs David Rubenstein and Daniel D'Aniello. They are often collectively referred to as "the Founders" or, in Carlyle Group culture, as "DBD" (David, Bill and Daniel). At the material times they owned around 68% of Holdings between them. They were each officers of CIM, TCG and Holdings itself.

The claims

23. Somewhat oversimplifying the position for the purposes of introduction, CCC and its liquidators claim that TCG, Holdings and CIM were, by virtue of their relations with CCC and the power and influence which they exercised over it, either "shadow directors" or *de facto* directors of CCC in Guernsey law, and that they therefore owed to CCC the duties of *de jure* directors. Whilst it appeared from the pleadings that the Plaintiffs might also be alleging other legal bases for fixing CIM, TCG and Holdings with liability to CCC, by the conclusion of the hearing it had been confirmed that the Plaintiffs' claims against these three Entity Defendants were confined to claims (a) based on the claimed status of TCG and/or Holdings and/or CIM in law as either *de facto* or shadow directors of CCC in material respects, and (b) as regards CIM only, as CCC's Investment Manager, in contract or as a concurrent claim in tort (which would be materially indistinguishable in scope).

24. In more precise terms, the 16 claims for relief which remain live in the action are stated to be variously for breach of fiduciary duty, gross negligence, statutory misfeasance pursuant to s. 106 of the Companies (Guernsey) Law 1994 ("**the 1994 Companies Law**") or s. 422 of the Companies (Guernsey) Law 2008 ("**the 2008 Companies Law**"), wrongful trading pursuant to s. 67C of the 1994 Companies Law or s. 434 of the 2008 Companies Law and, in the case of CIM, for breach of contract or tortious negligence. Together with interest claimed at a

compound rate up to the date of issue of the proceedings, the total amount of the claim is approximately $1.4Bn. Interest since that date brings the claim up to a little short of $2Bn.

25. There is a secondary alternative claim against CIM, TCG and/or Holdings made in unjust enrichment, which is for the return of, principally, the management fees paid by CCC during its short life, although the claim is drafted more widely to include also interest payments, expenses and "compensation" – I think here meaning remuneration - comprised of share allocations. This claim is quantified as being in excess of $70Mn and is claimed together with interest.

The action

26. The action was commenced on 7th July 2010. It has thus had a long procedural history, which is no longer of any direct relevance. There have been other actions brought in other jurisdictions as well. It is not necessary to recite details of either the procedural history, or the other actions, and I am not going to lengthen further what is unfortunately bound to be a lengthy judgment by doing so. I will refer to any relevant points as they arise. For general purposes here, it suffices to say only that there have been strenuously fought contests between the liquidators and the Defendants, in both this jurisdiction and in jurisdictions in the United States, on subsidiary matters including the production of documents and records and other aspects of evidence gathering.

27. Part of this contest was a hard fought dispute about the appropriate forum for trial. Most of the protagonists are, of course, American. However, CCC is a Guernsey company, and any issues regarding the conduct of its business, its governance and the adjustment of the rights of interested parties in its compulsory liquidation, arise under Guernsey law and must be decided according to Guernsey law principles. The claims in this action have therefore ultimately fallen to be determined here, the jurisdiction in which its promoters chose to incorporate CCC and in which it is being liquidated.

28. There have been yet other proceedings in the United States regarding aspects of the affairs of CCC but not involving the same parties as here. Again, it is unnecessary to refer to these, except to note, as a matter of context, that the dispute before me appears to be only part of a far more widely based set of hostilities which have been in train over several years.

29. As to this action, despite the remarkable length and detail of the pleadings, the real substance of the claims is actually quite simple. The liquidators claim that "from July 2007" (being just before the time, in August 2007, when CCC's finances suffered from the first shock in the financial markets) until CCC's eventual collapse in March 2008 (following the second crisis of an even greater magnitude) the sequence of decisions and actions (or inactions) either taken or endorsed by each of the Defendants as the actual or quasi-directors of CCC were not only wrong in the sense of being a mistake, but were also wrongful. It is claimed that these actions by the directors were in breach of their fiduciary duties as such, because they were improperly motivated in that they were taken for purposes other than the best interests of CCC itself, namely (and rather) for the perceived best interests of the wider Carlyle Group and in particular TCG and Holdings, or, as regards certain directors, for that director's conflicting personal benefit. Alternatively or additionally, it is claimed that these decisions and actions were taken negligently (and in CIM's case thus also in breach of contract) and indeed were even reckless, or at least so seriously negligently as to amount to "gross" negligence. The foregoing complaints are claimed also to constitute statutory misfeasance. It is further alleged

that these actions by the Defendants had the effect, from August 2007, of continuing the operation of CCC's business in circumstances where the Defendants knew, or ought to have concluded, that there was no reasonable prospect of CCC's avoiding going into insolvent liquidation, and thus, in short, that the Defendants were guilty of wrongful trading.

30. The Defendants reject all these allegations. The Entity Defendants deny that they were or became either *de facto* directors or shadow directors of CCC at all. But in any event, all of the Defendants say that all their decisions with regard to CCC were taken in good faith, and with due care, in what they perceived at the time to be CCC's best interests, including, where material, the interests of CCC's creditors, but they also say that, in any event, in all relevant respects, the interests of CCC and the Carlyle Group were in fact aligned. They say that they believed that CCC could and would recover from the difficulties it encountered in August 2007, that the course which was taken was believed to offer CCC (and thus also its creditors) the best chance of doing so, taking all the circumstances into account. They say that this judgment was reasonable, both subjectively and objectively, in all the circumstances at the time, even though, in the event, CCC did not survive. They say that its collapse was attributable to the second financial crisis of March 2008, which was not only unforeseen but was unforeseeable. They reject all the criticisms made of them as being either ill-founded on proper examination, or as being wise with hindsight.

31. They add that, in any event, the Plaintiffs simply do not prove that the matters which they criticise caused any identified or identifiable loss to CCC. They say that the Plaintiffs assert, but do not prove, that any of the actions which they now argue (with the benefit of hindsight) should have been undertaken on behalf of CCC from July 2007 onwards would have made CCC's ultimate financial position any better, in the result, than it ultimately was. In fact, they say that the alternative actions proposed by the Plaintiffs might well have made that position worse.

32. As part of their Defences, the Defendants also claim the benefit of exoneration clauses and indemnities provided in CCC's Articles of Association (and in the case of CIM in the IMA) in respect of any liabilities and costs incurred by them otherwise than (broadly) through their own gross negligence, misfeasance, wilful default or bad faith. The availability and effect of such clauses has given rise not only to legal arguments, but has also had a palpable influence on both the breadth of matters advanced by the Plaintiffs in their main case, and the emphasis of their arguments, as they seek to avoid the application of these provisions.

33. I have explained that the case itself, as I see it, is ultimately within quite a narrow and straightforward compass as a matter of law. It has unfortunately been complicated by two factors. The first is understandable. It is that whilst the principles of law involved may be relatively simple, the subject matter - CCC's business - is not; it is the intricate and sophisticated world of dealings in financial instruments and obligations, bonds and derivatives. That complication is inherent in the subject matter.

34. The second is less excusable. It has been the complicating of the claims made with matters which, on examination, are incapable of giving rise to any relief. I refer to this further below, but it gives rise to the following introductory point.

35. In this judgment, I have tried to concentrate on determining only material issues, ie those which are alleged to have caused loss to CCC or otherwise to found a pleaded cause of action. However, because of the quantity of material, the persistence, and the elaborate detail with

which all points in this case have been pursued, I have rather inevitably been drawn into making findings on peripheral issues at times. I have no doubt been inconsistent in the extent to which I have done this, or the degree of detail or analysis which I have gone into at different places in this judgment. However, I decided, that it was more efficient to risk such inconsistency, than to eliminate it either by doing a totally rigorous exercise of examination aimed at extracting and deciding only those complaints which were alleged to have themselves caused CCC loss, or by laboriously deciding all the breaches of duty alleged (I am told that there are 187 of them), material or not. The result is therefore something of a half-way house.

36. I will add though, that I have been comforted, in the writing of this judgment, by serendipitously discovering the November 2016 decision of the Privy Council in the case of *Smith v Molyneaux and others* [2016] UKPC 35, where Dame Mary Arden DBE at [36] says:

> *"……It is an important duty of a judge to give at least one adequate reason for his material conclusions, that is, a reason which is sufficient to explain to the reader, and the appeal court, why one party has lost and the other has succeeded: see, generally, the decision of the Court of Appeal of England and Wales in English v Emery Reimbold & Strick Ltd [2002] EWCA 605; [2002] 1 WLR 2409, especially at paras 15 to 21. The judge does not have to set out every reason that weighed with him, especially if the reason for his conclusion was his evaluation of the oral evidence:*
>
> > *"… if the appellate process is to work satisfactorily, the judgment must enable the appellate court to understand why the judge reached his decision. This does not mean that every factor which weighed with the judge in his appraisal of the evidence has to be identified and explained. But the issues the resolution of which were vital to the judge's conclusion should be identified and the manner in which he resolved them explained. It is not possible to provide a template for this process. It need not involve a lengthy judgment. It does require the judge to identify and record those matters which were critical to his decision. If the critical issue was one of fact, it may be enough to say that one witness was preferred to another because the one manifestly had a clearer recollection of the material facts or the other gave answers which demonstrated that his recollection could not be relied upon. (English v Emery Reimbold & Strick, para 19 per Lord Phillips MR, giving the judgment of the court)"*

37. I have taken this as permission - even encouragement - to aspire to succinctness, although in the event I have not really succeeded. Unlikely though it may appear to the reader, I have in fact resisted the temptation to set down every thought which has crossed my mind on every point and to deal with every piece of evidence adverted to by every party. This has been quite difficult, not least because it seems to me that for procedural purposes it is usually better for a first instance judge to err on the side of too much reasoning rather than too little. However, there would have been a major corresponding downside for both reader and writer if I had expanded any further than I have.

38. The statistics which follow below will demonstrate why this point has been made.

The trial

39. The action ultimately came on for trial, on 20th June 2016. The parties had previously applied for the trial to be conducted by judge alone. In view of the huge amount of material in the

case and the technical complexity of the subject matter, I was content to authorise this and made an order, therefore, that pursuant to section 13(1) (b) of the Royal Court (Reform) (Guernsey) Law 2008 as amended, the Court would sit unaccompanied by Jurats. The trial proceeded accordingly.

40. Advocates Jeremy Wessels and Abel Lyall represented the Plaintiffs, CCC and its Liquidators. Advocates Ian Swan, Anna Guggenheim and Bryan de Verneuil-Smith represented the Carlyle Directors. Advocate Gareth Bell represented the Independent Directors. Advocate Simon Davies represented the Entity Defendants. I pay tribute to the tenacity, industry and mastery of material displayed by all the Advocates. I also have no doubt that much is owed to the work of what I know will have been teams of support personnel behind the scenes, who also deserve commendation. I am appreciative of the fact that I only had tentatively to request a document or other assistance, and it would appear almost immediately.

41. A few figures will illustrate the size of the undertaking. The trial was scheduled for 85 court days. It has in fact occupied 67 sitting days because certain witnesses were not, in the event, summoned for cross-examination. However, this just left more intervening days available for reading and review at that time, rather than reducing the timetabled period of the hearing, largely because most witnesses were attending from across the Atlantic on pre-arranged schedules. Ultimately, with delays occasioned by an unfortunate accident suffered by the Defendants' last expert witness, and a three week delay caused by the Plaintiffs' lead counsel sadly becoming unwell shortly before final speeches, the hearing concluded on 8th December 2016.

42. The Re-Amended Cause in the action, (from now on referred to simply as "**the Cause**" for short) runs, in its final form, to 252 pages. It is the size of a small novel. The final Amended Defences and Counterclaim of the Carlyle Defendants and Entity Defendants who have taken the main defence role in the action run – unsurprisingly in the light of the material they were obliged to meet and the sums of money in issue - to 305 pages. Those of the Independent Directors are 269 pages. There is an amended Réplique and Defences to Counterclaim of 131 pages, and a whole volume containing *exceptions de forme*, some of which appear never to have been answered fully.

43. The pleadings in this case should not be regarded by the Guernsey Bar as examples to be emulated; quite the contrary – although this criticism is really levelled at the Cause, because defendants are inevitably responsive.

44. The rules of pleading in Guernsey state that the cause shall contain

> *"a statement of the material facts on which the plaintiff relies for his claim, but not the evidence by which those facts are to be proved"* (Royal Court Civil Rules 2007 ("**RCCR**") rule 10(2).

45. Whilst it may on occasions be difficult to draw the line between material facts and evidence, the appropriate level of detail is that which enables the other party to understand the nature and factual basis of the case which it has to meet, - no less, but certainly no more. If it is considered that a bald statement of high level fact or secondary fact (inference) is insufficient to achieve this, then the correct way to deal with that is to make the high level assertion, and then to plead the necessary facts which make up this statements as "particulars", doing so in sub-paragraphs, or if that is still too cumbersome, in a schedule. The whole point of a pleading

is to make the case clear for the reader, whether that be the opposite party, the judge, or anyone else with an interest. It is not, or should not be, to overwhelm the opposite party. It is the quality and not the quantity of material which counts. Including an unhelpful surfeit of detail only obfuscates the real case; if the recipient considers that he has been given inadequate detail, he can always raise *exceptions de forme*. Still less is it a legitimate aim to try to cow the opposition into submission or a comatose state by unnecessary and overweening repetition, the quotation of portions of correspondence, the inclusion of tendentious headings, or the insertion of a myriad of hyperbolic adverbs and inflammatory comment.

46. To the list of inappropriate inclusions, I would also add, as mentioned earlier, accusations of misconduct by the other party which do not found any head of relief being sought. This has been a major aspect of this case.

47. The claims which are made against the Defendants are all claims for financial redress. In the end, (and leaving aside the fall-back restitutionary claim) the Plaintiffs' right to such relief depends on proving, not merely some breach of duty as a matter of legal analysis, but also that that breach caused a loss to CCC. The necessary causation may of course be shown indirectly, but it still has to be demonstrated and pleaded. Otherwise, the effect of the complaint is evidential at best and whether or not it could be juridically characterised as a breach of duty (or suchlike) is irrelevant. If it is merely evidence, it has no place in a pleading under the Royal Court Civil Rules of Guernsey.

48. Whilst this Cause contains a goodly number of such assertions, I realise that some could charitably be explained as being left over from a further claim which was included by the Liquidators in the original cause, seeking an order for the disqualification of the Defendants as directors of a Guernsey company. I directed in 2015 that that claim should be stayed until after the conclusion of the trial on financial liability because it was an inconvenient, unnecessary, and trivial (in context) diversion from the real dispute. There may, therefore, be some excuse for such matters having remained on the pleadings here. However, that is by no means a full or adequate explanation for all the allegations which are inconsequential as to relief, and it is also no excuse for their having remained as an apparently substantive part of later submissions.

49. The obligation to provide a clear, concise, and disciplined pleading lies particularly on the pleader of the cause because the pleader of the defences, facing a badly pleaded cause, has the unpalatable options of either applying to strike out the pleading, or parts of it, for embarrassment or abuse - which means assuming a burden of time, trouble and cost, and possible risk as to the last – or answering all the material included in it as a matter of safety play. He can readily be excused for taking the latter course, even if it then causes him also to have to divert from the proper approach to pleading.

50. The pleadings in this case are unwieldy to the point of even becoming an impediment to the convenient disposal of the case, certainly from the point of view of the judge. Their complexity, length and ponderousness has made any attempt to use them as a reference point for analysing the material case on any point such a laborious and frustrating operation as to be well-nigh impossible and virtually useless.

51. On finding their lack of utility as a convenient summary of the case at the outset of my involvement, I directed initially that the parties should provide summary pleadings within the limit of 25 pages which is imposed by the English Commercial Court. These summary

pleadings provided me with a very useful starting point in understanding and following the matter at the case management stage, and seemed to me to contain the case perfectly well. There was, though, no acceptance that these summaries could be treated as superseding the original pleadings. The Plaintiffs in particular insisted that the Cause itself must always prevail over any summary, and that they were not abandoning any point pleaded in the Cause. The Defendants, in turn, objected that the summary Cause had in fact introduced yet more alleged breaches of duty. No labour saving in that regard was therefore possible at the trial itself. However, I have continued to find these summaries useful for my own purposes, for refocussing on the truly essential points in the action.

52. The further written evidence and documentary material in the action included two volumes of witness statements from 14 factual witnesses, and six volumes of expert reports from 16 experts. The total evidential material runs to 107 A4 double side printed volumes. 24 of these are simply the chronological correspondence during the core period of July 2007– March 2008, ie a mere nine months. In the end, and as so-often happens, a vast number of documents - in particular publicly available materials and materials obtained by the Plaintiffs from third parties - have simply never been referred to. Even so, the finally agreed list of "documents in evidence", which I required in order to fix by way of common ground what I should regard as evidence actually admitted in the trial, so as to ensure that the rules of evidence were properly observed, ran to 4,872 identified "documents", many of which were multi-paged, or were packs of presentation slides. Written closing submissions came in at 1,331 pages from the Plaintiffs and 1,641 pages (albeit less closely typed) from the Defendants. There have been over 300 authorities referred to in the written arguments, though mercifully not all were cited in speeches.

53. I have said that it is not so much the applicable legal principles as the subject of CCC's business which is esoteric. Ten of the 16 expert witnesses mentioned above dealt with such financial matters, and I heard oral evidence from nine of these experts, five for the Plaintiffs and four for the Defendants. These were respectively in the areas of financial economics (from a macro-economic and a micro-economic perspective, and in particular with regard to the residential mortgage backed securities market), investment management, risk management, "repo" financing (a term which I explain below) and insolvency. Seven of the experts who had provided reports and joint statements were not, in the event, required to attend for cross-examination. These were the two experts in each of the areas of audit and accounting practice, Dutch financial regulatory law and Delaware contract and company law, and the Defendants' expert on financial economics dealing with damages.

54. The complexity of the subject matter is illustrated by the fact that the Plaintiffs' main expert, Dr Andrew Carron, Chairman and former President of the US organisation, National Economic Research Associates Inc, felt it necessary to provide two expert reports. The first was his expert report on the issues in the case. However, this was prefaced by advice to read his second report before reading his first report, in order to be able to understand the first report. His second report was entitled "Bond Market Fundamentals". It provided a description of the functions of the US bond market and of bonds, including mortgage backed securities in particular, how these were traded, financed and valued at the relevant times and in the relevant markets, and the risks associated with aspects of this market. I can confirm that his advice was well worth taking. Further education in the detail of these markets was provided for me later by other experts.

55. The general impenetrability of this field to the uneducated outsider can perhaps be immediately illustrated from the fact that bond prices are usually described as "spreads", and that "duration" is not a measure of time but a measure of the degree of bond value sensitivity to changes in interest rates. Prior to becoming involved in this case, I would have expected that "synthetic shorts" were some kind of Lycra cycling gear. The Plaintiffs thought it helpful, as it most certainly was, to provide me with a glossary of all the acronyms and technical terms which they had assembled for me before the trial, extracted from the written evidence. This ran to more than 40 pages. It enabled me, for example, to distinguish my WALA from my Vega. Even that, though, could not assist in the interpretation of some of the documentary evidence. Whilst, as an outsider, I have an idea of what a "Bloomberg message" must be, making sense of the content of such a message is an esoteric art, confined to those who have been initiated into both the symbolism and the argot of the field. It was fortunate that there were several experts around, including, by this stage, the Advocates in the case, who were able to assist.

56. Consistently with modern technology, the trial was covered by a live transcript service, and the whole of the documentary material potentially in the case was uploaded on to a specialist legal proceedings service, to enable documents to be produced on screens in the courtroom, with supporting software enabling notes and annotations to be made, both by the court and by the parties, (on separate networks). Apart from the teams of counsel and support staff present in court, the proceedings were video-streamed to overflow rooms in the court building, and also to offices both here and in London, the United States and Australia where members of the parties' legal teams were working. This trial management IT system, together with the many and various visual aids and aides memoire produced by both sides, have been of great assistance in the case itself. It would probably have been unmanageable without them. The extent of their existence and use also helps paint a picture of the scale of this litigation, and its importance to the parties.

About this judgment

57. Structuring this judgment has not been straightforward. Usually, after outlining the case, the parties and the procedural background, I would first try to set out a neutral history of the matter down to the commencement of proceedings, based on common ground but identifying disputed matters on the way. With this background, I would then follow, in a convenient order which naturally varies from case to case, by setting out the relevant law (deciding any disputed legal points in the course of this), giving my views of the witnesses and any other evidence, identifying the issues, and then discussing and giving my conclusions on each of these, before pulling matters together in a final summary.

58. However, I quickly found that trying to write an initial neutral account of the entire factual history up to the time of CCC's collapse was impractical. It was only towards the end of the trial that the parties themselves succeeded in producing a so-called "neutral chronology", a document which, whilst helpful for providing a concise sequential skeleton of milestone events, was in practice so neutral as to be largely uninformative about facts relevant to the disputes. It also rapidly became obvious that attempts to write a history which described events in sufficient detail to identify the disputed implications of these, even with my aim of confining myself to the truly essential matters of dispute, would produce a historical account of enormous length, which would then need repetition at the later stage of decision-making. In addition, with ten separate Defendants and six separate dates which the Plaintiffs nominated as

dates for examination of their claims that breaches of duty, etc, had been committed, (identified as being around 31st July, 31st August, 30th September, 13th or 30th November, and 31st December 2007, and 27th February 2008), successfully managing all these matters in a single introductory narrative structure would have been well-nigh impossible.

59. In the end, therefore, I have decided that the most economical, manageable, and I hope comprehensible, course for the reader, will be first to give a general history of the matter up to the first point at which the Plaintiffs assert any breach of duty on the part of the Defendants. That date has been identified as the date of the CCC Board Meeting of 26th July 2007. That account will, I hope, provide the reader with sufficient background and appreciation of the subject matter of the case to be able to follow easily my account of the later periods of time when culpable conduct is being alleged, and my findings and reasons in that regard.

60. At that stage I then take stock of the situation, review the law, review the witnesses, and review particular aspects of the evidence and other general points, and set out a list of the issues as I then see them. I then proceed to deal in turn with the claimed causes of action with regard to the sequential dates relied on by the Plaintiffs, having regard to the issues identified and the principles of law and suchlike already considered. I think it both important and helpful to consider the claims on this chronological approach because of the importance of judging the Defendants' actions only on the basis of what was known or thought at the relevant time and without the influence of hindsight. This course inevitably involves some repetition of matters which it has been appropriate to refer to in more than one context, and it has also at times been more convenient to deal with a particular topic out of strict time sequence, in which case I have noted this, and done so at the point in the story where it has most significance. A high level summary of my conclusions then appears at the end of the judgment - as I have little doubt will already have been discovered by those who have read this far, but who will have reacted in the time-honoured way to receipt of this judgment, by turning to the end of it to see the result.

2. The History

61. In this first narrative section of the judgment, I set out the background history of CCC up to the time of the events of which the Plaintiffs complain. It is therefore a scene-setting exercise. It largely sets out facts which are either common ground, or are accepted. Even within this period though, there are some matters which are disputed, and I have drawn attention to the most important disputes, and indicated my findings. Where I refer to any matter which may have been controversial without comment, then what I say can be treated as my findings of fact in those respects from the evidence in the trial.

The Carlyle Group

62. As already noted, The Carlyle Group is a large and well-known global asset management and investment organisation. It was founded in 1987, and was then wholly owned by the three Founders, Daniel D'Aniello, David Rubenstein and Bill Conway, the First Defendant.

63. By the time of CCC's formation in August 2006, the structure was more complex. The umbrella operating company in the organisation was TCG, which owned 100% of CIM. Holdings owned 94.25% of TCG. CGEC (the employment company) owned 0.25% of it, and a single outside institutional shareholder, CalPERS (the California Public Employees Retirement System) owned 5.5%. Holdings was the sole managing partner or member of

TCG. Holdings was owned, as to 68% by the three Founders, and as to 32% by other "global partners" of the Carlyle Group. Although they are known as global "partners", they are in fact shareholders in Holdings. Both Holdings and TCG were, at the relevant time, private companies, incorporated under Delaware law.

64. In October 2007, as will appear in more detail later because of the importance the Plaintiffs attach to this, Holdings sold a 7.5% interest in TCG to another major outside investor, the sovereign wealth fund of Abu Dhabi, known as The Mubadala Development Company ("**Mubadala**").

65. This reduced Holdings' interest in TCG to 86.75%, and the global partners, including the Founders, all received a *pro rata* distribution. Nothing else changed in the structure of the Group. Thus, it is accepted that the Founders have, at all material times, held the great majority of shares in Holdings and in turn in TCG, and effectively a controlling interest in it.

66. Mr Conway's background was in banking and corporate finance. He had been Chief Financial Officer and Treasurer of MCI Communications Corp, before the founding of Carlyle, and had previously worked for ten years for First National Bank of Chicago, focusing on corporate finance, corporate lending and general management. Mr Conway was and is "a" managing director and officer of TCG. In American corporate governance terminology the term "managing director" denotes a level of responsibility rather than a post with specific responsibilities, as it would in the UK or Guernsey.

67. At the material time, Mr Conway held the role of TCG's Chief Investment Officer. He also was, and remains, the Executive Managing Director of CIM. He has, throughout Carlyle's existence, been primarily responsible for the oversight of the investment strategies and practices of all the range of investments undertaken by Carlyle except those concerned with real estate, infrastructure and energies; these latter are supervised by Mr D'Aniello. Mr Conway's fields of expertise and operation are buyouts, venture and growth capital, and "leveraged finance" ie corporate debt. Mr Rubenstein's areas of responsibility and leadership are those of investor relations and fund raising.

68. In 2006, the Carlyle Group employed 418 investment professionals across 18 countries. Its core business was private equity investing, or "buyouts". These involved raising money from investors to purchase a controlling interest in identified target companies (ie, those identified as potentially undervalued) which Carlyle would then take in hand and rebrand or restructure, and improve in order eventually to sell the ownership onwards at a profit. Those projects were thus finite in the sense that, ultimately, there would be an exit through which investors' funds were turned back into cash and returned. Carlyle undertook other forms of business as well, however, and by 2006, had four main investment sectors, namely buyouts, venture and growth capital investments, real estate investments, and leveraged finance (the purchase of corporate debt of various species, with borrowed funds).

69. Particular investment funds, or vehicles, were promoted by each sector, the most usual structure being that of a private limited partnership between a Carlyle affiliated entity and a cohort of outside investors. The funds' affairs would actually be administered by CIM, under a management agreement, under which CIM would provide both investment advice and management and administrative functions, by supplying the services of appropriately experienced personnel, as well as "back office" administration and transactional services. This would be done in whatever way was appropriate for the particular enterprise. CIM itself had

no employees, as already noted, and the personnel performing the services were formally employed by CGEC, the Group's employer company. CIM would, of course, earn fees for its services, usually comprising a basic recurring fee, with an additional performance or "incentive" fee earned upon the achievement of results above a specified benchmark or standard.

70. Carlyle's investment projects are relatively risky. They typically require the commitment of large amounts of capital for long periods of time. Whilst the ultimate profit may be considerable, and is obviously hoped to be so, there is no guarantee of profit and indeed there is the real possibility that the investment may be entirely lost. For that reason, Carlyle investors are – and I understand that, under US securities law, they are required to be – "Qualified Investors". This means that they are not only wealthy, but also within the class described as "sophisticated". This is a shorthand term for investors who not only have sufficient net worth to be able to afford both to tie up capital and undertake significant risks with it, but also who are sufficiently experienced and knowledgeable in financial matters to appreciate the risks which they are running. Such investors therefore include funds and institutions which are large and established, with knowledgeable personnel and appropriate objects, so as to be able to run the potential risks of the particular projects because they deem it worth doing so for the potentially greater return which can be made. They also include high net worth, or ultra-high net worth, individuals who are similarly knowledgeable and financially well-placed.

Plans for diversification into mortgage backed securities

71. In 2005, the successful Carlyle Group was expanding, and, (I think as always) was looking to diversify its activities as part of such expansion. Carlyle executives conceived the idea of moving into a new kind of investment fund, a speciality finance vehicle, with different objectives from those of the more usual Carlyle vehicles, namely to be a "yield vehicle" whose appeal to investors would be that of both attractively high but steady returns and potential liquidity at the same time. I am told that the idea was borne of noting that a competitor of Carlyle, KKR Financial Corporation, had promoted such an entity. It was known as KFN. This vehicle, which had had moderate success, used the Real Estate Investment Trust ("**REIT**") model. Carlyle wanted to be able to offer investors something comparable, but better. Investigations as to a possible model had started in 2005, but were not pursued with full vigour until the following year.

72. The idea was to be able to offer investors both the ability to invest smaller amounts of money than were typically required by other Carlyle investments, and a more liquid investment. The aim was thus not only to produce a high (when compared with other sources of regular and steady income) return, but also to enable investors to trade easily in and out of the investment as and if they chose, since it would be publicly listed. To make the new investment vehicle appealing, however, the dividend returns offered had to be sufficiently attractive. The dividend level targeted was described as "double digit". This is an aspiration which appears remarkable today, but was conceived, it must be remembered, in the heady financial days of 2006 when the Federal Reserve Prime Interest Rate was 8.25% and the US Treasury Federal Funds rate - the solid and basic benchmark "risk free" rate for comparing US investments - was 5.25%. To be attractive as compared to risk free investments, the projected dividend would have to be competitive in this context, a view which was relayed to the promoters of

CCC by the investment banks who had been selected as likely placement agents and underwriters.

73. The business model for the new venture was intended to be distinctive from anything currently in the market, so as to provide a selling point. It was to achieve its objectives by investing in a combination of high quality fixed income assets, and riskier, but therefore higher earning, leveraged finance and credit assets (ie debt), thereby providing a diversified portfolio, constructed to produce the appealing projected dividend return.

74. (I pause to record here that, in this action, the term "fixed income" seems to me to have been used in two different senses, the first being the strictly correct one of a security yielding income of a constant fixed amount, but also sometimes and second, as a reference to a security yielding an income which is "fixed" in a formulaic sense, such as a fixed relationship to LIBOR, even though the amount produced may thus be variable. The contrast when used in this second sense is with securities which yield an intrinsically variable income, such as a dividend. The sense in which the term "fixed income" is being used in any instance, insofar as it is of importance, is generally apparent from the context.)

75. It was envisaged that the latter class of investment (the leveraged finance assets) would include investing in other Carlyle funds - yet a further benefit for the Carlyle Group itself. In addition, and as usual, CIM would manage the investments and thus earn fees. It was hoped that such a vehicle would not only be an attractive investment in itself, but would also provide an attractive convenient temporary investment in which Carlyle investors could hold funds pending a capital call or investment in other Carlyle funds, thus indirectly benefiting Carlyle's wider business as well. The project had potentially advantageous features all round.

76. The second class of assets mentioned above, ie the more risky, but therefore higher earning, leveraged finance assets, was typically corporate debt of differing kinds - syndicated bank loans, corporate debt below investment grade, "mezzanine" debt and distressed debt. This was a class of assets that was already the subject of specific investment funds, with various profiles and objectives, managed by Carlyle. The new entity could therefore make such investments by participating in these other Carlyle investment products This asset class carries with it the risk of default by the corporate entity ("credit risk"). The degree of that risk, and thus the value of the debt asset, is therefore influenced by the credit rating of the paying entity in question. A lower credit rating would imply a higher risk of default, but the return would therefore be relatively greater. Because the benefit of owning the debt would not be so attractive in all respects, it would not be so valuable and its price would be relatively lower.

77. This trade-off illustrates a point which has been made repeatedly in the course of this case. It is that in the investment world, risk and return are correlated. An investor expects a greater return for a more risky investment and accepts a lower return for a safer, or high quality, one. The concomitance and correlation of risk and return, and the recognition by all players in the market that to obtain a high return necessarily means taking greater risk, is a point in this case which can scarcely be over-emphasised. I was struck with the extent to which risk appeared as a factor which almost all witnesses, both factual and expert, were conscious of and had regard to. Indeed, at times, when discussing the market, the financial economics experts were so focused on risk that they expressed themselves in a way which made it sound as though investors were investing in risk rather than the actual assets.

78. The second class of assets, the high quality fixed income assets, which were to be invested in by CCC became, as the proposed business model was refined, Agency AAA Residential Mortgage Backed Securities or "**Agency RMBS**". The "Agency" tag denotes that these securities were issued by one of the three giant American "Agencies" or quasi-governmental issuers of securitised mortgage products, colloquially known as Fannie Mae, Freddie Mac and Ginnie Mae (although this case is concerned only with securities issued by the first two). "MBS" is an acronym for mortgage backed securities, and "RMBS" is thus the generic term for residential mortgage backed securities. However, such securities are also issued by institutions or brokers other than the Agencies. The "AAA" tag denotes quality - it is the assessed rating of the risk involved - although it is in fact superfluous in the long title given above. This is because Fannie and Freddie only issued AAA rated securities in any event. Other institutions could issue RMBS of lower credit ratings.

79. During this case the term "RMBS" alone has often been used by experts and witnesses as shorthand to refer to the "Agency RMBS" issued by Fannie and Freddie, and where I use the label "RMBS", I will be referring to such securities. Where it is necessary to make it clear that I am referring to other species of RMBS, I will do so expressly.

80. The following account of both the structuring of RMBS and the mechanics of CCC's financing operations is doubtless oversimplified in technical terms, but will hopefully provide a sufficiently accurate background for understanding the issues in this case.

RMBS

81. In essence, RMBS are securities based on, or derived from, a parcel, or pool, of the debts due on mortgages granted to homebuyers or homeowners by lenders. The mortgage debts are collected together, either by the original lender, or by an assignee from original lenders, and sold on, as explained below. This enables the original mortgagee to obtain capital funds relatively quickly, which it can then use once again, to lend on to home-buyers or owners, thus helping to keep the mortgage market active and benefit the economy.

82. The pool of mortgage debts can, if desired, be assembled so as to concentrate particular attributes, such as geographical area, sizes of loan, credit ratings of individual borrowers, etc, which investors may find attractive. The selected pool of mortgages is then "securitised", which means converted into investment products by the institutions, or brokers, in that area of business which now hold them. These investment products are then offered and sold to investors. They can be, and usually are, themselves structured so as to have different attributes, as I describe later.

83. At the material time, and historically, the standard US residential mortgage (this is a "bond" in Guernsey law, but I shall refer to them as "mortgages" to distinguish them from bonds of other kinds) was a repayment mortgage for a period of 30 years at a fixed interest rate. However, and unlike in Guernsey, it is relatively easy and inexpensive in the US to make early repayment of principal, without penalty. Consequently, it is quite common for homeowners to change their mortgage or mortgage provider, either by moving, or simply by cashing in their mortgage and refinancing with a replacement mortgage. They have to do so if they move house, as mortgages are not transferable, and they will be likely to do so if better (ie lower) interest rates come on offer. The <u>average</u> time for holding a residential mortgage in the US market in 2006 was, I understand, around five years only.

84. As to the mortgage debts themselves, the payments being made by the homeowners are then made to the securitisation fund which has taken over the mortgages as part of the pooling process mentioned above. There is firstly the interest element within each monthly instalment payment. Then there are the small but gradually increasing tranches of capital repaid within each such instalment (called "amortisations"). In addition there are the larger, irregular, early repayment sums ("prepayments", which can be either total or partial) as already noted. The right to receive all these payments can be divided and packaged in various ways and on different terms, which have been devised by those involved in the securities and derivatives market over many years. They will be theoretically based on the 30 year duration of the underlying mortgages, although in practice they will almost certainly not last that long, but will eventually be renegotiated by the then current holder of the investment.

85. At their simplest, such packages merely involve pooling the mortgage debts into one big fund, with the purchasing investors receiving a *pro rata* share in the total pool of net income and, eventually and as it arises, capital. These are known as "pass through" MBS. They are subject to credit risk (ie the risk of individual mortgagors defaulting on their repayments) but that risk is spread amongst all investors in the pool and therefore diluted.

86. However, the mortgages can be packaged in more elaborate ways, sometimes referred to as "products". The package can be notionally sliced in layers of different priorities, such that lower tranches take the risk of default first, before higher, more protected, tranches. That way, the credit risk is distributed differently, in a hierarchy, between the securities created in the different layers, with securities at the lower levels being more vulnerable to credit risk than those in the higher ones. Their credit ratings vary accordingly. Their prices will also vary, because the more risky investments are likely to be less attractive from a credit risk perspective and therefore, all other things being equal, will fetch lower prices. Their yield, or return on capital, though, will be correspondingly higher, illustrating the basic market principle mentioned above, that investors expect a greater return from a more risky investment. The balance of risk to return is one which particular investors will select to suit their own situation, or appetite for risk.

87. There are other ways in which the derivative securities can be different. They may, for example, have a variety of terms as to the interest rate return payable or guaranteed. For example, this can be a fixed or floating rate, and if the latter, it can also be subject to either a floor, or a cap. These features will again of course, affect their attractiveness, or perceived value, and hence their price in the market.

88. Another consideration is the strength of the covenant of the issuing institution behind the offered terms. In such a case the credit risk then ceases to be primarily that associated with the underlying mortgage debts and the mortgagors (albeit *en masse* rather than individually,) and becomes rather that of the issuing entity. In the case of Agency RMBS, the covenant strength of the issuer was regarded as the equivalent of that of the US government itself. In effect, such a security was credit risk free. This is why it was regardes as a high quality asset.

89. All these factors affect the desirability, and therefore the market value of the securities on offer, and this is the case with the species of RMBS with which CCC was concerned in this case, namely "Agency AAA capped floaters". First, (as already mentioned) they were issued by Fannie Mae or Freddie Mac, as the case might be, with the implicit guarantee of the US government behind those Agencies. (Agency RMBS issued by Fannie or Freddie are known as

"conventionals" to indicate this level of guarantee and to distinguish them from those issued by Ginnie Mae, which has the direct guarantee of the US government, and which are known as "governments".) They were regarded, therefore, as having no credit risk. Second, they were warranted to have AAA rating. The Agencies only accepted AAA rated mortgages, ie those where the mortgagors were "prime" and not "sub-prime", and also within certain bounds such as size. Third, the rate of interest payment on those securities (conveniently called the "coupon" although this may not be strictly accurate) was a floating rate, pegged to and slightly above that of one month LIBOR (London Interbank Offered Rate, which is the benchmark interest rate for short term investment financing), but subject to a specified maximum, the "cap".

90. The level of the cap can vary between bonds. In CCC's case, the bonds which it purchased – there were ultimately a total of about 165 purchased tranches of about 150 individual bonds, and to a total value of about $23Bn – were variously capped at 6.5%, 6.75% and 7%. The higher the cap, the more attractive and valuable the security is, potentially, because its return is less vulnerable to "interest rate risk", ie the risk that LIBOR rates might rise to a point where the cap takes actual effect. The degree of such risk itself will be perceived to vary, depending on the current levels of market interest rates.

91. I do not think it is in dispute, but I am satisfied on the evidence, that these particular RMBS therefore provided what was seen in the financial markets as being a very safe, secure and steady investment yield. Because the return had these characteristics, and because the return would (subject to the cap not becoming effective) represent a constantly beneficial relative rate of return on outlay comparable with totally risk free rates, RMBS tended to trade, in capital terms, at or very close to their par value.

92. Fannie and Freddie also issued other forms of security. The most relevant comparison for present purposes is straightforward debentures. These latter were not only free of credit risk, but were free of interest rate risk as well, because the coupon was fixed. However, by that same token, they would provide a lower yield, reflecting the absence of such risks, because they would trade at a higher price. An investor was absolutely certain of the return he or she would receive, but the price of that certainty was that the return would be more modest than for other, less certain investments.

Leverage

93. I note at this point that "leverage" in the context of this case and used as a noun, means either "borrowings" or "influence" or "exploitation". It can also be used as a verb with similar meanings. In this section it is used in the sense of "borrowings".

94. Whilst the income from Agency AAA capped floater RMBS was thus secure and steady and reflected current interest rates, it was in itself nothing like the double digit return on capital which Carlyle considered that the new company needed to offer to make it an attractive income yield vehicle for target investors. The income rate was normally only a few basis points above LIBOR, a basis point (or "bp") being 1/100 of 1%, ie .01%. The way to deal with this, and increase the actual return to the new company so as to enable it to make a sufficiently high return itself to pay the targeted dividend to shareholders was therefore to borrow money, or to "leverage" the purchase of the RMBS.

95. Borrowing money to make such purchases would enable a greater volume to be purchased for the same outlay of CCC's own funds. Provided the costs of any borrowing were lower than the return on the assets purchased with the borrowed money, the new company would make a profit equal to the net difference. The more borrowed money used, the greater the total amount earned which, after paying the costs of the funding, would remain in the hands of the new company as effective profit upon its own small amount of capital invested. However, just as such increased borrowing, or "leverage", will magnify profit being earned, it will also magnify any losses relative to invested capital, if these are suffered.

96. A high degree of leverage is thus an additional source of risk in itself. An appropriate business model will therefore take account of this risk along with all other perceived risks and build in precautions to mitigate or cope with the effects of any risk, or volatility, in the various factors incorporated into the model. What these precautions are will depend on the perceived likelihood of the risk materialising, the gravity of the consequences if it does, and the cost implications or other disadvantages of any precautions which might be taken to guard against such risk.

Repo financing

97. The natural source of borrowings in the financial markets in which the new company would be operating was "repurchase financing" or "repo". This is a somewhat specialist form of funding, and different from the simple bank loan, secured or otherwise, which outsiders first think of when imagining a source of borrowings for a business. I understand that the likely terms of any simple loan capital transaction would not have been viable as a funding source for a project such as that of the new company, but at any rate, using repo financing for the venture appears to have been regarded as normal and natural by those involved at the time. Indeed (and notably, given the widely ranging complaints which are made in this action) there has been no criticism of CCC's assuming the use of this mode of financing as the basis for its original business model. However, this was not a mode of financing in which the then current teams at Carlyle were experienced.

98. Repo finance is a huge financing industry in the United States, described by various participants and experts as being both "wide and deep". In money terms the American repo market is estimated to have been some $10 Trn in mid 2007, the time with which I am concerned, and this would have been more than twice the value of US Treasury securities then outstanding. I think it is common ground, but in any event the evidence satisfies me, that at that time repo financing was a standard and accepted method of financing borrowings for the purchase of securities. The repo finance market for such activity had been established for many, many years.

99. Funding the purchase and holding of RMBS by this mechanism was attractive for the new company because the interest rates used in repo finance borrowing transactions were also fixed by reference to LIBOR. Although fixed by an individual lender, the rates would tend to be very similar because the lenders were all in competition for business. They would also broadly fluctuate with, and be very slightly below, current LIBOR. It was thus – as it obviously needed to be to make any economic sense – a lower rate than the similarly floating rate being earned on the RMBS which the new company was expected to acquire, thereby providing the necessary profit, and going a long way towards eliminating funding interest rate risk – the risk

of an adverse mismatch between the rate payable on borrowed finance and the rate being earned on the asset so financed.

100. Although such financing is in substance a loan, and is even treated as such in the books of the borrowing company, it is in fact put into effect as a sale and repurchase, so as to provide the lending bank (the purchaser) with security for the repayment of its loan in the shape of title to the assets themselves. Such security is particularly effective, because the lender, with title to the assets, can enforce his security immediately his right to do so crystallises, and is not subject to the risks of delay in, nor the trouble of having to implement, an enforcement process.

101. Repo transactions are typically conducted on the terms of a Master Repurchase Agreement ("**MRA**") between the borrowing entity and the lending bank, which establishes the framework of the relationship between them. The MRA lays down the general terms and conditions under which the repo financing will operate as and when a specific transaction is entered into. The terms of the specific transaction will then be agreed between the repo dealer and the borrower at the time of the transaction, and will fix the parameters for that particular transaction, such as (obviously) the quantity being sold and the loan being made, the interest rate, and the transaction's duration, all within the framework of the MRA terms.

102. Repo transactions work like this. The assets (here the RMBS) are "sold", by their owner (here CCC) to the lending bank at a price which corresponds to their market value at the time, less a percentage, known as the "haircut". Less colloquially, this is the borrowing margin or another way of looking at the loan-to-value ratio. At the same time, the owner/borrower (CCC) undertakes to repurchase the assets after a fixed time period, at a price which corresponds to the sum being loaned, plus interest on that sum. The fixed period may be anything – as little as overnight (as it quite frequently would be between banks) or as long as a year, or even more. However, the commonplace period, and that generally operating in this case, was 30 days.

103. If the borrower fails to repurchase the assets, the lending bank, as the owner of the assets, is in a position to sell them immediately (or possibly after a period of grace, depending on the precise terms of the transaction), to recover its outlay. The "haircut" therefore provides the lending bank with some protection, in the event of a default by the borrower, against its selling costs and the possibility that the market price of the assets has fallen since the start of the repo period, ie the volatility of the asset price. The evidence consistently suggested that it was and is viewed principally as the latter. The very structuring of the loan transaction as a sale and repurchase also enables the lender to side-step any problems caused by the bankruptcy of the borrower, at least to the extent of the value of the assets which, legally, it owns.

104. However, the banks do not confine themselves to reliance on the haircut for protection. The MRA terms will also entitle the lending banks to call for margin deposits from the borrower during the period of the repo transaction, if and as the market value of the assets does fall. The margin deposit required will be calculated to bring the value of the security held by the repo lender back to the agreed loan to value ratio, taking into account the now reduced value of the assets. This process can and does operate even on a daily basis, although the borrower is typically given a day or so after a "margin call" to satisfy that call. It is also, though, a two way street, and if asset value rises, the borrower is entitled to call for margin deposits to be repaid.

105. Who, then, determines the market value of the securities? There are pricing agencies whose day-to-day published assessments can be used, and at any rate up until events in 2007 their

published pricings were indeed generally regarded as being the standard. These were principally one known in the trade as "IDP" or "FT" (there had been a change of name), but I understand that there was also a Reuters and a Bloomberg service.

106. Up to the times with which I am concerned, the repo finance banks would, as a matter of course, use pricing agency figures for the value of the securities upon which they were lending. However, typical MRAs – there was no one standard version - would be framed in terms which often, at least ultimately, entitled the lending bank itself to decide what market value it would attribute to the assets in question, which it would then use to set the financial parameters of the repo transactions, and margin calls. Whilst this may not be of great significance on an initial repo transaction – the borrower can always go elsewhere if not satisfied with the terms on offer - it assumes greater significance during the term of the transaction, because the borrower's options are more limited. Unless it can negotiate its way out, it will have either to pay the margin call in question or default. There would be no practical route to resolving any dispute as to the reasonableness of the bank's chosen pricing - even assuming that there were some term, express or implied, in the MRA requiring the repo bank to act "reasonably" or "in good faith" in its pricing - at least during the term of a repo transaction. This is partly because "reasonableness" is an elastic concept, depending on a value judgment of particular circumstances as well as the point of view of the propounder, but more importantly, because the timescales which operate in these transactions are so short that there would simply be no prospect of obtaining the determination of any such dispute within an effective timescale.

107. Because the duration of the RMBS bonds could in theory be up to as much as 30 years before final redemption, and the repo financing was for a mere 30 days, repo transactions were repeat business. They would come up for renewal, or "roll", at the 30 day intervals. The roll was timed to coincide with the monthly payments made by Fannie and Freddie, respectively, (this making reckoning up the financial account very much easier) with the former being on the 25th of the month and the latter on the 15th, or, in each case, the nearest following working day.

108. Repo transactions were not bound to be renewed. Within the general principles of the MRA the precise terms were up for renegotiation at each roll. The precise terms for the next roll would be discussed between bank and borrower in advance so that the actual transactions would roll smoothly on the relevant day. The evidence, however, satisfies me that previously to about mid-2007, once counterparties had agreed the terms for a repo transaction, the borrower could generally expect that renewals would be on the same material terms as previously, particularly as regards the agreed level of haircut.

109. A borrower such as CCC would expect to agree the availability of repo "lines" with several potential lending banks at large amounts, but this was in fact agreement only in principle. Such a line is described as a "soft" line, as there is no contractual obligation to provide it and the actual terms still have to be agreed in relation to each transaction at the relevant roll, although it may come to be implicitly understood between parties that the previous terms will be re-offered to a greater or lesser degree. However I was told that as a matter of preserving reputation and relationships, it would be unusual for a bank to fail to offer the full amount of a promised repo facility if called upon, and, indeed, the bank has something of an incentive to provide the finance, because it wishes to put its money to profitable use. So the system tended to work. However, the point - and it is a point on which the Plaintiffs lay stress - is that a "soft" line was only indicative and not committed. A lending bank could, of course,

discourage the use of its lines by insisting on less advantageous terms attaching to the next roll, and thus inducing the borrower to turn to another repo financier prepared to offer better terms.

110. A "hard" or committed line of repo financing could be granted, but would be more expensive for the borrower, because absolute commitment would come at the price of some form of commitment fee. Similarly, longer term repo financing transactions, ie for terms longer than 30 days, would generally come on less advantageous terms (to the borrower) than the lender banks were prepared to give for shorter term loans. This is, of course, because the lender would be committing itself to terms which it could not re-set after 30 days, as in the standard transaction, but would have to honour those terms for the longer duration of the agreement, whatever changes in market conditions had intervened. It would therefore require more advantageous terms to protect its position. I am told that, typically, the difference in terms would show as the lending bank requiring a higher "haircut" rather than, say, a higher rate of interest. In other words, the bank would be willing to lend only a smaller percentage of the apparent market value of the assets. Obviously this reflects the risk of the greater amount of uncertainty inherent in a longer term commitment.

111. Transactions for longer than the standard 30 day transaction are referred to as "long term repo" and also sometimes as "structured repo". "Structured repo" can also, and perhaps more accurately, refer to any repo transaction with features more complex than the straightforward ("vanilla") elements described above, eg with other embedded features such as options.

112. That, then, describes the broad mechanics of repo transactions and the repo market with which CCC would be concerned, but in the necessity to concentrate on the facts relating to CCC's position and business, it must not be forgotten that this is part of a vast network of interacting commercial arrangements which form the whole financial market. The banks which provide repo finance (and in their jargon, the transaction with a borrower such as CCC is a "reverse repo") do not simply hold the securities which are their security in a vault like a pawn-broker. They use them, themselves, to raise finance from other parties. They can do this within the timescale of the 30 day transaction with CCC, for example, by borrowing on overnight repo, which is very common.

113. An apparent quirk of the situation, it also seems to me, is that the income (interest and capital amortisations and prepayments) from CCC's RMBS securities remained payable and credited to CCC, despite the sale and purchase nature of the transaction, and despite whatever deals the repo lender might then be effecting for itself. This seems a somewhat bizarre treatment of the legal and beneficial title. However, this would no doubt be a matter dependent on the terms of the relevant repo or other agreement, and I was not required to look into the juridical analysis of a repo financing transaction in any depth.

114. The point of these observations here, though, is that it is always salutary for a court and advocates to remember that the subject matter of a case is not usually entirely isolated and self-contained in fact, nor usually and not unreasonably, would it have been occupying the entire waking attention of the protagonists at the time. It must therefore always be seen in context, and with an awareness of the possible effects of outside factors and circumstances.

The new company's intended business

115. Because the new company's business was to be centred on RMBS, even if Agency AAA RMBS, two considerations played an important part in its business model. Repo financing

was plainly potentially subject to volatility in the market price of the RMBS, because a fall in this could result in margin calls, which would have to be met, and met in short order - I think within 36 hours - from liquid resources. If they were not met then a default could be called by the lending bank, and after any appropriate remedial period (again, typically, a matter of days at most) the lending bank could forfeit the securities and realise them. A foreclosure would obviously cause reputational damage to the company on any basis, but, and particularly if prices were currently depressed or there were several simultaneous foreclosures, it could fatally undermine the business structure of the company. Certain safeguards were therefore put in place in the new company to protect against such eventualities.

116. First, it was intended, and this policy was implemented, that the new company which became CCC should have a diversified portfolio, including a suitable quantity of leveraged finance assets (as already described) as well as the quantity of high quality but very highly levered Agency RMBS assets. These leveraged finance assets were more risky than Agency RMBS in terms of credit or default risk, but, by the same token, produced a higher yield, and consequently would produce the required return per unit of CCC's own capital deployed with less leverage. These assets had also, historically, shown patterns of volatility which were uncorrelated with those of RMBS, a feature which would buffer and even out the effects of price volatility risk. Their inclusion in a reasonable quantity in the overall portfolio therefore gave CCC flexibility and protection, and relieved CCC of some "concentration risk".

117. Second, in order to cater for the uncertainties of fluctuating prices and margin calls, it was decided that CCC needed to have a "liquidity cushion" of immediately available cash or fully liquid assets which would be ring-fenced, preserved and available to cater for the effects of adverse market conditions in which margin calls might arise, by enabling these calls to be met without being forced to sell CCC's core investment assets at a possible undervalue. An attractive feature of RMBS, as will probably already have been deduced, is that, through amortisations and prepayments, they necessarily produce payment of their par value, in full, on maturity, which is, at the latest, by the end of their term, but probably very much earlier.

118. These various considerations eventually led to CCC's devising a business model with Investment Guidelines which provided, initially, that it should hold no more than 85% of its assets in the Agency RMBS upon which it was proposing to centre its "buy and hold" financial strategy (in the event I think it settled down with about 68% concentration), that it should seek to maintain a liquidity cushion equal to 20% of its issued capital, and that it should maintain a minimum borrowing capacity of 150% of its estimated funding requirements, ie that it should have that amount of lines of finance, albeit only soft lines, available to be called upon, thus providing enough "headroom" above its actual requirements to maintain the flexibility to shift suppliers if necessary. The constant and continual ability to obtain borrowing finance was central to CCC's sustainability, as there was an inherent mismatch in the maturity of its assets and its borrowings.

The formation of CCC

119. This account has jumped ahead of the story somewhat, however. As already mentioned above, the Carlyle plan to launch a new "public specialty finance" company as a permanent capital yield vehicle was resumed in 2005-6. Research had initially been carried out by Mr Mayrhofer, Carlyle's head of Private Equity Funding. With corporate credit assets being envisaged as a part of the investments, Mr Zupon was also involved. However, with the

intention having been determined to expand the investments into mortgage backed securities to a significant degree, and this not being within Mr Zupon's area of expertise, it was decided to recruit a suitable Chief Executive Officer to head up the new company venture, although working with Mr Zupon. A high level recruitment service was engaged by those who were progressing the project, including Mr Conway, to find a suitable candidate. Mr Stomber, the Third Defendant, was interviewed and selected.

120. His background was perceived as being eminently suitable. He had spent 28 years in Wall Street banking, having worked for eight years for Deutsche Bank, where he had risen to become Head of US Marketing for Derivatives and latterly Treasurer of the Americas Division, and where he had overseen funding and risk management for capital markets and banking activities, and gained considerable experience of repo financing, although with regard to the financing of US Treasuries rather than Agency RMBS. In this position he had seen the effects of the market shock of 1998, known as the "LTCM" (Long Term Capital Management) crisis, and caused by the default of certain Russian financial entities. In 1999 he had moved to become, Chief Financial Officer of Merrill Lynch. This was a "Treasury" function, with overall charge of the financial state of the bank itself. In this position he had been instrumental in Merrill's internal restructuring of their own financial model in the aftermath of the LTCM crisis, which had involved a scheme for increasing liquidity by holding highly rated Agency and government securities to provide a resource for use as collateral security and liquidity in difficult credit conditions. It also, I understand, made use of the repo market as its natural borrowing source. Subsequently, between 2004 and 2006, having "*lost the race*" to the very top position in Merrill Lynch, Mr Stomber had moved on to work for two years for Cerberus Capital Management. The various facets of his experience were thought to match him well with the experience and skill sets being sought for the CEO of "Newco".

121. The Plaintiffs have suggested that Mr Stomber in fact had no experience of financing the holding of Agency RMBS through leverage, as this was no part of any of the functions in his experience; the repo financing with Deutsche Bank had been of US Treasuries and the RMBS acquisitions with Merrill Lynch and Cerberus had used unleveraged funds. The Plaintiffs have not, however, made any claim or allegation that engaging or appointing Mr Stomber to the position of CEO for CCC was culpable or incompetent by anyone. This allegation therefore seems to me to add nothing to the appropriate rigour of the review of any decisions of Mr Stomber which are actually criticised or challenged in this case, as regards the requisite degree of skill and care to be expected of someone in his position. At most, it may provide a piece of evidence from which I could be invited to infer that Mr Stomber had some misguided preconceptions which could have explained those decisions, but since his actual decisions are apparent and there is no dispute (I think) about what they brought about in practice, it is the quality of those decisions in their own right which is the important point. I should add that I do not think that Mr Stomber accepted the basis for the Plaintiffs' criticisms.

122. Mr Stomber was brought in to take charge of a 15 person team which would be dedicated to running the affairs of "Newco" which was eventually to become CCC. He began work at Carlyle on 25th April 2006. As already noted, he was formally employed by CGEC, who paid his salary, but his services were seconded to CIM for the purposes of intra-group charging, and were dedicated entirely to CCC.

123. He was consulted about the employment of a suitable supporting team, and in turn he brought in two former colleagues to the new team, Mr Patrick Trozzo with extensive experience in risk

management, repos and derivatives, who had been a former dealer at Deutsche Bank, and Mr William (also Bill) Greenwood, a former trader in fixed income securities who had been involved in the structuring of Merrill Lynch's Agency portfolio, which Mr Stomber saw as a potential model for CCC. It was Mr Stomber's initial task, together with his team, to develop a suitable business model.

124. The direction of interest prior to Mr Stomber's arrival had been primarily to use a REIT structure, as used by KFN, and which operates with certain US tax advantages, although other models such as a Master Limited Partnership, were also considered. In the end, however, upon a comparison of the advantages and disadvantages in various different areas (structure, regulation, taxation, marketability, etc) a Guernsey company structure was chosen. A Guernsey company met the requirement that there should be no corporation tax levied on the entity itself, which would have caused a double charge to taxation, ie at both the corporate and the individual investor level. A positively attractive reason for choosing a Guernsey company was the lack of legal constraints on the permissible range of its investment portfolio compared to a REIT.

125. Another advantage, albeit this was shared with a REIT, was that a Guernsey company could operate under IFRS accounting rules rather than US GAAP. IFRS rules did not require unrealised losses on assets to be reflected in the company's annual accounts unless and until the relevant assets had to be regarded as truly "impaired" as against their cost, whereas US GAAP rules required unrealised losses to be treated as losses for profit and loss account purposes. By operating under the IFRS regime, the new company would not have to take price fluctuations in the underlying assets – particularly Agency RMBS – into its accounts as a matter of routine, and since it was intending to hold such assets for income rather than sell them on for profit, this was both convenient, avoiding the complexities of revaluing assets regularly in order to complete sets of accounts, and could be regarded as appropriate and justified, since CCC would not be actually suffering any such losses until it actually sold the assets.

126. Mr Stomber therefore proposed that CCC be structured as a Guernsey company, and that is what happened. CCC was incorporated, on 29th August 2006. It was named "Carlyle Capital Corporation Limited" - this name having been selected, even before the beginning of May 2006, - because it was thought that branding it with the well-known Carlyle name would be an advantage for attracting investors. In the event, this was a decision which the Founders no doubt came to regret, because the name tended to identify the company with the Carlyle Group as a whole in the immediate perception of the investing public, not differentiating that CCC was technically not even a subsidiary company.

CCC's structure

127. The actual incorporators of CCC were Mr Conway, as the sponsor representative. and Mr Loveridge, the Seventh Defendant. Mr Loveridge lived in Guernsey, and a Guernsey company is required to have a Resident Agent who is either a resident director of the company or a corporate service provider. It would also be required to comply with Guernsey financial regulation, and dealing with this often benefits from a local touch. Mr Loveridge was invited to become an independent director of CCC both for these purposes and because he was already known to Carlyle.

128. He had worked in trust management for over thirty years, initially with Ernst and Whinney, then Guernsey International Fund Managers and finally Butterfield Fund Managers. He had formed his own firm in 1996, eventually selling his interest to Mourant Guernsey Limited whom he therefore knew, and who were intended to take on company administration services for the new company. He had considerable experience as a Board Member of various funds and corporate investment vehicles promoted by major international investment groups based in Guernsey. He was known to Carlyle through having previously been engaged in such capacity for a number of Carlyle entities, including at least three particular active funds. However, the apparently large number of such directorships is misleadingly inflated by the fact that many of these were subsidiaries for individual projects, especially in relation to a group known as Terra Firma. Mr Loveridge was apparently suggested as a potential Guernsey based Board Member by someone in Carlyle's legal department.

129. As regards CCC's precise corporate structure, CCC's share capital was to comprise 7 Class "A" shareholders, with all the remaining, vast majority, of shares being Class "B" shares. The Class A shares had voting rights but no dividend rights, and the Class B shares would receive dividends but have no voting rights. The Class A shareholders were deliberately chosen by the Carlyle promoters for being affiliates (either employees or partners) of the Carlyle Group, but also for being non-resident US citizens and not green card holders. This obviously had implications for both taxation and accountancy with which I am not directly concerned. The aim was to prevent CCC being a US controlled entity and to keep TCG or Holdings from having to consolidate CCC's financial statements with its own.

130. Its effects with regard to control of CCC are controversial. The Plaintiffs assert that through this share structure, "Carlyle" controlled the A shares and therefore in practice (either on this score alone or in conjunction with other circumstances) controlled CCC. The Defendants have denied that any of the Defendants "controlled" the A shares; they plead that these were held by the A shareholders in their personal capacity. They deny generally that any Entity Defendant controlled CCC.

131. This is a matter I will have to examine more closely when I come to consider the significance of that contention in the context of the claims being made. For present purposes I record that there was no secrecy about the shareholding or the Board or the employment structures. They were openly described in some detail both in the PPMs and the OM issued in connection with CCC's development and its IPO. However, amongst senior Carlyle personnel it is quite clear that this share structure had the intended purpose of ensuring that Carlyle could ultimately be sure of a sympathetic Board in CCC, so as to protect CIM from being ousted from its management position, protect the fees which this generated, and protect the potential for CCC to be a source of investment funds for other Carlyle entities, whilst at the same time Class B shareholders would receive the returns they expected, delivered by CCC, and they would thus - hopefully - be content.

CCC's Board

132. Following CCC's incorporation on 29th August 2006, five more potential directors, after Mr Conway and Mr Loveridge, were approached and agreed to act and make up the full Board of CCC, although not formally appointed until the eventual first Board Meeting on 4th October 2006.

133. I have already mentioned Mr Stomber and Mr Conway. Mr Hance, who became CCC's Chairman, was already a senior Carlyle consultant – a position which he said he preferred to that of being an employee. He had started his career as an auditor with PricewaterhouseCoopers (**"PwC")** and subsequently moved to Bank of America where he rose to the roles of Vice Chairman, Executive Vice President and Chief Financial Officer. He had supervised the management of a $400Bn portfolio of Treasury and US government backed securities including Agency RMBS and thereby gained a working understanding of managing a leveraged portfolio of such assets. His wider responsibilities had included the oversight of Bank of America's Finance group, which had included treasury, accounting and internal control operations. He had attended Asset and Liability Committee meetings and received reports about the Bank's own entire portfolio. Upon retirement from Bank of America he had joined Carlyle in 2005, as a consultant, and was to become a global partner in 2007.

134. Mr Zupon's special experience, and the particular reason for his direct involvement with the new company project that was to be CCC, have already been mentioned. Previous to his employment with the Carlyle Group he had had a finance career of more than 20 years, starting in the Acquisition Finance Department of Canadian Imperial Bank and moving on, in 1993, to NationsBanc Markets to work in leveraged finance (the function of funding a company with below-investment-grade debt, usually so as to enable it to achieve a particular objective). After two years at Merrill Lynch in high yield bond underwriting, he had joined Carlyle in 1999, founding its Leveraged Finance Asset Group as already mentioned, becoming a global partner in 2001, and serving on Holdings' own Management Committee.

135. The remaining three directors were the "Independent" Directors of CCC. In fact, under CCC's original Articles of Association adopted on 29th August 2006, there was no requirement for specifically "independent" directors, and the number of directors was merely to be at least two. On 4th October 2006 , at the same time as the appointment of the five additional CCC directors, the Articles were amended by Special Resolution to introduce the concept of "Independent Directors" (ie "*independent of and not affiliated* [as defined] *with* [CIM]": see Article 1), to require that the number of directors be not less than two nor more than eleven (Article 88), to require that at all times (save when caused by death, resignation or removal) a majority of the Directors must be Independent Directors (Article 88), and to stipulate (by Article 117) that certain significant actions required not merely the voting approval of the Directors as previously laid down (under Article 109), but also the special approval of a majority of the Independent Directors. These provisions remained the same when the Articles of Association were further amended on 27th December 2006, but by new Articles of Association later adopted on 8th May 2007, the requirement that a majority of the actual Directors of CCC should <u>be</u> Independent Directors was dropped (New Article 107) and reintroduced as a requirement that a majority of all the Directors <u>voting</u> on any effective Board Resolution must be Independent Directors (New Article 126). The specific actions requiring an additional independent majority vote of the Independent Directors remained the same (New Article 134). These last were the Articles actually in force at the time of the matters which are the subject of this action. Nothing has been argued to turn on the historic changes which were made.

136. Mr Loveridge has already been mentioned. Mr Allardice was a retired banker, who then (ie in August 2006) held board positions on a small variety of companies. He had worked for 20 years at Morgan Stanley and subsequently at Deutsche Bank, where he had been a senior colleague of Mr Stomber, and whence he retired in 1999. He had been one of Mr Stomber's

referees, and Mr Stomber had subsequently suggested that he be considered for this appointment. It had then emerged that Mr Allardice was known to Mr D'Aniello from their naval service together, decades earlier. Mr Allardice was notable for his habit of sending emails all written in upper case, in the naval tradition, until he eventually ceased doing so because recipients felt they were being shouted at.

137. The final director, Mr Sarles, was also a retired commercial banker, having worked, somewhat unusually in this day and age, for the same entity for in effect all of his professional life. This was FleetBoston Financial, a major regional US bank, and its predecessors, where he spent 37 years, followed by one year as Vice Chairman of Bank of America when the latter acquired the former in 2004. As FleetBoston's Chief Administration Officer he had been responsible for administrative functions, corporate strategy, risk management, technology and operations, treasury services and mergers and acquisitions, and latterly was responsible for its wholesale banking business. He was known to, and proposed by, Mr Hance, having worked with him during their overlapping tenure at Bank of America. He had retired the previous year.

138. Thus, with a view to the independence structure being introduced, Messrs Loveridge, Allardice and Sarles as the required "Independent Directors" were by design not employed by, nor partners, nor consultants with Carlyle entities at all, although they will no doubt have received fees for their appointment with CCC. I am not certain that the fees granted to the Independent Directors are in evidence, except that I believe that Mr Loveridge's annual fee, at least, was to be $50,000; the Plaintiffs did not raise this point nor cross examine on it.

139. Together, the Independent Directors would in fact be a majority of the voting Board, and in addition would have separate power, acting by a majority, to give or withhold approval to decisions relating to key aspects of CCC's business guidelines and structure. They were responsible for making certain decisions and approving certain types of actions, including changes to the policies or procedures governing CCC's investments, related-party transactions, employee compensation, the adoption of equity incentive plans, and any material changes to CCC's investment strategy or capital allocation guidelines.

140. Thus, CCC's Board comprised seven directors with an overlapping mixture of backgrounds and former functions. The two who were directly involved in the management of CCC's business, Mr Stomber, (the CEO and the recruit with perceived extensive experience relevant to the intended core business of CCC) and Mr Zupon, (the incumbent Carlyle executive with specialist skill in the other significant sector of CCC's business) were non-voting, reporting and advisory directors, although with their own particular executive functions on behalf of CCC, Mr Stomber in particular. Of the remaining five, voting directors, two only, (Mr Conway and Mr Hance) had an interest in the Carlyle Group. Mr Conway, obviously a substantial part owner of the Carlyle group as a Founder, brought his knowledge, oversight and experience as the chief investment adviser and strategist in the Carlyle Group to the Board, as well as his contacts. Mr Hance brought the perspective of a senior Carlyle Adviser for several years, coupled with his broader external experience and in particular his period as Chief Financial Officer of Bank of America.

141. If appropriate, the three Independent Directors could, in theory control the Board, although it naturally appears unlikely, as a matter of pragmatism and reality, that a conflict of such dimensions would ever develop.

142. I note here that the Plaintiffs dispute that the Independent Directors were truly independent at all, citing their previous acquaintance with Mr Stomber and Mr D'Aniello (as to Mr Allardice), with Mr Hance (as to Mr Sarles) and Mr Loveridge's position as Board Member on other Guernsey registered Carlyle affiliates. At the time of their proposal for appointment, the requirements for "independence" were considered by Carlyle's legal department, and it was concluded that each of them qualified as "independent" under the guidance as to that attribute applied by Nasdaq and New York Stock Exchange rules. I am perfectly satisfied that all three of these directors, including Mr Loveridge, were appropriately "independent" within the meaning and the obvious objectives of CCC's Articles of Association. Indeed I regard the pleading of Mr Allardice's historic and coincidental naval acquaintance with Mr D'Aniello as being trivial to the point of absurdity. It is in fact the kind of point, the inclusion of which makes one look more critically at the merits of the maker's other points. However, in the end, that is all irrelevant. What is at issue in this action is not whether these gentlemen fitted particular criteria or qualifications for "independence" as a matter of form, but whether they in fact fulfilled their duties as directors of CCC. Those duties fell upon them, whether or not it would be correct to call them "independent".

143. All of those who came to serve as directors of CCC were acquainted with the duties of a director of a Guernsey company under Guernsey law through a memorandum prepared for that purpose by Ms Joanne Cosiol, a legal counsel with the Carlyle Group. She had only recently, in April 2006, been recruited to the Carlyle Group's Legal and Compliance Department, having previously worked in private practice for five years after completing her legal degree and qualifications. She was given the responsibility of dealing with legal, regulatory and administrative requirements and formalities for CCC, reporting to Mr Jeffrey Ferguson, a Managing Director and Chief Legal Counsel to the Carlyle Group. She became the natural first port of call for legal advice for the directors or senior officers of CCC in the United States. Recognition of her functions saw her given the title of CCC's "General Secretary". However, whilst she appears on occasions to have carried out functions which are the function of a Guernsey company secretary, I am satisfied that her title was a label of convenience only, and was not intended to (and did not) appoint her to any particular office within CCC, as a matter of Guernsey corporate law.

Management of CCC's business

144. The Board was not responsible for carrying out the day-to-day management of CCC's affairs. Instead, CCC was externally managed by CIM pursuant to the IMA already mentioned, formally entered into between CCC (acting by Mr Loveridge and Mr Conway) and CIM on 20th September 2006, but which had plainly been drafted in advance of that. One knows this because its effect was capable of being referred to in an initial confidential PPM issued on 11th September 2006 to which I refer below. The IMA was ratified by CCC's Board at its first meeting on 4 October 2006.

145. The IMA is "*governed by and construed according to the laws of Delaware without giving effect to the choice of law principles thereof*" (Clause 9). It is thus roundly and firmly a Delaware Law document.

146. CIM was to have the obligation and authority to invest CCC's assets in accordance with CCC's investment objectives, policies and restrictions (as set out in the Preliminary PPM dated 11th September 2006, mentioned above and described later) and to carry out certain

administrative functions for CCC (Cl. 1 and 2(a)). The IMA gave CIM broad discretionary power to manage CCC's day-to-day affairs and operations, including selecting and purchasing assets, obtaining finance, and risk management activities. CIM was also charged with the task of implementing the Investment Guidelines adopted by the Board and providing advice and recommendations to the Board. In return, CIM's fees were to comprise (i) a flat rate annual Management Fee equal to 1.75% of CCC's current equity (as defined), calculated and paid quarterly, and (ii) a variable Incentive Fee based on a formula (the details of which do not matter) related to earnings achieved per quarter per share (Cl. 5). I have been told that this fee structure and rates were typical of offshore fund management agreements at the time, and I did not understand the Plaintiffs to contest this, even though they ultimately claim, at least, the return of the fees actually paid.

147. The IMA contains an indemnity from CCC to CIM and its personnel in respect of any losses, claims, expenses (etc) against them, excluding those arising from CIM's own wilful misfeasance, bad faith, gross negligence (as recognised by Delaware law) or recklessness (see Cl 6). It also contains an exoneration clause, excusing CIM from any liability to CCC in respect of any act done in performance of its duties except where the relevant act amounts to wilful misconduct or gross negligence (as recognised by Delaware law) (Cl 2(b)). The agreement was terminable on 180 days' prior written notice by CIM or the passing of specified resolutions by CCC and independently by its Independent Directors (Cl. 7).

148. In order to carry out its responsibilities, CIM had a team of personnel dedicated primarily or solely to CCC's affairs, and which came to be referred to as "Management". As mentioned, Mr Stomber led this team, which included Mr. Greenwood (Chief Dealer), Mr. Trozzo (Treasurer and Chief Risk Officer), Mr. Randolph Green (CFO), Mr. Vincent Rella (Chief Accounting Officer), a Ms. Fox (Chief Operating Officer, who otherwise plays no visible part in the case), Mr. Dean Melchior (also Risk Management) and Mr. Jason Ng (Trading), who was a junior. There were others who had responsibility for CCC's accounting and back-office operations.

149. CIM would also provide investment management services to CCC in respect of the leveraged finance elements of its portfolio through the Carlyle U.S. Leveraged Finance Group, supervised by Mr. Zupon. This managed about a dozen funds and entities for Carlyle, specialising in bank loans and other corporate credit debt instruments, and this was an area, therefore, with which the Carlyle Group was familiar.

150. CCC was formed with a corporate subsidiary (known as Carlyle Capital Investment Limited ("**CCIL**"), which was to hold title to a portfolio of corporate credit assets, primarily bank loan securities, for CCC. This separate subsidiary structure had been employed by Carlyle previously. The management of this sector of CCC's portfolio was ultimately to be the subject of a Managed Account Agreement between CCC and CIM. CCC's Management had discretion to determine what amount of CCC's capital would be allocated to this account, but Mr. Zupon's separate team then had primary responsibility for the selection of its actual portfolio securities.

151. It is suggested by the Defendants that the contractual relationship with CIM established by the IMA gave CCC the benefit of access to Carlyle's extensive resources and personnel, which would allow it to keep its operating costs lower than if it had to build its own infrastructure and operating systems. I think this is true. Of course, though, it also benefitted the Carlyle Group

hugely in that CCC would be a source of fees earned by CIM, a source of investment in other Carlyle investment funds or products, and an indirect means of helping attract funds for other projects by providing an appealing liquid repository of funds for prospective investors, and keeping the Carlyle Group within their field of awareness.

CCC's administration

152. As regards other aspects of CCC's corporate governance and administration, it is convenient to mention these here, although not all were formed at the initial stages. An Investment Committee was formed by CIM for CCC's benefit, on 25th October 2006. This committee was intended to advise and supervise the CIM personnel handling CCC's affairs and to monitor the overall performance of CCC's portfolio. The committee comprised Messrs. Conway, Hance, Stomber and Zupon, and thus the four directors of CCC who were affiliated with Carlyle, but who also possessed the core investment expertise and experience from which CCC could usefully benefit. This committee did not hold formal meetings, although the Defendants say, and say that it is apparent from the documents, that its members were in frequent contact with one another regarding market conditions and CCC's investment strategies, and less was required of this committee than in the case of other Carlyle funds because CCC had its own Board. This was unusual for a Carlyle investment vehicle which was usually structured differently.

153. CCC also had an Asset and Liability Committee ("**ALCO**"), the membership of which was Messrs. Stomber, Trozzo, Greenwood and Melchior – in other words, the senior members of the "Management" team. However, Mr Stomber made it clear from the outset that all Board members were invited to attend ALCO meetings and to receive ALCO papers, so as to keep themselves fully informed. It is apparent from the papers that Board Members sometimes did so. This committee was active from the outset of CCC's existence, but from June 2007 (the time of CCC's IPO) it met twice monthly until CCC's collapse. Wherever possible, ALCO meetings were timed to take place before or after other formal meetings. The purpose of ALCO was to review market events and conditions that might impact on CCC, examine the performance of CCC's investments on a regular basis, review CCC's compliance with its Investment Guidelines, discuss various risk and performance metrics, and the management of CCC's liquidity cushion but it was principally a reporting committee.

154. CCC also had an Audit Committee, comprising the three Independent Directors. Mr Allardice was its Chairman. In the event, this committee only met formally (ie with Minutes) twice during the period with which I am concerned, although from at least February 2007 it appears to have conducted several informal meetings.

155. It is also to be noted - and it is indeed clear from the documentary evidence in the case - that apart from formally convened meetings, there was a considerable amount of email communication between members of the Board, frequently taking in all of them. Mr Stomber, in particular was a prolific writer of emails. I am also told, and I would accept since it would be natural, that, in addition, there were telephone conversations.

156. I am also told that there were face to face communications between many or most of the individual defendants. The extent of this is not so easy to gauge, however. Mr Stomber and the CCC "team" were based at Carlyle's New York Office on 42nd Street. I am not sure if that included Mr Zupon. Mr Conway was based in Carlyle's headquarter offices in Washington DC, although he used to travel a great deal. Mr Hance lived in North Carolina,

and obviously had to travel significantly to have face to face meetings. Mr Loveridge was in Guernsey, and went to New York, I think, only for formal Board Meetings. Whilst Mr Allardice lived in New York, and the papers do suggest, as he said himself, that he quite often went into CCC's offices, Mr Sarles lived in Boston and was therefore not around on an everyday basis. Whilst I understood that I was being told that the two US based independent directors were accustomed to attending CCC's offices and speaking to its management on a "regular basis", regularity would be of a different order depending on the length of journey required. The credibility, adequacy, worth and weight that can be accorded to any such face to face meetings outside formal Board meetings is a matter of major dispute between the Plaintiffs and the Defendants.

157. To complete the picture, CCC had a corporate administrator, Mourant Guernsey Limited, which was responsible for various compliance, filing, document retention, and regulatory requirements applying to CCC. The evidence suggests that they were not seen as covering themselves in glory, but none of this matters for the issues in this case.

158. In overview, the governance of CCC would seem, on the surface at any rate, to have been structured so as to provide a practical balance between an internal and an external perspective on its business affairs. The Defendants say that the overall arrangements were effective and, importantly, they were in any event such that CCC's own interests and the Carlyle Group's interests (meaning those of all the Entity Defendants) were aligned. Both were interested in CCC's business being a success; there was no conflict between them. The Plaintiffs say, in a nutshell, that the overall arrangements were so incestuous and cosy that CCC was in effect run for the Carlyle Group's overarching benefit and as a unit of Carlyle, without proper regard to the individual and independent interests of CCC (and, when they should have been, of CCC's creditors) and in fact, in a way which was ultimately inimical to those interests.

Launching the business

159. During the summer of 2006, Mr Stomber and Mr Zupon had worked on the business model for CCC, although Mr Stomber, who I am satisfied possessed energy, enthusiasm, and a strong determination to prove his worth, really took over. Varying asset allocations and mixes were considered during the process of refining the model. Although I heard no direct evidence on this, I infer from the expert evidence which I subsequently saw and received that this involved extensive computerised modelling of potential asset allocations for comparison, feeding in different combinations of assets and possible market trends or scenarios.

160. The devising of the CCC business model was done with consultation and feedback from the group of six underwriting banks - Citigroup, Bear Stearns, Goldman Sachs, JP Morgan, Lehman Brothers and Deutsche Bank - with which CCC would work in raising its capital. This would be initially by a private placement, with these banks acting as placement agents, so that they would be supporting the proposed model at least by association. The placement would be in stages. The business would become established by this means, and subsequently there was to be the IPO leading to CCC's becoming a public company by listing on the Euronext Exchange. It is not apparent why this particular exchange was selected but neither is it important.

The Preliminary Private Placement Memorandum

161. By 11th September 2006, CCC was in a position to, and did, issue a Preliminary Confidential PPM to lead the initial commitments from the investment banks. It actually started business operations on the following day, using funds borrowed from Carlyle, pending the receipt of the proceeds of the anticipated placement.

162. This PPM document set out CCC's then intentions with regard to a private placement of shares. It recorded that certain Carlyle affiliates had committed themselves to buy shares, and that there was to be an initial closing to the investment banks on 16th October 2006. The intention was to have two future closings to outside investors on 28th December 2006 and 4th January 2007 and an optional further closing on 15th February 2007. The proposed offer price was $20 per share with a minimum investment of $5Mn. These arrangements were a scheme to enable CCC to begin to build up its business, initially with borrowed funds to be repaid from the receipt of placement proceeds, and subsequently by calling down instalments of the placement proceeds. The precise detail again does not matter.

163. This preliminary PPM is a lengthy and detailed document, and it is also not in precisely identical terms to the eventual PPM which was issued in December, in solicitation of investments from investors outside the banks. This latter was, of course, updated with regard to events in the interim, but there were some other small changes of wording, although not, so far as I can see, any change of general form and content. I note just one or two points from its content here.

164. First, it is stated that:

> "*The investment objective of the Issuer is to achieve superior risk-adjusted returns for Shareholders through capital appreciation and current income, by investing in a diversified portfolio of fixed income assets with an optimal mix of mortgage products and leveraged finance assets. In an effort to achieve this objective, the Issuer intends to invest in a wide range of fixed income assets and credit classes and utilize fixed income derivatives technology to balance the trade-off between prudent risk-taking and returns. The Issuer believes that proper management of the funding of assets is of equal importance to the proper selection of assets. CIM intends to allocate capital utilizing an asset allocation model that it believes mitigates the effect of leverage based on value and risk and isolates risk-adjusted returns.*"

An illustrative, but emphatically illustrative only, portfolio pie chart shows what was then viewed as a "*wide range of fixed income assets*", in that the proposed asset allocation was to be 90% mortgage backed securities of which 77% would be Agency RMBS, and 10% leveraged finance assets of which 8% would be bank loans. Elsewhere in the text, investors were notified that CCC would intend to leverage the acquisition of Agency RMBS by 27x, but the leveraged finance assets at a much lower level of 1x – 5x, depending on asset type.

165. Elsewhere the preliminary PPM sets out the intention to distribute 90% of CCC's net earnings as a quarterly dividend. It gives short biographies of the proposed directors and detail of the investment management arrangements with CIM and the relevant fees. The anticipated availability of the expertise of the Carlyle Group's US Leveraged Finance Assets Group is referred to and it is stated that

> "*CIM and the Issuer have structured their relationship to ensure that their interests are closely aligned."*

It also made it clear that

> *"The Issuer intends to employ leverage extensively, which may be employed without limit……"*

166. The proposed source of funding for the leverage of RMBS assets is mentioned, but not particularly prominently (it is not even mentioned in the Executive Summary) and I infer that this is because it was not considered to be particularly noteworthy. What is said is that

> *"The Issuer expects to finance its investments in RMBS using a diversified approach involving repurchase agreements with multiple commercial and investment banks and through one or more commercial paper programs. Because this financing is expected to be short-term and floating rate, the Issuer intends to mitigate its interest rate risk through the use of various interest rate risk management strategies, including interest rate swaps. The Issuer expects, at least initially, to leverage this asset class approximately 27 times the amount of its equity, but this level may change."*

167. Access to "*the Carlyle Group's Established Infrastructure"* and *"Extensive Relationships and Deal Flow"* are noted as some of the *"Investment Highlights*" and the Carlyle Group's reputation and established track record were set out, plainly expected to be a positive feature.

168. The Memorandum warned that the company could change its investment strategy as and if it saw fit, but also stated that there would be "*Investment Guidelines"* approved by the Board. It stated that

> "*changes to the investment strategy* [changed to "*guidelines*" in the subsequent December PPM] *must be approved by a majority of the Independent Directors".*

I shall return to consider the point of the "Investment Guidelines" later, because they, and the way in which they were subsequently treated by CCC, have been the subject of much examination in this case, but it suffices to mention here that the three central guidelines, were (i) an asset allocation balance of a maximum of 85% RMBS to other asset classes, (ii) the maintenance of a minimum borrowing capacity of 150% of anticipated needs, and (iii) the maintenance of a liquidity cushion of 20% of capital, to meet possible margin calls.

169. Otherwise, in general terms to which I do not think I need refer further, the PPM encouraged investment on the basis that Carlyle personnel and the placement agents were themselves investing, but at the same time there was set out a great amount of information and disclosures and a myriad of warnings as to possible risks which might affect CCC's business and investments, including all those perceived to have any potential effect on its assets, business or operation with greater or lesser degrees of specificity. They included that

> *"An investment in the Shares is speculative and involves significant risks. An investor should understand such risks and have the financial ability and willingness to accept them for an indefinite period of time and the ability to sustain the loss of its entire investment"*

and

"*An investment in the Shares is suitable only for investors who are experienced in analyzing and bearing the risks associated with investments having a very high degree of leverage".*

Another warning was that

"*Various potential and actual conflicts of interest may arise from the overall advisory, investment and other activities of CIM, its affiliates and their respective clients."*

170. Around this time, CCC also began entering into repo MRAs with various funding banks. By 14th September 2006 it had already acquired $690Mn of RMBS. Although this figure looks large, it was of course small compared to the ultimate intended size of CCC's holdings, which would be over $20Bn.

171. Having regard to the point already noted above in considering the structure and effects of repo financing, it is interesting to note the differing approaches to the question of valuation of the assets in the various MRAs of these banks, which I infer were in the particular bank's standard form. The MRAs of two such banks (Goldman Sachs and Lehman) provided for the "Market Value" of the securities for the purpose of margin calls, to be their price obtained from a "*generally recognized source agreed by the parties*" and at its most recent closing bid quotation. The MRA with Bear Stearns allowed Bear Stearns to price the securities "*in its discretion exercised in good faith*". The agreement with Deutsche Bank provided for an agreed "*generally recognized source*" but that if such source could not be agreed, Deutsche had "*sole discretion (using the bid price for such Securities) to determine the value*". The agreements with Citigroup and JP Morgan entitled those banks to choose (in good faith) the pricing source to be applied. The lack of uniformity about this suggests to me that this point had rarely arisen for serious consideration of its effects and operation in recent market practice, either as a matter of review, but still less, contentiously.

4th October 2006 - First BOARD MEETING

172. CCC's first Board Meeting took place on 4th October 2006 in Washington DC, with all directors present in person or by conference call and various members of Management, other senior Carlyle personnel, and Mr John Reville of PwC, who were to be CCC's auditors, also in attendance. The many and various formal matters relating to the setting up of the company were ratified insofar as CIM had already effected them, otherwise they were formally resolved upon. This included the formal appointment of the last five directors, which appointment lay in the power of the subscribers to CCC's Memorandum of Incorporation.

173. The new personnel were also introduced to the Board. Three "related party" transactions between CCC and Carlyle were reviewed and approved, (this requiring the approval of the Independent Directors). These were taking up investments in two other Carlyle managed leveraged finance asset funds and the taking of a bridge loan from Carlyle to enable CCC to start purchasing securities in advance of receipt of share capital. The point of this last was to reduce the phenomenon known as "ramp drag", which is where acquired share capital remains non-income producing for the period taken up by the process of acquiring assets. The method of dealing with this is to borrow funds in advance with which to acquire the assets, such that their income is already flowing when the capital raising takes place. The loan is then repaid out of the capital proceeds. This manoeuvre illustrates the fact that in this business it is seen to be worthwhile and even necessary to look for every small step which maximises and

improves return on assets. They all feed into the eventual financial results by which an entity's success or failure will be judged.

174. Continuing with the Board Meeting, CCC's business strategy model was presented by Mr Stomber, who explained the model and its intended use of leverage. The Board noted that it was intended to invest at least 65% of CCC's assets in mortgage related products (thus, it was expressly noted, limiting CCC's ability to invest in Carlyle sponsored products). The Board also noted, discussed and approved the draft Investment Guidelines circulated in the Board pack, and referred to above under which CCC (through CIM) would operate, and that these could be amended only with the majority approval of the Independent Directors. In fact, with Mr Stomber notably not being a person to delay, CCC had already committed to purchase $2Bn of securities the previous day, in accordance with the business plan.

175. There was discussion of the operation of the credit product section of CCC's intended business, led by Mr Zupon. This appears in more detail in the Minutes, possibly reflecting the fact that this was a more familiar area of business for Carlyle personnel. A warehouse of suitable investments for this portfolio sector had already been provisionally acquired and held by a broker (CitiGroup) and their acquisition was formally approved. After a review of the arrangements and timetable for the intended Private Placement of shares, various enabling resolutions for this were passed, including that CCC should enter into the relevant Agent Placement Agreement with the six proposed agent banks, the creation of the Audit Committee and the appointment of PwC as CCC's external auditors. The intended timescale to the eventual IPO of shares was reviewed. The requirements of Guernsey corporate governance and regulation – and in particular the qualification that the company should be a Qualifying Investor Fund ("**QIF**") in Guernsey law – were discussed, and the appointment of Mourant Guernsey Limited as CCC's Guernsey administrator was approved.

176. Mr Hance, as Chairman, stated his intention to call a Board Meeting in December, prior to the second closing of the private placement, another to review CCC's year end financial statements and subsequently at least one meeting every quarter.

177. I have not recited every minute, but these give a flavour. My overall impression from the Minutes is, in short, that they record a comprehensive and businesslike meeting, as one would expect for a sophisticated finance vehicle intended to become a public company.

October 2006

Mr Stomber and Mr Zupon

178. At around this time, however, tensions emerged between Mr Stomber and Mr Zupon. It appears that these had been present from an early stage, owing to a personality clash (put simply, I think that they just did not like each other) and a lack of clarity as to their relative positions and the importance of their respective areas of responsibility. Mr Stomber was conscious that he had been recruited to be the CEO of CCC, and it seems that he was unhappy at the degree of influence and authority which Mr Zupon – already, of course, a known and trusted executive in the Carlyle Group - was either exercising or expecting to exercise in relation to the planned operation of CCC. The original intention had been that Mr Stomber should act as CEO of CCC with Mr Zupon - who was to have supervision of the credit product section of CCC's portfolio with an executive function as a "President" (in American corporate

terminology) of CCC - reporting to Mr Stomber. However, it was becoming, or had become, clear that this was not going to work.

179. Internal contractual arrangements had to be made under which CCC's leveraged finance assets would be held, in order to comply with US securities law, by entities controlled by Mr Zupon's team, with intra-group charges being made. This necessitated negotiations between Mr Stomber and Mr Zupon. When these negotiations became bogged down in mid-October 2006, Mr Stomber involved Mr Conway, by copying him into emails. In frustration, Mr Conway felt obliged to tell both executives, fairly bluntly, to resolve their differences, with an apparent threat to remove them both if they did not do so. This was on 15th October 2006. They did; the Managed Account Agreement was completed on 16th October 2006.

180. However, Mr Stomber raised with Mr Conway his concerns that if the role of CCC was simply that of servicing other Carlyle investment funds, his mandate needed reconsideration. He was reassured by Mr Conway, who is plainly a master of diplomacy and the smoothing of ruffled feathers, that CCC was to have an individual and important role as a new and diversified investment vehicle in its own right. In consequence (I infer) though, Mr Zupon's executive position was disengaged sideways, and a structure was devised under which he had no reporting role. Mr Stomber operated as CEO calling on Mr Zupon and his team to effect such transactions as were appropriate for the ring-fenced credit product portion of the business, under the Managed Account Agreement.

181. It is quite apparent that throughout the life of CCC, Mr Stomber and Mr Zupon did not have a cordial relationship. Indeed, other witnesses acknowledged this in their evidence, with varying degrees of bluntness. Messrs Stomber and Zupon were themselves diplomatically circumspect on the subject in their own evidence, although Mr Stomber appeared more uncomfortable with being diplomatic than did Mr Zupon. I read this as simply a difference of personality. My assessment, however, is that whilst their personal relations were cool, as regards the management of CCC's affairs their relationship was professional, although conducted as far as was possible and practicable through the intermediary of others.

Refining the business model

182. As already mentioned, CCCs' proposed business model was put before the six Investment Banks who were to underwrite CCC's' private placement and subsequent IPO, functions for which they would earn significant fees. Mr Stomber emphasised this point in his oral evidence; they had all reviewed CCC's business model including its evolutions, and had all been content to put their names behind it and to promote investment in CCC to clients - albeit with varying degrees of energy. Indeed ultimately they had all exercised the so-called "greenshoe" option, by which underwriting banks can choose to take a further 15% of a public share offering in their own right if it is successful, either to protect themselves from having over-committed to procure shares for investors on a particularly attractive offering, or with a view to on-selling shares at an anticipated profit. Either way, this suggests that the banks took the view that the shares on offer were a good buy. In the light of the part which at least some of these banks later took in placing the stress on CCC which ultimately destroyed it, Mr Stomber pointed this out in his evidence with scarcely concealed bitterness.

183. The first closing of capital raising, to the placement agents themselves who would then sell on, took place on 16th October 2006. CCC's business was officially launched the following day. It paid back the initial $15Mn bridge loan from Carlyle from the proceeds, which it then began

to deploy. The twin processes of refining CCC's business model and seeking further rounds of capital investment continued in tandem. Marketing efforts at this stage were focused on CCC's existing known investor base, who were, naturally, Qualifying Investors of the required standard.

Investment Guidelines and risk management.

184. During the capital raising campaign, at the beginning of November 2006, Mr Stomber sent a more specific email to identified potential investors explaining some particular risks with regard to CCC's portfolio, and how it was intended to manage or mitigate these. He referred to: exposure to the defaults associated with a potential credit cycle (applicable to the Leveraged Finance Asset part of the business and guarded against by investing only in B+ rated products and limiting individual exposures), the weakness of the US housing market, (avoided by investment in only Agency RMBS with the implied guarantee of the US government), exposure to any liquidity shock (dealt with by operating with a liquidity cushion tested against the 1998 LTCM crisis) and interest rate rises (assessed as being highly unlikely to any degree which would hurt CCC). In addition it was pointed out that the returns on the two parts of the business - credit products and RMBS - were entirely uncorrelated with each other, but were held in equal balance as regards returns on equity ("**ROE**") owing to the leverage employed, thereby mitigating the effects of any shock to either element. These emails provide an insight into how, by this time, Mr Stomber, as the CEO and advisory guiding hand of CCC, saw the main features of CCC's business model and associated risk, and lead appropriately to a closer look at the Investment Guidelines which were fixed upon for CCC's business and approved by the Board.

185. Investment Guidelines may cover various matters, but their effect will be both to shape the particular character of the relevant business venture, and to be a risk management tool. Their adoption, and their publication to investors, suggest a carefully considered strategy and a management with the intention of a responsible and self-disciplined approach to running the business.

186. As already noted, though, it was always stated in the documentation, ie the PPMs and the OM for the IPO, that CCC's Investment Guidelines were not immutable and that they could be departed from without notice to shareholders, although only with the approval of a majority of CCC's Independent Directors. The implication is that this last point is being offered to investors as a comforting safeguard as regards their investment otherwise being handled entirely in the discretion of CCC or, more accurately, CIM as its investment manager. In the event, the guidelines were departed from by CCC, and criticisms both of this fact, and the way in which the Defendants dealt with it, form a major part of the case made by the Plaintiffs. It is convenient here, therefore, to look at the guidelines more closely.

Guideline 1 - Asset allocation

187. First, there was the asset allocation guideline. This was to govern the balance between RMBS and other leveraged finance assets in CCC's portfolio. Ultimately, the guideline was fixed at a maximum of 85% for RMBS generally (ie here including non-Agency) as against other, leveraged finance, assets ("**LFAs**").

188. The effect of a high proportion of RMBS was that a very high degree of leverage would likely be undertaken in the acquisition of these assets. This was made express and clear in CCC's

business model and its various offering documents. It was noted above that at the time of the PPMs the leverage of RMBS was intended to be at 27x. This describes that for every $1 of CCC's own capital spent on acquiring RMBS, it would borrow $27, ie it would actually own 1/28th of the investment value itself.

189. By the time of CCC's IPO, this intended figure had risen to 32 – 37x, because the business model had been varied such that now only Agency capped floater RMBS were to be the intended acquisitions in that class. These are less risky, and therefore, by the same token, lower yielding assets, so CCC needed to acquire more to achieve the same return on its own capital deployed, which meant borrowing more. This proposed leverage ratio was specifically mentioned in CCC's OM. It was also expressly stated, though, no doubt to preserve CCC's flexibility and room for manoeuvre, that CCC would be placing no self-imposed limit on the extent of its borrowings. For perspective, in the OM it was stated that CCC's overall leverage rate would be approximately 29x, and the LFAs would be leveraged at between 1x and 8x.

Guideline 2 – liquidity cushion

190. The second guideline was the liquidity cushion guideline, ie that CCC would maintain a block of cash or unencumbered assets available to meet immediate financial obligations. The final model specified a liquidity cushion of 20% of "equity" or "net asset value" or "adjusted capital". (To the extent that these may not mean exactly the same thing, I consider that "net asset value" is the most accurate articulation of what was intended.). This meant that, in practice, 20% of CCC's capital assets would be held in a liquid form, in the shape of either cash or immediately realisable assets.

191. The quantum of the liquidity cushion was Mr Stomber's recommendation. It was a large increase over the figure of 5% which had been tentatively proposed in the initial model. The increase was made because, in the course of devising the business model, the proposed structure was stress-tested by applying simulations and projections to see how the model would fare under particularly difficult market conditions or trends. Adjectives used to describe this in the case have been "turbulent", "volatile", and "dislocated".

192. The model was tested against the conditions of the worst liquidity crisis in general memory, which was the Long Term Capital Management crisis of 1998. The principle of the stress test applied was that of modelling what resources would have been required in order to survive the conditions of that crisis to a 99% confidence level as to survival, on the assumption that no corrective measures to the portfolio were taken for 20 business days. This is known as a "stressed VaR" (Value at Risk) assessment. The parameters are conservative, both as to the "20 days with no corrective action" assumption and as to the 99% confidence level. Typically, VaR analyses were carried out on a more normal basis of a 1 day inactivity period and a 95% degree of confidence. Using "stressed VaR", related to the conditions of 1998 rather than simply to those of the most recent few months (again more normally used, and being described as "current VaR"), was also conservative.

193. The stressed VaR analysis had thrown up a 16% liquidity cushion requirement. Mr Stomber had then added 25% of this for further safety, to reach the 20% figure. He said that the reason had been to add something, in order to be conservative as against even the worst financial crisis which could be pointed to.

194. As stated, the purpose of the liquidity cushion was to protect CCC from inability to meet immediate financial obligations owing to absence of liquid funds, with the particular concern being the ability to meet margin calls. CCC would be borrowing heavily on the security of the investment assets which it was purchasing. It would do so, as regards RMBS, typically for 30 days and at a borrowing margin of 98% of the current value, ie market price, of those assets.

195. If the market price attributed to the relevant assets in a repo transaction falls during the repo finance period, any such fall eats into the 2% value buffer which protects the repo lender against loss if it is obliged to sell its security. The terms of the repo finance therefore entitled the repo lender to require CCC to provide additional security (ie "margin") in such a case, sufficient to restore the value of the security held by the repo lender to 98% of the new (reduced) value of the security. To do this would require the posting of a margin amount equal (simply by mathematics) to 98% of the reduction in the value of the relevant securities. In the context of the size of investments envisaged for CCC, which would be in $Bns, this could be a significant absolute sum, ie several $Mns. As already mentioned, margin positions were assessed daily and consequently CCC could be required, on mere hours' notice, to post such additional security.

196. It was therefore vital that CCC should have immediately liquid funds to enable it to comply with any such demand without relying on selling its assets. Apart from the fact that these were unlikely to be realisable in the required short time frame in any event, such a pressure to sell would very likely mean that the assets had to be sold at a price which was less than their best, and indeed might even be regarded as "distressed" prices, ie those produced by an obviously forced sale. This is sometimes referred to as "firesale" prices.

197. The liquidity cushion, though, was intended as a protection against having to meet margin calls, and only margin calls. It was not envisaged as a protection against any other factor which might adversely affect CCC's financial position under its repo financing. The most immediately salient of these factors - at any rate as one becomes more familiar with the practical aspects of the repo financing market - was the possibility that lenders might seek to reduce the 98% loan to value ratio of their repo lending, by increasing the "haircut" to more than 2%. The effect of this would be to require CCC to put more of its own money into buying the assets than the mere 2% required if it were able to borrow 98% of the price.

198. CCC's business model was predicated on a 2% haircut being applied to its borrowings by its repo financiers. The evidence suggests that whilst this possibility of a higher haircut being demanded was not overlooked at the time of devising CCC's business model, it was dismissed for being theoretical rather than real. Mr Stomber said that his understanding and his experience had been that this was the level of haircut which was universally applied, in the wide and deep repo funding market, by repo banks lending in relation to this particular asset class, and that this had pertained even during the 1998 LTCM crisis. Where a practice was universal, if a dealer had attempted to impose a higher haircut, he was likely to find that his counterparty disappeared and "rolled" his business to a lender who was maintaining the conventional terms, ie, here, the 2%. There was enough available finance around in 2006/early 2007 for this to be easy. In those years, banks wanted, and indeed needed, to lend money to make their own profits, and the competition between them gave the borrower power in the market.

199. The Plaintiffs have rather late in the day (but they say on the basis of the evidence at the hearing, and in particular that of their own repo expert, Mr Welles, in cross-examination) suggested that Mr Stomber had got this wrong, that the relevant rates were in fact in a range of 2%-5%, and that the 2% rate obtained by CCC in its early days was "concessionary" (owing to its connection to Carlyle) and therefore could not be relied on as being available into the future. They suggest, I think, that Mr Stomber was assuming that the 2% rate applicable to the even more stable Agency "pass through" securities or debentures, would also apply to Agency capped floaters, because his experience was in dealing with the former and not the latter and he therefore made an unwarranted assumption.

200. It certainly emerged later from the evidence that banks would also regard the financial standing of the borrower as having some materiality to setting the haircut, rather than merely the quality of the assets – although it was not so clear to me what weight this consideration might have had at different times. But it also appeared – and I think that Mr Welles agreed – that the combination of high quality assets and a "Tier 1" borrower was regarded as making a 2% haircut satisfactory, that this would have been general practice, and that CCC was regarded as Tier 1 because of its association with the highly respected Carlyle Group. I am therefore not satisfied that there was necessarily any error in Mr Stomber's apparent assumption. But in any event, I note that the Plaintiffs have never alleged that CCC could be criticised for constructing its initial business model on the basis of the 2% haircut assumption, and I would be most surprised if this had been overlooked during the years of preparation for this trial, if there had been any hint of a possibility that this assumption was suspect.

201. The haircut, or achievable loan to value ratio, is part of whether finance is manageable for the borrower, because it affects the amount he has to find from his own resources either initially or during the currency of a loan term, but there are two other factors which affect this.

202. Marginally less obvious than the nominal loan to value ratio granted is the postulated value of the security on which the loan is granted. The amount of the loan is fixed by multiplying two component parts, the value of the security and the loan to value ratio. A change in either will affect the amount of the finance being offered.

203. This price, or value, of the securities is commonly referred to in financial markets as their "mark". This is because market participants habitually review the value of their securities as against apparent market prices, doing this even as frequently as daily, and "mark them to market" (hence "**MTM**").

204. I have already noted the industry practice of using prices posted by one of the known pricing agencies as the value for calculating the amount of loan finance they are prepared to offer (or put another way, and I think more in accordance with actual practice, the amount of security they require for making a loan of a particular amount). These prices are based on the agencies' collection of data on known transactions, although with (I understand) adjustments to reflect the impact of current financial circumstances where felt necessary. From this data they determine a current market price which they publish. The agencies' published prices had always, before 2007, been used as the basis for calculating the amount of the loan which a repo lender was willing to provide, and departure from this practice was seen as so unthinkable - at any rate by those dealing with CCC's business - that the possibility of such a departure was not seen as a risk - or certainly not one against which it was necessary expressly to safeguard. That risk was, of course, inherent in the terms of most of the standard MRAs into which CCC

entered with its repo counterparties which I have noted above, but it was certainly not appreciated or evaluated as even requiring to be noted, as far as I can see.

205. One might have thought that a third factor which would affect the acceptability of borrowing terms for CCC would be the interest rate to be applied to the loan. This is because, to an uneducated outsider, it appears only natural that a more nervous or reluctant lender simply seeks to obtain a higher interest rate from a more risky or less attractive transaction. Surprisingly, to me at any rate, the interest rate has just never figured as a factor of any major importance at all in this case; it has only ever been given peripheral mention. When I enquired about it, I was told that it is simply insignificant in the general order of terms to be negotiated, because interest rates were much of a muchness because of competition between lenders, and the financial effects of any likely amount of difference would be vanishingly small in this kind of transaction. This is because it would vary only in terms of a few basis points, and for only 30 days – one twelfth of a year. Moreover, given that the securities themselves were providing monthly interest payments which were above, and with a direct correlation to, the interest rate being charged on the repo finance, the likelihood of the interest rate being charged ever posing any financial problem, or even becoming a serious consideration for CCC, was simply not there. As a risk attaching to the use of 30 day repo finance in the markets of 2006-7, this aspect therefore just did not figure as a serious concern in any assessment.

206. I was taken in the course of the case to some evidence of repo transactions being discussed and negotiated, in which interest rates were mentioned, or treated as a negotiating point, but none of it suggested to me that the point was a matter of major portent, in stark contrast to the issues of pricing and haircut levels. This tends to bear out the above comments. I need therefore say no more about it except to record, for the curious, that the interest rate being charged to CCC during early 2007 appeared to be about 5.30%, give or take a basis point or two.

Guideline 3 – Minimum borrowing capacity ("MBC")

207. Returning to the importance of CCC's Investment Guidelines, the third specified guideline was that CCC would maintain a "minimum borrowing capacity" of 150% of its anticipated actual repo borrowing requirements. In practical terms, this guideline translated, in relation to CCC's RMBS portfolio, into CCC's maintaining promises of unused available repo finance from its cadre of potential repo counterparties roughly equal to 50% of the value of the portfolio of RMBS (bearing in mind that its borrowing requirements were 98% of that total value). The point of this guideline was, of course, to ensure that CCC had an available backstop finance facility to give it flexibility in case it wished to "roll away" from any particular repo counterparty, and to enable it to do so without coming under any stress as to borrowing terms.

208. This point draws attention to one aspect of CCC's business model which is of major importance as context for the matters under scrutiny in this claim. I have already referred to it but the implications bear repeating.

209. This central aspect of CCC's' intended business rested on continuously renewing contractual relationships with repo counterparties, which were subject to renegotiation twice every month, in the two large tranches required to support the "rolls" of the Fannie Mae and Freddie Mac RMBS, respectively. CCC's borrowing capacity depended on promises of availability, should CCC request it. However, firmly committing to the availability of finance may require the lender to decline other opportunities of deploying available funds at profit, and therefore a binding or "hard" line of available finance typically incurs a commitment fee, or comes on

more expensive or less advantageous terms. Similarly, longer term finance availability will come at a higher cost than short term loans, because the shorter term enables the lender to reconsider and re-set the return which he wants to receive more quickly, thus reducing his risk of having committed funds on terms which become disadvantageous before the transaction expires. But any addition to the borrower's costs caused from incurring any such increased fee or rates of course reduces his profit.

210. Uncommitted, and therefore merely "in principle", or "soft", availability incurs no tangible fees, but it still has disadvantages for the lender, in that his reputation for reliability will depend on actually delivering, if called upon. Even though, therefore, it may not require formal balance sheet commitment, the lender must have at least some regard to holding available funds which might otherwise be deployed to advantage, although he obviously has more freedom to take a view on whether he is likely to be asked to meet his soft promise, and in markets as broad as these he would no doubt expect to be able to do some juggling with other transactions in order to do so. However, the extent to which banks are willing to promise even "soft" repo finance availability therefore still has commercial limits. Its availability will be influenced, not just by the interplay of financial calculations, but also by reputation, and very often also the state of relations between the parties, and the consideration of favours owed or wanted, and the courting of future possible business of other types.

211. Thus, the advantage of having potential "soft" availability without paying a fee for certainty is balanced against the possibility that soft availability may dry up if the interests of the lender lean in a different direction, and plainly, at some point, the size even of a soft promised line may cause the bank in question to pause.

212. These factors, ie the uncertainty of soft repo lines, and the greater ideal of having committed, and/or longer term, repo lines available, were not entirely unnoticed in the early days of CCC as is shown by an email exchange of 18th- 21st November 2006 between Mr Trozzo and one of his managers, Dean Melchior, into which Mr Stomber was copied. Whilst obtaining longer term repo financing may have been considered, it was not, though, followed through to a conclusion. I find that this was due to a combination of the factors, the first being that it would be more expensive and this needed to be balanced against profit earning, and the second being that it was not seen as an urgent or pressing necessity in the then relatively benign current market conditions. In evidence, Mr Stomber said that negotiation of such an agreement with Bank of America had in fact gone a long way, but the volatility in the market which occurred in April and May 2007 stalled progress, and this was then overtaken by the market disruption of August 2007.

213. It is also apparent from the evidence though, that, in the context of this financial trading market, where transactions can move very quickly, and the difference between a good or poor deal can rest on slim differences of terms, the securing of repo finance for CCC generally was at all times a matter which demanded monitoring, direction and even nursing on virtually a daily basis. Agreement requires two sides, and in respect of any individual repo finance transaction CCC was to be engaged in 24 rolls annually, with a cohort of around ten repo financiers in relation to each roll. This involved individual commercial negotiations with repo traders on behalf of the relevant banks, each anxious to secure benefit for his own employing bank, with CCC equally anxious to secure the best terms for itself.

214. In times of stability, with a reasonable balance between borrowing requirements and lending capacity in the market, such transactions are likely to be secured on industry standard terms which each side regards as reasonable and adequate to enable it to meet its commercial requirements or aspirations. Thus the negotiations will be relatively easy as no-one will break out of line, and there are conventional norms of behaviour and tacit understandings which operate. Mr Stomber said that there was a kind of "honour system" about the way in which market participants dealt with each other, and I can accept this, in general terms. It is relatively easy to be honourable in good times. In all commercial negotiations, though, parties still need their wits about them to avoid giving away advantage, and when circumstances change and commercial pressures mount, parties will negotiate hard, and potentially ruthlessly. How hard depends on the extent of the pressures (external or internal within the organisation) operating on the negotiators, and their particular character and appetite for ruthlessness. In those circumstances, the previously unwritten rules of the game may well go out of the window, as honour gives way to self-protection.

215. CCC's business model involved repeatedly entering upon such negotiations, and relying upon their outcome to provide sustainable resources for continuing CCC's business. Success would therefore depend on the skill and even tenacity of its negotiators, and the degree of clout (or "leverage" in another meaning) which CCC was able to bring to bear in any such negotiations. That, however, is intrinsic to business.

20th December 2006 – Second BOARD MEETING

216. This Board Meeting was held by telephone on 20th December 2006. The Board discussed CCC's performance to date and the progress with its asset purchases, on which Mr Stomber reported positively. As was common practice in the Carlyle Group, a parallel vehicle company to CCC had been set up, called CCC Coinvestment Limited ("**CCC Coinvest**") , to enable Carlyle Group employees and affiliates to make investments in the subject company (ie CCC itself). That had been done in this case and CCC Coinvest had already made a commitment to invest some $45Mn in CCC. The Board approved increasing the acceptance of this investment to $63.8Mn.

217. Mr Stomber updated the Board on the progress of the private placement. The PPM, in virtually identical terms to the Preliminary PPM mentioned above, had been issued on 16th December 2007. The required preparations for CCC's IPO were authorised to proceed. PricewaterhouseCoopers (Guernsey) were formally appointed as CCC's auditors, following confirmation that they were suitably independent; the importance of this attribute was noted.

December 2006 – February 2007

218. By the end of 2006, CCC had secured, or was negotiating, repo lines with at least ten banks, namely its six underwriting banks mentioned above, and also Bank of America, RBS/Greenwich, Merrill Lynch and Morgan Stanley. These lines were all, and without negotiation, at a 2% haircut. Lehman initially quoted 2.5% but immediately reduced their terms to 2% when challenged. This was all, therefore, in accordance with Mr Stomber's professed belief as to the norm in this regard for Agency floaters, and his team's experience. It was also the expectation of Mr Hance and Mr Sarles, according to their witness statements, although this is in the context of their far more limited experience. Paperwork evidencing early trades by the team confirm that 2% was routinely offered. However, this rate also confirmed CCC as being perceived to be a highly credit worthy customer, no doubt owing to

its association with Carlyle. The evidence shows that occasionally during the period from late 2006 through to the time of the IPO a bank might propose a haircut higher than 2%, but this was never persisted in when contested, and CCC never "paid" (perhaps a misnomer but common parlance) more than a 2% haircut.

219. The private placement of shares took place in two tranches, the first completing on 31st December 2006 and raising some $263Mn in capital at a price of $20 per B share. A roadshow had been devised to educate investors about CCC and its strategy. Although certain banks were engaged as placement agents, CIM and Carlyle personnel carried out much of the work of securing investors, looking mainly I understand to "legacy" investors, that is: previous Carlyle investors.

220. In January 2007, Mr Conway, in his annual letter to Carlyle investment professionals, noted that the financial successes of the last and previous years had been fuelled by the vast availability of easy credit (the "*liquidity environment*"), which he believed simply could not last - although he did not predict that the tide would turn quite as quickly as it actually did. As to the future, he requested Carlyle staff to start taking a more cautious approach in their pursuit of appropriate projects, and to consider projects with less ambitious investor returns than in the past if they also presented lower risk.

221. Mr Conway had, he accepted in evidence, begun to feel concerns about the continued buoyancy of the US economy during the forthcoming year of 2007; there were plainly some signs that the economic situation might be on the turn. There is a recognised economic cycle, under which economies do not grow or progress steadily, but in periodic waves of growth and prosperity and then slowdown and even contraction. However, and as Mr Conway pointed out, his cautionary comments were directed generally at all the areas of Carlyle business which were his main oversight, and were certainly not focused particularly on the new project of CCC.

222. Audit Committee meetings of CCC took place on 6th February and 15th February 2007, with nothing of moment to be recorded.

15th February 2007 – BOARD MEETING

223. A telephone Board Meeting took place on 15th February 2007. All the directors were present, and Miss Cosiol, Mr Buser (an accountant and Carlyle's Chief Accounting Officer), and Mr Reville from PwC, with an assistant, were in attendance. The Board discussed and approved CCC's year end financial statements and other important administrative matters including approving the charter for the Audit Committee, and approving the cost-sharing agreement with CIM and the plans for CCC's IPO.

224. Importantly for present purposes, the Board discussed and gave approval to two requests from Management (in effect Mr Stomber) with regard to the Investment Guidelines. The first was to incorporate a definition of the liquidity cushion into the guidelines and the second was to reduce the target minimum borrowing capacity from 150% of needs to 125%. The former made no change to the concept and was really just refinement. The latter was requested because of the increasing size of CCC's portfolio as it made acquisitions. It had been discovered that banks were not willing to make available, even on a "soft" basis, very large repo financing lines which would not be used. At that time the repo finance markets were active and stable, and the directors agreed that it did not appear that available borrowing

capacity needed to increase in direct ratio to the size of the portfolio, and so this amendment was approved by the Independent Directors. It was agreed that the MBC guideline was a target, and if excess availability could in fact be secured then it would be.

225. The Board also recorded that the eventual OM must make it clear that the Investment Guidelines were indeed guidelines and not rigid constraints, and could be changed without shareholder approval. This was in order to allow Management enough flexibility to do what it felt was required at any time, as speedily as was considered necessary, particularly as to changing asset allocation and with regard to the liquidity cushion and leverage. This requirement had been made very clear in an email circulated generally by Mr Stomber the previous day, and the point was taken up by Ms Cosiol.

226. On 28th February, the second round of CCC's private placement completed, raising a further $337Mn at $20 per share, and bringing CCC's total capital at that stage to $600Mn.

5th March 2007 – BOARD MEETING

227. The next Board meeting was held at Carlyle's offices in Washington DC on 5th March 2007 (with a routine Audit Committee Meeting on the same day) and with Mr Conway in attendance by telephone. Ms Cosiol and Mr Ferguson, Mr Buser, Mr Harris (Carlyle's Chief Financial Officer), Mr Reville, and the three senior Management personnel, Mr Greenwood, Mr Trozzo, and Mr Rella, were also in attendance.

228. The Board received reports of CCC's activities during January and February using the private placement funds, and in particular a positive report that CCC had been able to acquire RMBS at prices in line with those anticipated in its business model, and that CIM would thus likely earn its incentive fee for that quarter and be fully profitable for Carlyle.

229. It is necessary, when reading the relevant minutes presenting the above material, to get used to the convention in this market that prices for bonds are described as "spreads" rather than as actual prices. This is because the essentially interesting aspect of a bond is its yield, ie the income earned, as a return on the costs of purchasing it. In the outside world, the yield is usually described as a percentage of the price paid, but in the bond world, it is described, not in absolute terms, but as a comparison with a benchmark interest rate which in this case is LIBOR. The "spread" is the difference, expressed in basis points, between the LIBOR rate and the rate of return on the bond at its then price. Thus, the greater the spread from LIBOR, the higher the return that is being made and, since the return reflects the ratio of the income to the price paid, it reflects a lower price, or value. Conversely, if the return converges on the LIBOR rate, this "narrowing of the spread" shows a lower return, and thus reflects a rising price. The spread therefore provides an easy measurement of price changes or trends.

230. Whilst an actual price can be computed from the spread with the necessary data available, the bond market finds it more convenient to make comparisons of value or price for investment decision purposes in terms of the spread itself. Since price also reflects the perceived risk in the investment (more risk means lower price) it follows that a "narrow" or "tight" spread – a higher price - indicates that a bond is viewed as less risky than one trading at a "wide" spread and lower price. Looked at another way, the spread from LIBOR is a measure of the perceived risk premium inherent in the particular investment comparing it with the relatively risk free LIBOR rate.

231. As the avowed purpose of CCC was to provide dividends, there was discussion as to how future income and cash flow might turn out. Among the presentation papers were financial summary illustrations, labelled "*Risk Analysis and Summary"*, which became a standard feature for meetings. They showed projected figures for CCC's progress, including leverage at around 29x and a liquidity cushion of 22%-23%, except where increased, exceptionally, by the receipt of funds from raising capital. The ratio of the liquidity cushion to CCC's calculated 20 day VaR (described above) was also shown.

232. The Board also discussed the draft OM for the IPO, and various other resolutions with regard to the Board's responsibilities under the rules of the Euronext Stock Exchange.

Market events - Spring 2007

233. By the time of this Board Meeting of 5th March 2007, falterings in the market, which were later to develop into the "sub-prime" mortgage crisis, can now be seen to have been developing. CCC had, of course, already started investing by this time. Within CCC the effect of these market factors was seen as being that higher quality RMBS, such as the Agency RMBS in which CCC was focused, were becoming more attractive, but that instability in the REITs market had made investors wary of anything apparently mortgage based; it was therefore going to be necessary to explain and emphasise to potential investors in CCC how CCC, and its risk profile, differed from those of other RMBS based investment vehicles such as REITs. CCC, it will be recalled, had devised a business model which was, and was intended to be, different from other investment funds in the mortgage-backed financial markets, and this difference was intended to give it a unique competitive edge. Within CCC, the sub-prime difficulties were therefore not perceived as affecting the solidity and viability of CCC's business model in practice. Mr Stomber sent a reassuring email to investors on this topic on 15th March 2007.

234. With the preparations for the IPO underway, ALCO met for the first time on 30th March 2007 and, as already mentioned, fortnightly thereafter. This meeting was chaired by Mr Trozzo, and Mr Allardice was in attendance by telephone. It reviewed aspects of the market, compliance with the Investment Guidelines and generally felt its way towards how it would run in the future.

235. On 3rd April 2007, Mr Stomber sent a request to all Board Members by email for a temporary reduction in the liquidity cushion to 15%. This was not because of any forced need for liquidity, but to enable CCC to buy attractively priced mortgages, in advance of the IPO. He explained how the cushion would be restored, either from the proceeds of the IPO in June, or out of a bridge loan from the IPO underwriters, as part of the IPO process, or, ultimately, through the maturing of CCC's assets. Board Members asked questions, and found this a sensible request, to reduce ramp drag (already explained) and each of them expressed their agreement. Mr Stomber reported, later, that the cushion had in fact been restored out of funds from the underwriters' bridge loan, and that this exercise had gained $1.7Mn for CCC.

26th April 2007 – BOARD MEETING

236. CCC's Board Meeting of 26th April was a telephone meeting, held after an Audit Committee Meeting, and was primarily concerned with arrangements for the upcoming IPO scheduled for June. However, the Board also discussed and approved a plan to grant share incentives (a restricted stock grant) in CCC to the Independent Directors and to CIM at the time of the IPO. I am told that such a grant is a common form of remuneration for directors and senior

employees, and it is apparent that it was fully disclosed to investors in PPM and OM materials. Plans for the IPO were discussed, appropriate resolutions authorising the necessary preparatory steps were passed, and Messrs Conway, Stomber, Hance and Allardice were appointed to be a Pricing Committee which was to have full powers to deal with matters of pricing and the size of the IPO.

237. The definition of the liquidity cushion was further refined at the suggestion of Mr Reville. The Board also formally adopted the guidance issued by the Guernsey Financial Services Commission ("**GFSC**") with regard to corporate governance practice. It formally approved CCC's taking the bridge loan from the underwriting banks, mentioned above and below.

Market events - May 2007

238. The bridge loan of $191.7Mn was negotiated by Mr Trozzo and Mr Greenwood, and was entered into on 10th May 2007. On the same day, Mr Stomber emailed the Board to report its completion, and therefore the rescission of the approval for the reduction of the liquidity cushion guideline, which now was to go forward at 20%, again. The bridge loan terms in fact contained a covenant that CCC would not permit its liquidity cushion to be less than 20% of the "Value of its Investment Assets". This is an obvious mistake, as it was only ever the value of CCC's Adjusted Capital, or Net Asset Value which was intended to be the base figure for fixing the level of the liquidity cushion. Fortunately the loan was relatively short-lived and no issue ever arose.

239. CCC used about $155Mn of the loan proceeds to purchase about $4Bn of Agency floaters in May 2007, and about $30Mn to restore the liquidity cushion. This reached 31% by 10th May, and in fact remained above 25% from then until after completion of the IPO. The bridge loan and its key terms were disclosed in the OM.

18th May - ALCO Meeting - Market volatility

240. CCC held its second ALCO meeting on 18th May 2007, attended by Messrs. Trozzo, Greenwood and Melchior, and also Mr Buser, who had just become a new member. Mr. Greenwood informed the Committee that spreads had widened over the last two months on Agency floaters but that CCC's RMBS portfolio did not have the kind of credit risk exposure that was affecting other yield vehicles at the time. Mr. Trozzo discussed CCC's compliance with its Investment Guidelines, all of which it was passing, except for parameters concerned with the leveraged finance assets (ie not the RMBS sector of the portfolio).

241. The materials presented to the Committee were produced by Management using CCC's internal software market modelling system called Polypaths. This software produced both CCC's daily price projections and its price volatility and VaR calculations, drawing on daily market data inputs to do so. These inputs included, but were not limited to, swap rates, forward interest rates, and the implied volatility also known as "cap" volatility. I do not need to explain these metrics; their very names illustrate the kind of technical information and predictions which provided material for Management to assess trends and make decisions. Polypaths was both a price modelling and risk management tool.

242. CCC's liquidity cushion, consisting of the uninvested proceeds of the private placements, was reported then to be $148.7Mn, or 26%, although it was noted that if these values were adjusted to the market price shown by Polypaths, there would be a reduction bringing it down to 21.8%.

The "*Risk Summary*" slide showed that the asset allocation ratio of CCC's RMBS calculated using Polypaths was 55 %, and the ratio of the liquidity cushion to CCC's 1-day VaR was 9.2x. All these were very comfortable figures - although of course the opposite side of such very comfortable figures is that they suggest that the company is perhaps not exploiting its assets to best effect. It is in the balancing of such comfort and risk to gain optimum returns that the art of successful business lies.

243. In late May 2007, there was a decline in prices for CCC's Agency floaters. The evidence suggests that this was the result of market participants' fear of interest rate risk or cap risk; there were concerns that the economic growth then happening would lead to a likely rise in interest rates and fears that this might bring the cap on CCC's capped floater returns into operation. Mr. Stomber summarised the situation in a 31st May email to Mr. Hance and Mr. Conway:

> "*In short, in the last two weeks the unrealised MTM gains are gone and we have a small MTM loss since inception as spreads shot out.*"

244. Translated, this means that the previous small price rises which had showed as a gain in net asset values had been wiped out as the bond prices had fallen. However – and this is a constant feature of the business in this kind of market – this was not all bad news because wider spreads (lower prices) presented a buying opportunity.

245. CCC was at that time, an active player in the market, and looking for opportunities to achieve its objectives. It is easy to forget, looking at events with the benefit of hindsight and with focus on the desirability of selling, that, up to this time, there had been an active and relatively stable market, especially in the Agency backed sector. Participants were looking for good buys just as much as good sales, and CCC was, at that time, seeking to set up the business which it had modelled as advantageously as possible. In fact, in early June 2007, CCC's Management even broached with Carlyle the possibility of being given an additional $100Mn loan to buy more floaters at favourable prices, although in the end, this did not happen.

20th May - Meeting of Carlyle Partners

246. Before that, however, on 20th May 2007, Mr Stomber provided an update about CCC to the Management Committee of the Carlyle Group, along with the heads of other Carlyle funds. This presentation was a means by which senior Carlyle Group personnel kept an overview of the Group's activities and performance. The same day there was a meeting of the global partners of Carlyle.

247. This event is not part of CCC's own history, but the Plaintiffs lay emphasis on it as evidence of one of the matters which they say created a conflict of interest on the part of at least some of the Defendants, and put them into breach of their duties to CCC. It is said to illustrate the accepted oversight of CCC exercised by Carlyle and it being simply taken for granted that the raison d'être for CCC was to operate for the benefit of the Carlyle Group.

248. It was the practice to hold such a meeting at least once a year, to discuss matters of interest, review performance and prospects, discuss the future, and no doubt also to strengthen internal relationships and create a collegiate ethos by recording anniversaries, new partners and suchlike. CCC, its creation, and what it was doing, was part of the subject matter presented and reviewed at this meeting.

249. The Agenda on this occasion also included a discussion of what were referred to as "Strategic Alternatives" for the future development of the Carlyle Group itself. The Plaintiffs have chosen to dub these "Carlyle's Strategic Objectives" in their Cause and submissions, although that is not the language actually used. The Defendants object that this is tendentious, and that they should rather be called "Alternatives" or "Options". They were the identified possible courses which Carlyle might take to develop itself and expand. Among them were three which the Plaintiffs highlight. These were, first, the possibility of taking on a syndicated loan of up to $1.5Bn to provide working capital, second, that of making a further private placement of shares in TCG/Holdings, and third, that of conducting an IPO of Carlyle itself. There were others. The slides for the meeting show that the perceived advantages and disadvantages of each of these courses were listed and were obviously discussed.

250. In the event, the term loan option was indeed pursued and was in fact accelerated in order to enable Carlyle to assist CCC in August, when it first suffered from the global liquidity crisis.

251. The second material option noted above eventually came about in the shape of a second sale of a major interest in Carlyle (7.5% of its earning shares) to Mubadala, the first having been that to CalPERS. This transaction was under negotiation from about this time until it completed in October 2007, and thus during the time when CCC first suffered major financial difficulty. It provided three of the Directors with a significant capital distribution as payment for the reduction in their own interests in TCG, as later detailed. The Plaintiffs assert that in making their decisions with regard to CCC at the relevant time, the Defendants improperly put the interests of Carlyle in general, and these three Defendants in particular, in securing the best price from Mubadala ahead of the interests of CCC itself and its creditors.

252. As to the third option, an IPO of Carlyle itself (in effect, I think TCG), this was not pursued at this time. One eventually took place in 2012. However, the Plaintiffs say that it was then in prospect and, once again, the Defendants' decisions with regard to CCC were improperly influenced by the concern of not jeopardising that prospect.

253. Thus, the Plaintiffs argue that when it came later to the decisions made in respect of CCC, and in particular what they dub the "inexplicable" failure to deleverage its position after August 2007 by selling off at least half of its RMBS and winding the company down, those decisions were in fact driven, they suggest, not by a consideration of the best interests of CCC and its creditors, but rather by the interests of the Carlyle group in general, and those three of CCC's directors in particular. These lay in avoiding the potentially adverse financial effects and ignominy of a public company bearing the Carlyle name being wound up, or having to admit the failure of its widely publicised intended business model. It was (say the Plaintiffs) these kinds of considerations which provide the real explanation for CCC's directors resolving that it continue on an apparent "business as usual" basis, and which resulted in its taking the obstinately reckless course as to its future, which ultimately caused it to collapse more spectacularly and expensively than would have been the case if decisions governed solely by CCC's own interests had been implemented.

254. But all this is jumping ahead.

June 2007 - Bear Stearns hedge funds fail

255. Returning to the history, on 7th June 2007 came the first sign of what eventually turned into the sub-prime mortgage crisis, and the collapse of the Asset Backed Commercial Paper

("**ABCP**") market. Bear Stearns announced that it was suspending redemptions from two of its hedge funds that were heavily invested in subprime RMBS. "Subprime" was not, in fact, as pejorative a term then as the label nowadays conjures up. It simply means "not prime"; it is not the same as "junk".

256. Management, though, (and likewise Mr Hance) did not expect this event to have an adverse effect on CCC's portfolio of Agency floaters. Indeed they expected that it would actually benefit CCC, as investors shifted capital away from such assets and into safer fixed income assets like the Agency RMBS in CCC's portfolio, in the phenomenon known as a "flight to quality." The Defendants point out that this general belief and reaction was shared by others around this time, citing speeches by the Chairman of the Federal Reserve, Ben Bernanke on 17th May 2007, and research bulletins even of late June 2007 by analysts at Credit Suisse and elsewhere.

257. On 7th June 2007, Mr. Trozzo reported to Mr. Stomber that there had been a significant jump in the 5-year swap rate, a forward-looking indicator of rising interest rates, and that as a result, CCC's Polypaths software was suggesting that the value of CCC's RMBS portfolio had declined by about $45-50Mn; if CCC's repo lenders' pricing followed suit, the result could be a mark-to-market write down in the value of CCC's RMBS portfolio of some $55Mn, which would prompt margin calls of a similar order. (On a 2% haircut, the margin call would be 98% of the reduction in the recorded market value of the asset. Therefore, treating the call as the actual reduction in value provides a good working figure.) Margin calls of that magnitude would reduce CCC's liquidity cushion to 20.4%, and Mr Stomber so reported to Mr Conway and Mr Greenwood.

258. Mr. Conway responded briefly, copying Messrs. Hance, Allardice, and Stomber, that this was why one had a liquidity cushion. Mr Stomber and he then agreed, by email, that if the additional $100Mn loan were to come from Carlyle as had been suggested in order to purchase more assets, CCC would need to use part of it to protect the liquidity cushion.

259. In one of his general emails to CCC's Board that evening (7th June), Mr Stomber gave his view on the effects of market conditions on CCC's asset prices and consequent likely margin calls, but reminded the Board that the same assets were backed, effectively, by the US government and would ultimately pay their par value, whatever happened. His stated view was that whilst the recent developments might affect the eventual level of dividend which CCC could pay in the third quarter of 2007, they would not rule out paying a dividend, and CCC was still likely to compare favourably with other investment vehicles with different asset allocations which were more exposed to absolute fixed rate assets. He suggested, even, that the fall in market prices provided a buying opportunity, which it would be useful to take advantage of before the IPO.

260. On 8th June, however, Mr Stomber emailed Messrs Conway, Hance and Allardice describing events of the previous day as a "*perfect storm*" and a "*4 standard deviation event*", which CCC's own internal price modelling suggested would result in a mark-to-market price reduction of $60-70Mn in CCC's assets. In the event, though, the margin calls made on CCC on 8th June were only for $20.3Mn in the aggregate, far lower than predicted. The reason for this was later worked out to be that CCC's repo lenders at this time fixed their price marks by using the external pricing services already referred to, and these tended to have a time lag in recording the effects of actual market transactions, which Polypaths applied immediately.

261. Emails between Messrs Stomber, Conway, Hance and Allardice, over the next two or three days show them considering the workings of the liquidity cushion, how to approach the potential use of it, and the appropriate reaction for CCC to the immediate market conditions. They reflect a view that the purpose of the liquidity cushion was that it should be used if necessary to meet margin calls in order to avoid selling assets in a disadvantageous market.

262. On 10th June 2007, there was an exchange of emails between Mr. Stomber and Mr. Trozzo in which, in the context of considering taking the loan to buy more RMBS at advantageous prices, Mr Trozzo proposed reconsidering the size of CCC's liquidity cushion for the whole portfolio and making purchases only of an amount which would leave this. Mr Stomber disagreed, proposing to apply the guidelines only to the new purchases, although allowing that these should be at a more generous 25% liquidity cushion. In oral evidence he explained his reasons as being his view that the current market volatility was not likely to continue, and that CCC was not facing "*an event like 1998"* (a reference to the LTCM crisis).

263. Presumably for the purpose of arguing that Mr Stomber's judgment or conduct should be found wanting, the Plaintiffs seek to make something of the fact that Mr Trozzo has not been called as a witness by the Defendants. They suggest that this justifies an inference that Mr Stomber was actively (and presumably culpably) disregarding advice from Mr Trozzo. I will consider later and generally the Plaintiffs' submissions as to adverse evidential inferences from what they term "missing" witnesses, but for the present it suffices to say that Mr Trozzo's views and Mr Stomber's response are, in my view, perfectly apparent from the emails, and that in any event, this exchange pre-dates any matter of complaint by the Plaintiffs by at least six weeks. The only evidential significance that can be attached to it is the rather tenuous suggestion that it shows an attitude of mind which might have continued and therefore influenced the later decisions which actually are in issue. Its significance is reduced further, though, by the fact that, in the event, CCC did not borrow any more money from Carlyle in order to make any such purchases at this time.

264. On 12th June there was another unusual spike in swap rates, which Mr Stomber considered to be a second "*4 standard deviation event."* His reaction, in order to protect against price falls and consequent margin calls, was to instruct his traders to stop buying assets, and that some bank loans should be sold. $150Mn of these were sold, on 13th June, at their full market prices and therefore at no loss to CCC. They realised $25Mn in liquidity.

265. In an email to all members of the Board on 13th June Mr Stomber comprehensively reported these few days' events and his own actions and comments. Basically, his view was that the value of CCC's RMBS was being adversely affected by the market perception that interest rates were likely to rise, thereby increasing the risk that the payment cap on CCC's Agency floaters might take actual effect. This drop in value had resulted in margin calls - though not as dire as had been predicted - as to which bank loans were being sold in order to increase liquidity; Mr Stomber described this as invoking *"emergency powers"*. However, he pointed out that as the two parts of CCC's portfolio were, intentionally, uncorrelated, the value of the bank loans had not been affected, and it had been possible to sell them, therefore, at prices which had caused no loss to CCC.

266. He warned that CCC's own internal software was predicting that market conditions could well produce further margin calls which could produce a reduction in the liquidity cushion to below its intended 20% level to around 11%. He advised that the IPO would need to be postponed in

these uncertain and disadvantageous circumstances. Mr Conway responded laconically but calmly that now CCC would *"see how robust our model is".* This email alerted all Board members to the fact that there was a significant adverse market event happening at the time, and the steps Management was taking to manage its effects. Emails show telephone discussions between Mr Stomber and Mr Hance.

267. On the same day, Mr Stomber also requested Independent Director approval for the temporary reduction of the liquidity cushion requirement to 10%, so that margin calls could be met without the need to sell RMBS. A telephone conference between the Independent Directors and Mr Hance was arranged and the resolution was proposed the following day. It was discussed and approval was given, although with Mr Loveridge being away on holiday at the time, he did not actually sign the resolution until 18th June. In the event, though, CCC's fears as to margin calls did not materialise.

268. What I take from this flurry of correspondence, which is a reasonably typical example of the kind of correspondence and communications which occurred during the material period, is that Mr Stomber was anxious to, and very much did, keep the Board fully informed of what was going on, with commentary, and that he took steps to react effectively and proactively to crisis circumstances. What I also derive is that in fact the liquidity cushion was lined up to fulfil its purpose and would have done so even if it had had to be utilised and had thus been depleted to 11%. In fact it remained above 20% at all times. Whilst the suspension of the liquidity cushion guideline was never formally rescinded, and the Plaintiffs have made a point about this, I do not find this particularly surprising or even particularly culpable. It is obvious from the documents that everyone later assumed that, with the crisis past, the basic guideline remained operative. No-one was misled as a result. That "*lapse in corporate documentation governance*", as Mr Stomber accepted it was, was totally trivial and, in the great scheme of matters in this case, not worthy of having any time spent on it.

269. I have mentioned that the appropriate timetable for CCC's IPO still remained in question. This was because, whilst CCC's business model had stood up, it was perceived that the jolts to the market might well have caused investors to be nervous at the very mention of "mortgage backed" products, and result in a lack of appetite for taking up shares in CCC, however much CCC might seek to educate investors that entertaining such fears on a totally general basis was mistaken.

270. Having perceived this possibility himself, Mr Conway went to Carlyle's lawyers with a request that they research a potential alternative plan for capital raising if the IPO appeared not to be viable. He did not inform the remainder of the Board, or Management, that he was doing so. He says that this was so as not to divert the attention of Management, and he just thought it would be useful to have a second group working on an alternative. The Plaintiffs say that this sheds significant light on Mr Conway's attitude to and relations with the Board, which they characterise as autocratic and controlling.

271. A possible further private placement was indeed mooted, I think; there is allusion to some such discussions in other emails between Mr Stomber, Mr Conway and Mr Hance at this time. But ultimately this is all immaterial. No such proposals ever went to the Board because in the end CCC's Pricing Committee opted to proceed with the IPO, following the successful negotiation of the June market circumstances and general stability seemingly restored.

14th June - ALCO Meeting

272. CCC's regular ALCO meeting took place at exactly this time and in fact early on 14th June 2007. It was reported that CCC was complying with all of its Investment Guidelines, that the liquidity cushion had dropped from 31.4 % as at 1st June, to 28.2 % as at 11th June, and various predictions were modelled to show the effects of margin calls. As to these, Mr Trozzo commented that the projected worst case basis for *"uncalled RMBS margin calls"* being included, showed a consequent dip in the liquidity cushion to 15.3%, but that this was based on CCC's internal model rather than an external pricing service, and therefore *"possibly overstates"* uncalled margin. I refer to this further below.

273. Further data showed that the average price volatility ("**APV**") for CCC's RMBS portfolio as calculated by CCC's Polypaths software had risen from 0.55 % on 1st June to 0.79 % on 11th June. An increase in this volatility metric is a matter of concern because it shows reduced stability in the market, and CCC's original business model had been stress-tested on the basis of an APV of 0.85%. However, increased volatility was also, it was pointed out, inherent in the nature of the metric itself, given that Polypaths had been projecting a decline in prices. Volatility measures price changes, and thus a fall in prices inevitably increases the range of figures which feed the calculation of APV.

274. The ALCO meeting noted that even though there had been a period of unusually high volatility, CCC's liquidity cushion had in fact remained above its 20% mark, and that although CCC's own model had predicted that the liquidity cushion would fall to roughly half of the guideline level after the events of 12th June, in fact CCC still had capacity in its liquidity cushion. Management also discussed the ways in which CCC was "*position[ing] itself defensively and bolster[ing] liquidity in light of the ongoing market turbulence.*" This was through the sale of bank loans.

275. I sense from the minutes of this meeting that, at the time, the concerns being expressed were not so much as to the prices of CCC's RMBS being depressed, but as to CCC's modelling software producing unduly conservative predictions compared to the real world. I find this understandable. In the circumstances at the time, the important aspect of risk management tools such as CCC's own price modelling was that they should be accurate and dependable, so as to enable CCC to make reliable decisions and deploy its assets sensibly but efficiently. Whilst a cautious approach of pessimistic pricing would provide safety, it would do so at the cost of less profitable asset deployment. Caution is valuable and necessary when the situation is known to be unsafe, but undue caution is wasteful where the situation is stable. The art of success is therefore managing the balance of the two, and is in any event a quality to be exercised by management judgement rather than inherently built into pricing models designed to provide information. In the circumstances at that time, and at that stage of CCC's development, it seems to me to have been quite reasonable for CCC's Management to focus on whether their internal software pricing model was accurately reflecting the market, and that is what they did.

276. The breadth of materials supplied to ALCO, and the minutes recording their discussion, demonstrate the extensive tracking of relevant data and metrics set up to enable Management to review what was happening in the market, consider what this suggested about CCC's assets and business, and decide on appropriate action in the circumstances. It is important, though, to recognise such materials as what they are; tools for analysis to enable good business decisions to be made. They take various forms. Some will measure facts, to provide a series of comparisons over time, to assess both performance and risk. They also provide

measurements in the form of ratios, the comparison of which, from time to time, enables human managers to get a sense of trend or other matters, again so as to help inform their decisions. They can be used to make predictions - but the important point in this respect, it seems to me, is that they are illustrations representing probabilities, and not plans or targets in themselves.

277. Because the Defendants' reactions to the figures recorded periodically in these metrics has been the subject of much discussion and cross-examination in this case I give one example of my views about the limits on how these figures can properly be prayed in aid. This is with regard to a particular metric which has figured centrally in this case, called the "20 day VaR" metric. As at 11th June, CCC's liquidity cushion (at $149Mn) remained slightly above the then calculated figure for 20-day VaR produced by Polypaths, though the figure was expressed as a ratio of the one to the other. The underlying meaning of this was that, assuming that the Polypaths calculation of recent price volatility was correct and would apply going forward, CCC had enough liquidity to have a 99% chance of being able to withstand 20 days of the statistically-calculated worst degree of price volatility it might encounter, judged from that which had occurred in the recent past – I understand taken at three months – even if it took no corrective actions at all (such as selling assets or obtaining a loan) within that period. Thus, this calculation provides the human manager with a general feel of how 'safe' CCC's business position currently is, which can be compared with similar statistical calculations using facts at a later date, to get a sense of trend. The postulated scenario, though, is completely unreal. Its purpose, along with that of similar metrics modelling different financial matters, is emphatically an aid, to provide that sense in order to assist management to decide what to do. It does not mean that CCC is in fact going to continue for 20 days doing nothing, or that it will only decide on what action to take after 20 days. The question what CCC's Management would therefore do "at the end of the 20 days", is therefore meaningless. I mention, and perhaps even labour, this point, because at times this was what the cross-examination of Mr Stomber seemed to amount to.

15th June - Repo roll

278. In fact, during 14th June itself, CCC's repo dealers one by one confirmed their use of IDP pricing, such that margin calls based on the lower prices predicted by CCC's Polypaths software did not materialise. CCC's liquidity cushion remained above 20 %, with CCC still being about to receive the $25Mn from the sale of bank loans already mentioned, as these completed.

279. The successful negotiation of a repo roll in the face of difficult market circumstances had been achieved. I am satisfied that this would, and I think quite reasonably, have given CCC's Management and Board some confidence in the efficacy of the business model which had been devised for CCC.

280. Mr Stomber, Mr Hance and Mr Conway each say that their view of the volatility of the market as it affected CCC was that although this appeared to be fuelled by perceptions of interest rates rising, their own views of the state of the economy were that it was actually slowing down and weakening, such that interest rates were in fact more likely to fall in the longer term; it was therefore only a question of when. In the light of these views about the likely trajectory of the U.S. economy (and therefore interest rates), they say that they believed that CCC's business model remained strong.

Start of the sub-prime mortgage crisis and demands for increased haircuts

281. The first definite signs of what turned out to be developing market instability began to emerge in June 2007. The first repo lender to ask CCC seriously for an increase in haircut levels from the customary 2% thus far enjoyed by it as a "first tier" customer (because of its connection with Carlyle), with high quality assets, was Deutsche Bank. It actually did so on 13th June 2007- apparently too late for this to be the subject of discussion at the next day's ALCO meeting, reported above.

282. Deutsche Bank had suffered in the Bear Stearns hedge fund turmoil. Mr Stomber says he took the view that this made Deutsche Bank a special case, with its own particular reasons for becoming more cautious or trying to reduce business exposure. CCC's 13th June 2007 "*Summary of Repo Methodology*" spreadsheet, in which it recorded the state of play with each of its repo counterparties, noted that Deutsche Bank was seeking a higher haircut but not until after a later meeting. In subsequent summaries, starting from 10th July, it was noted that Deutsche Bank had quoted a 3% haircut to CCC for a new repo line, because of "*subprime pressure.*" and that it had been turning away new repo business *"amid BSAM [Bear Stearns hedge funds] turmoil*", but also that CCC had in fact negotiated it back to a 2% haircut.

283. On 18th and 19th June 2007, CCC received a direct warning that instability in the sub-prime markets might affect its own position in an adverse way. Mr John Duffy, a managing director with Bank of America, warned Mr Ng of CCC, that his bank was "*increasing haircuts across asset classes (including the safe stuff)"* and that CCC might find others doing the same in the light of *"recent hedge fund/mortgage liquidations"*, seemingly referring to the Bear Stearns incidents. The next day he gave a similar warning to Mr Greenwood. However, Bank of America did not, in fact, ask for a higher haircut from CCC at this time. CCC rolled about $1Bn of its repo away from Bank of America to Bear Stearns. The Plaintiffs say that I should infer that this was because Bank of America must have demanded a higher haircut (in the light of Mr Duffy's warnings), rather than, as CCC said, a dispute over the interest rate, which at the difference of 1bp which was put to Mr Stomber, he said would have been "silly". Mr Stomber was not involved in the transaction, however, and I am not prepared to draw the adverse inference which the Plaintiffs invite as it would be speculation, and I note that Mr Ng, the trader involved, did seem to act on the basis of fine differences in interest rates at other times.

284. JP Morgan followed suit to Deutsche Bank on 21st June 2007. It proposed a 3% haircut, citing "subprime pressure" as the reason for its request. However, and again similarly to Deutsche Bank, it fell back to 2% for the upcoming repo roll when CCC negotiated with it.

285. On 25th June 2007 Man Financial also requested a 3% haircut. Man Financial does not appear to have been a major player in the repo market. CCC only had a small ($240Mn) line with it. CCC apparently did not think much of Man Financial, viewing it as having inadequate infrastructure for the repo market, and hence demanding uncommercial terms. CCC's response was to roll its repo away from Man Financial to other banks which were willing to provide repo finance at a 2% haircut.

286. The Plaintiffs say that CCC's Management ought, at least from the time of the Board meeting about a month later, to have seen these warnings and requests for higher haircuts as clear signs that CCC could not, in the future, count on maintaining the 2% rate of haircut upon which its business model was predicated. The Defendants say that this is being wise with hindsight. At the time, CCC's Management did not, and reasonably did not, see these matters as cause for

alarm but as being prompted by the relevant banks' temporary personal circumstances and concerns, and that this perception was supported by the fact that such demands were not followed through. They stress that CCC never had to accept a haircut above 2% at this time. They also anticipated, and they suggest quite reasonably in the circumstances, that markets would swing back towards the more apparently "normal" conditions of before. These views were conveyed to the Board members by Mr Stomber.

287. Thus, the credit market risks which had been exemplified in the Bear Stearns incidents were not expected to have anything but a superficial and short term effect on CCC's RMBS portfolio. Mr Stomber says that he saw these as the effects of bad news rather than anything more serious. However, they did have a negative effect on the value of CCC's credit products (which it will be recalled were, by design, "*uncorrelated*" with the RMBS portfolio) as reported by Mr Stomber to Messrs Conway and Hance on 24th June 2007. The correspondence shows that this was not a surprise, though, and it would not bring CCC's liquidity cushion below 20% after the next repo roll the following day.

Reinstatement of CCC's IPO

288. As mentioned above, the turbulence in the market of the second week of June had caused Mr Stomber to recommend the postponement of CCC's IPO. However, when matters did not turn out to be as bad as predicted, and with the successful negotiation of the 15th June repo roll, Management proposed moving forward with CCC's IPO, as previously planned. The fact that CCC's repo lenders had endorsed IDP pricing for CCC's assets enabled CCC's share value to be reasonably reliably calculated. The effect of this was that CCC could, in fact, proceed to register with the Netherlands Authority for Financial Markets ("**AFM**") and proceed with the IPO.

289. Mr Stomber therefore recommended to other Board members, and in particular Messrs Conway, Hance and Allardice, as CCC's pricing committee, that the plans for the IPO be resumed. Taking the view (they say) that the present price volatility in the market was temporary, did not cast doubt on the solidity of CCC's business model - which had in fact shown itself to be even more robust than internal predictions - and that the expansion of CCC's investment base and the liquidity of a public listing were both what investors expected, and were in their interests, the committee members agreed.

290. Whilst the Underwriters were cautious, they did not seek to dissuade CCC from pursuing the IPO and they lent their support, thus providing, in effect, at least an implicit endorsement of CCC's business model. They had, of course, been supplying repo finance to CCC at the modelled 2% haircut for the previous ten months. In this regard, the Defendants refer to an internal memorandum of Citibank, dated 22nd February 2007, as demonstrating the kind of vetting which underwriting banks would carry out as part of due diligence in deciding to support such an offering. The memorandum noted that Citi had been in an "*ongoing dialogue*" with CCC since June 2006 "*to better understand its business objectives and long-term strategy as it pertained to the organization, initial private raise and initial public offering of CCC*", and that Citi had had several conference calls with key CCC and Carlyle individuals "*to discuss issues related to structure, operating environment, business plan, audited financials and financial projections*" and that "*the deal team will continue to conduct due diligence prior to the commencement of marketing to investors.*" Such cautious views as the underwriters expressed were therefore, it is suggested, a product of their views of investor interest at the

time, rather than misgivings about the fundamental strength and viability of CCC's business model.

291. CCC therefore submitted its final version of the OM to the Dutch regulators on 18th June 2007, and the OM was formally published the next day. There was a downturn in the IDP pricing of CCC's RMBS on 18th June, but this was assessed as just another flutter in the market, not evidence of a long term trend and likely to reverse itself because the fundamentals which drove these asset prices were still favourable (for example, a recent reduction in interest rates). It did not, therefore, deflect the offering process.

Offering Memorandum

292. The OM itself is a very long and rather more elaborate document than the PPM. It announced the global offering of 19,047,620 Class B shares in CCC, in total. It contains all of the material in the PPM, noted above, and more. It included the Investment Guidelines (as they then stood), the fact that amendment of these required the approval of the Independent Directors but that this could be done without notice to shareholders, and a description of the liquidity cushion. It disclosed clearly that CCC's intended source of funds would be repo financing. The risk disclosures set out in it are (to my eye at any rate) notably comprehensive. They included warnings as to the extensive use of leverage, possibly "*without limit"* and that this would magnify the effects of adverse events, even to the extent of causing CCC to default or fail, and that demands for margin could arise very rapidly. They noted that the

> "*expiration or termination of available financing for leveraged positions, the requirement to post* [additional] *collateral … can rapidly result in adverse effects to [CCC's] liquidity and its ability to maintain leveraged positions and may cause it to incur material losses."*

293. They announced CCC's overall expected leverage ratio to be 29x and its RMBS ratio to be 32x-37x. They warned that a decrease in the market value of CCC's securities could require CCC to post additional collateral or sell assets at a bad time, that if CCC were forced to liquidate assets quickly it could realise significant permanent losses and that in unusual market conditions, the liquidity cushion designed to meet reasonably foreseeable margin requirements might be insufficient. They disclosed reductions in the value of CCC's assets due to market events since 1st April 2007, up to 13th June 2007.

294. I do not think I need describe any other statements in the OM, which, as I have said, contained all the usual information about the company, its governance, its business and objectives, the possible consequences of investing and the warning that it would be quite possible to lose all of one's money. The content of this document is of only contextual significance in this case because it was issued a month before the Plaintiffs' first alleged cause of action arose. I have, though, mentioned the most relevant parts of it.

295. The uptake of orders up to 27th June 2007 was almost $300Mn, but this was lower than had been hoped, and was attributed to "Bear fears". (In the interim, on 22nd June 2007, Bear Stearns had announced its decision to bail out one, but not the other, of its two failed hedge funds.) The consequence was that it was decided to postpone a pricing announcement and reduce the number of shares on offer, and to issue a supplemental OM in this regard. This was announced by a press release on 28th June, and the supplemental OM was issued on 29th June 2007.

296. That document, prepared by CCC's counsel, was integrated into the original OM. It alerted investors to the reduction in the size of the offering from $415Mn to $300Mn (15,962,673 Class B shares) and a revised offering price of $19 per share from $22 per share. It disclosed, in a section on "*Recent Developments*", the effect of recent market events on CCC, and the reduction in CCC's fair value reserves between 1st April and 26th June 2007 of $84.2Mn. This could be compared with the similar disclosure in the original OM of 18th June, which had disclosed a reduction of $28.9Mn between 1st April and 13th June 2007.

Completion of the IPO and events up to 26th July 2007

297. CCC's shares were listed on the Euronext Exchange on 4th July 2007, and the IPO was concluded on 11th July 2007. CCC did reach its revised target of $300Mn for new capital raised - but the Plaintiffs point out that this was apparently only achieved because Mr Rubenstein undertook a forceful personal marketing initiative with the Bank of Angola, an entity which had expressed interest in investing with Carlyle, but whose enthusiasm had not been entirely reciprocated previously, at any rate by Mr Conway. The Defendants, on the other hand, point to the fact that the underwriting banks exercised the greenshoe option to take up 15% extra shares, which, as mentioned above tends to suggest a successful offering.

298. Thus, in total, CCC raised approximately $345Mn. After commissions and expenses, CCC was left with just over $322Mn. $191Mn of that went to repay a bridge loan which CCC had taken from the Underwriters in order to purchase assets in advance of receipt of the proceeds of the offering, to prevent ramp drag. The remaining net proceeds were therefore about $130Mn. In the event, about $70Mn of this was invested and the remainder was allocated to CCC's liquidity cushion.

Review

299. This account of the sequence of events has now reached the completion of the IPO and the point in July 2007 at which events become directly material to the first claims of breaches of duty which the Plaintiffs make, namely with regard to the Defendants' decisions taken at the Board Meeting of 26th July 2007. It is therefore appropriate here to take stock of the case.

300. First, the Plaintiffs make no complaint about the Defendants' actions at any point before 26th July 2007. There is no complaint about, for example, the wisdom of hiring Mr Stomber, or the initial devising and adoption of CCC's business model, with its assumption that repo finance would be obtainable at 98% of the value of CCC's RMBS assets. The Plaintiffs' claims for breach of fiduciary duty, and negligence (and also breach of contract against CIM) are in respect of the Defendants' conduct only at, and (in effect) continuously after, the Board Meeting of 26th July 2007.

301. As regards the Plaintiffs' further or other claim for wrongful trading, they place that as being at all times from about mid-August 2007, being the point at and from which they say that the Defendants first knew, or ought reasonably to have known, that CCC stood no reasonable prospect of avoiding going into insolvent liquidation, until the end of December 2007. It was the effect of events at the beginning of August 2007 which, they say, changed the trajectory of CCCs business so irremediably in the direction of insolvency – at any rate without appropriate action - that this ought to have been appreciated and acted upon accordingly, at least by the time of the extraordinary Board Meeting of 23rd August 2007. The important point for present purposes, though, is that the Board Meeting of 26th July 2007, viewed in the

light of events immediately preceding it, is the starting point of the Plaintiffs' case against the Defendants.

302. I have given an account of the events earlier than this starting point in some detail, for two reasons. The first is the obvious one that it recounts the background of facts known to the Defendants and against which their conduct, and in particular either side's assertions as to what they knew or thought, has to be considered. The second is less obvious but just as important. It is that I have to judge the conduct of the Defendants in the context of the business world in which they and CCC then operated. To do so fairly means seeking to gain as full and sound an impression as possible of the workings of that world leading up to and at the material time, and some understanding of its characteristics, culture and atmosphere. The account I have given has therefore been intended to give some of the flavour of this background which I have found to be important, although I will expand later on some of the impressions and understanding which I have gained from the evidence.

303. Before moving on to the rest of this judgment, though, it is helpful to set out a high level summary of the facts which are the ingredients of the Plaintiffs' allegations of breach of duty, misfeasance and wrongful trading. Knowing this, will help the reader follow my consideration of those allegations.

3. Overview of the claims made

304. For practicality in their closing submissions, the Plaintiffs group the breaches of duty and other claims which they allege by reference to five successive periods. Conveniently identified, these are: July 2007, August 2007, September 2007, October to December 2007, and lastly early 2008.

(1) July 2007 – 26th July Board Meeting

305. As regards July 2007, the Plaintiffs submit that CCC's business model was "fragile" from the outset, and that various warning signs showed that the risks to CCC had increased significantly. They cite the "fundamental changes" in the repo market following the collapse of the two Bear Stearns Hedge funds (which I will now call the "Bear Stearns incidents"), a growing risk of higher haircuts - evidenced by an increasing number of proposals for these, - which they say should have been foreseen, adverse increases in the metrics of interest rate volatility, the price volatility of RMBS and suchlike, the unanticipated but significant lost value (even if unrealised) which CCC had already suffered on its RMBS portfolio, and the difficulty of achieving a successful IPO for CCC.

306. They say that by the 26th July Board Meeting, these signs required the Defendants to re-evaluate CCC's business model, to adopt a risk-averse approach, to reduce leverage, to secure additional and varied sources of cash funding, to make no more asset purchases and to implement sales of RMBS, in the shape of a programme of (as they eventually specified) selling more than $2Bn worth, monthly, to increase liquidity. At a minimum the Defendants should have been on "heightened" alert at this time. What they actually did, namely freeze further purchases of assets, was obviously (the Plaintiffs say) insufficient, and in fact the Defendants actually allowed CCC to complete a purchase of about $1.5Bn more RMBS at the end of July/beginning of August 2007. Carrying on otherwise with "business as usual" was, the Plaintiffs say, a *"knowing or in the alternative reckless [breach] of duty".* Within this phrase, for convenience, they also include gross negligence or negligence.

(2) August 2007 – including 23rd August Extraordinary Board Meeting

307. In early August 2007 - in fact the particular date is 9th August - the financial markets were rocked by the suspension of redemptions from three more hedge funds operated by BNP Paribas, and the general collapse in the ABCP trading market began. The Plaintiffs submit that this was a further and fundamental change in the financial markets, which meant that, from that time, CCC's existing business model was now *"terminal".* They cite a list of matters, examples of which are: further increasing price volatility, requests for higher haircuts, and repo lenders pricing to their own conservative prices rather than using an outside pricing service, amongst many others, as major and obvious warning signs that CCC's business was no longer viable, and to which they say the Defendants, did not, either individually or as a Board, pay proper regard. When CCC's liquidity began to run dangerously low, the Independent Directors, in particular, simply agreed to suspend the liquidity cushion investment guideline to fit the facts, rather than insist on steps being taken to increase liquidity.

308. Because of the perilous depletion in CCC's liquidity, on 20th August 2007 Mr Stomber and Mr Conway did the rounds of CCC's six major repo lenders and underwriting banks at high executive level, to persuade them to agree to hold haircuts at 2% in return for the Carlyle Group making a $100Mn loan to CCC to ease its liquidity. The reaction was disconcertingly unresponsive and negative, even to the extent that Mr Black of JP Morgan advised that CCC should immediately sell $10Bn of its $23Bn RMBS portfolio. The Plaintiffs say that this obviously good advice was not heeded as it should have been.

309. In the event, Carlyle made the $100Mn loan anyway. An extraordinary Board Meeting was convened on 23rd August 2007 for the purpose of considering CCC's financial position and the Plaintiffs complain that the decisions taken at that meeting - which they attribute to Mr Conway, and which were not to embark on selling RMBS but, in effect, to continue to hold CCC's portfolio as before - were patently inappropriate, were reckless, and were thus in breach of duty. They make general assertions that the Defendants should have investigated all avenues available to CCC to sell RMBS and/or raise further capital and reduce leverage, and should have insisted on such a course being taken; they should have carried out urgent reviews and assessments of CCC's position, made a plan to return to compliance with the Investment Guidelines, and sought investment and insolvency advice. In failing to do so they were in reckless breach of duty.

310. The Independent Directors were, the Plaintiffs assert, in further breach of duty in failing to ascertain the strength of Carlyle's commitment to assist CCC with a loan, or the true extent of the support for CCC which Carlyle was known to be giving by making an agreement with Citi Bank under which Citi would give CCC favourable repo terms. They say that Mr Conway was in breach of fiduciary duty to CCC by not revealing all the terms of such agreement to CCC's Board.

311. It is from this point that the Plaintiffs say that it should have been plain to the Defendants that, without a change of strategy, CCC would not avoid an insolvent liquidation, such that they became guilty of wrongful trading.

312. The Plaintiffs say that from and after this time, CCC could and should have implemented a policy of selling RMBS, either as part of a necessary process of reducing leverage and increasing liquidity, or of winding down CCC's business (the effects probably being much the same). CCC needed to sell some $10Bn of its RMBS portfolio to achieve acceptable liquidity,

and it could have done so, at least, by a properly devised and controlled programme of selling RMBS at the rate of $2-$3Bn a month for several months, which could have been successfully achieved at acceptable prices.

313. The Plaintiffs add that the criticisms which I have summarised above were, and remained, the Defendants' core breaches of duty throughout the remainder of CCC's operating life, although other alleged breaches committed later are also relied on.

314. Although the Plaintiffs submit that it is not necessary for them to do so as the breaches speak for themselves, they offer suggested explanations for such breaches, as support for the findings which they urge. The first is a dogged pursuit of paying a double digit dividend, even though this was not in CCC's interests, because it would help achieve the Carlyle Group's "Strategic Objective" of making a highly lucrative private placement sale of shares in TCG/Holdings to Mubadala, thereby also securing significant personal financial benefits for Messrs Conway, Zupon and Hance. The second suggestion is a desire to avoid the embarrassment and reputational damage of the failure of an entity bearing the Carlyle name, only weeks after its public launch. The third is the proposition that Mr Stomber was "subservient" to Carlyle and to Mr Conway, and placed his desire to please them ahead of his duty to act in CCC's best interests and advise accordingly. The fourth is that the Independent Directors were not truly independent, but merely acted as a rubber stamp for decisions made by Carlyle, personified in Mr Conway and Mr Stomber.

315. These matters, if found on the evidence, would not merely provide an explanation for lack of care, but would also amount to matters of improper motivation and conflict of interest, thus (the Plaintiffs argue) giving rise to findings of breach of the Defendants' fiduciary duties to CCC.

(3) September 2007 - no Board Meeting

316. As regards September 2007, the Plaintiffs repeat the various aspects of their complaints regarding August, and say that these had simply continued. They say nothing had materially improved, and CCC faced increasing difficulties in obtaining acceptable repo finance, including an obvious risk of haircuts rising, even to 4% or 5%, which would be unaffordable. Its net cash outflow, principally being margin payments, had been a staggering $418Mn to the end of September 2007; it remained in a state of either actual or borderline insolvency.

317. The Plaintiffs submit that by this time the Defendants had obviously recognised that CCC's business model was no longer viable, - CCC was only surviving because of the special deal with Citi Bank, (the details of which Mr Conway still failed to disclose fully to the Board), and because Mr Stomber later issued "threats" to Bank of America as to loss of Carlyle business if BoA did not assist. The Defendants nonetheless did nothing to devise a viable business plan or to take the "*Required Actions*" (namely, deleveraging by making sales of RMBS, raising additional capital or other finance, or winding the company down) and did not consider these options properly or at all, and did not even hold a further Board Meeting.

318. The Plaintiffs complain about the statements made about CCC to the global Carlyle Investment Conference in September 2007 by Mr Hance, Mr Stomber and Mr Conway, which they say amounted to misleading the conference, and thus the market in general, as to steps CCC would take or had taken to reduce leverage, adopt a new business model and improve its funding strategy in the future. They also complain that Mr Hance gave the conference a

misleading statement of the value of CCC's shares, which information was subsequently and improperly deleted from the website record of the conference.

319. At the very end of this period, on 1st October 2007, the Plaintiffs complain that the Defendants, and in particular the Independent Directors, once more suspended CCC's Investment Guidelines for a further three months, without any proper consideration or deliberation, and as a mere formality, and culpably failed to make public disclosure of this matter, adequately or timeously, as they should have done.

320. During this period or shortly afterwards, the Carlyle loan to CCC was converted into a revolving credit facility.

(4) October to December 2007 - including 13th November Board Meeting

321. As regards October-December 2007, the Plaintiffs again repeat the various complaints about the Defendants' actions or inactions during and since August, saying that the Defendants continued, culpably as before, to do nothing but hope to ride out the continuing adverse market conditions, ie depressed prices for CCC's RMBS and the difficulty of obtaining affordable repo finance. CCC was struggling to maintain or obtain new repo funding, and had no prospect of obtaining longer term repo financing.

322. Although the Defendants refer to the Auditors' (PwC's) confirmation that as at 30th September 2007 they considered CCC to be a "going concern" from an accountancy perspective, the Plaintiffs say that the Defendants cannot rely on that because they knew that PwC were relying on an enquiry of limited scope, and on management input some of which had been edited - this in itself constituting further evidence that CCC was being run improperly and kept alive only by illegitimate acts and decisions of the Defendants and the Carlyle Defendants in particular.

323. They refer, in particular, to the Board Meeting of 13th November 2007, which they criticise for lack of analysis or deliberation, for indecision, and for allowing matters simply to carry on as before, despite recognising that the situation was getting tougher, and would get tougher still as the counterparty banks went through the usual financial year end process of improving their balance sheets for presentation purposes. They criticise the Board's approval, once again through the Independent Directors, of the further suspension of the Investment Guidelines until March 2008.

324. Noting that the Defendants each purchased more shares in CCC at the end of November, they criticise the fact that (they say) this was done to try to stabilise CCC's falling share price (pointing to evidence of this being discussed at the Board Meeting and mentioned at the Carlyle Group Investor Conference in Paris on 20th November 2007), and this was illegal market manipulation under Dutch law.

325. The Plaintiffs highlight Mr Stomber's request to Mr Conway for Carlyle to be prepared to lend CCC another $50Mn over the calendar year end, citing this as a failure to recognise yet another sign of inevitable financial doom and criticising the fact that this facility was not publicly disclosed then, for being a breach of Dutch regulatory law.

326. Ultimately therefore, with regard to this period, the Plaintiffs reiterate that CCC continued to be in a state of actual or borderline insolvency, that the Defendants continued, in effect, to do

nothing and operate "business as usual", and in all the circumstances the Defendants were thus once again guilty of breaches of duty and wrongful trading.

(5) 1st January to 27th February 2008 - including 27th February Board Meeting

327. As regards the period from 1st January 2008 until CCC's eventual collapse on 12th March 2008, the Plaintiffs reiterate their complaints of doing nothing but hope to ride out the market conditions despite there being no evidence that these were going to improve, submitting that the economic conditions were then no better than at the end of 2007, the obtaining of longer term or third party repo finance was a forlorn hope, and the obtaining of continued affordable repo finance was becoming ever more difficult. The 27th February Board Meeting is once again criticised for accepting that there was still no viable business model and no sign of one, taking no steps to reduce leverage (etc) and approving the yet further suspension of the Investment Guidelines.

328. Similar points as before are made as to the illegitimacy of the Defendants' relying on PwC's year-end report on CCC, which endorsed it as qualifying as a "going concern" as at its year end of 31st December 2007.

329. The Plaintiffs say that the worsening of repo financing availability continued to be an indication of an ever worsening financial situation which had started with the August 2007 crash, and that the Defendants' contention that CCC failed because of an unforeseen second crisis from about 5th March 2008 onwards is incorrect and a colourable excuse; CCC failed because the Defendants failed, as they continued to fail, to take the obviously necessary steps of selling RMBS to deleverage and increase liquidity, or raise additional equity capital, or wind CCC down, and they were in breach of their directors' duties in not doing so.

4. <u>What this action is not about</u>

Claims which are not made

330. Before turning to the legal principles applicable to the Plaintiffs' claims, I need to make clear what this action is <u>not</u> about. This may be unusual, but it is appropriate to do so here because the allegations and materials have ranged so widely and over material much of which does not, in my judgment, have any effect as part of any operative cause of action for determination in this trial. To try to keep a manageable perspective on the real issues in the action, it is therefore necessary to focus on the real causes of action, and resist being distracted by matters of no real relevance. The following list is an aide memoire on this point.

331. <u>First,</u> this is not the trial of an application to disqualify the Defendants from being directors of a Guernsey company. That claim does appear on the original pleadings, but as previously noted, I directed in May 2015, during the case management stage, that that claim would be stayed and tried subsequently and separately - if appropriate. I regarded that claim as an inconvenient diversion in the context of the essential subject matter of the case, which is a contested claim for damages of nearly $2Bn including interest. In fact, given the national origins and residence of all the Defendants except Mr Loveridge, the reasons for cluttering up the substantive action with this additional claim have always seemed to me to be something of a mystery.

332. This point is important because matters of conduct which might give cause to question a defendant's fitness to hold such office go far wider than conduct giving rise to a claim for damages for breach of fiduciary duty, or negligence, or wrongful trading. Conduct falling short of appropriate governance standards will often cause no damage to the company. An example would be the directors' failure to ensure that the company complies with regulatory requirements, or statutory administrative obligations (leaving aside any fines involved), or complaints about their conduct in relation to third parties. Allegations of such conduct may have remained on the pleadings in this case as a legacy of the stayed claims, but that does not mean they should have remained in the evidence and final submissions, or that they have any real relevance to the issues which I actually do have to decide, or that it is appropriate to investigate them.

333. Second, and by the same token, this is not a disciplinary complaint about failure to comply with the rules of the Euronext Stock Exchange. It is possible that a failure properly to observe the rules of such an Exchange might be invoked as evidence showing a lack of care, or even arguably as being a breach of fiduciary duty. It is of course a duty of the directors of a listed company to seek to ensure that it observes any rules which attach to the privilege of being listed on the relevant Stock Exchange, and it is obviously in the company's best interests to keep in good standing. However, any misdemeanour in this regard would at best give rise to the sanctions prescribed by the Stock Exchange regulators, and would not *ipso facto* cause any actual loss to the company. By contrast, for the claims before me to succeed it is necessary for the Plaintiffs to assert and prove loss and damage suffered by the company as a result of whatever conduct by the Defendants is complained of. Whether or not that conduct is in breach of the rules of the relevant Stock Exchange (or any other relevant regulatory body, or even Dutch criminal law, for that matter) is just not relevant for present purposes. What is in issue is the financial consequences for CCC of the conduct of its Directors and not whether that conduct complied with any applicable rules and regulations.

334. Third, this claim is not an investors' compensation claim, of any description. It is not a claim for misrepresentation inducing the acquisition of CCC shares; that would be an entirely separate matter and indeed I believe that such a claim has been pursued separately, and has failed. Although the terms of both the OM and the earlier PPM have been referred to quite extensively in the course of the trial, their relevance is only as context against which the substantive claims for breach of duty to CCC need to be considered. Similarly, no complaint on the part of investors with regard to suggested misrepresentation in any of the public information documents, presentations, conferences or conversations subsequent to their acquisition of shares is within the present claim. Even if the Plaintiffs were to prove any such alleged misrepresentation, and even if this could also be shown to have been made negligently or improperly, that is of no avail to the Plaintiffs in this action unless it could also be shown to have caused measurable financial loss to CCC. Whilst there seemed to me to be arguments along this line surfacing in the early stages of the trial, by its end, they appeared to have retreated well into the background, where, in my judgment, they undoubtedly belong. Material relating to such allegations is again of the status of mere circumstance as regards this action, or just possibly as going to credit, although in the end no such argument really appeared to me to be made.

335. Fourth, this claim is not a claim that CCC was doomed to fail from the outset. That point is very important. Advocate Wessels expressly confirmed that it is no part of the Plaintiffs' case that it was negligent, or a breach of any duty, for the directors of CCC and for CIM to decide

on and implement the business model which was initially devised for CCC, even up to the time of its IPO which was made on 29th June 2007 and closed on 4th July 2007. The earliest time at which the Plaintiffs fix their complaints has been something which the Defendants have, very reasonably, been anxious to have clearly identified. The Plaintiffs' claim was confined, in Particulars which it delivered, to complaints about the actions of the Defendants "from July 2007". In the course of the hearing this was pinned down still further, and was ultimately stated expressly to be at and from the time of CCC's Board meeting of 26th July 2007.

336. It follows that the apparent strengths, weaknesses or flaws of CCC's initial business model are, again, relevant only as the context in which the actions of the Defendants from 26th July 2007 onwards are to be judged. Thus, whilst it is of course open to the Plaintiffs to argue that at the relevant time, the Defendants knew or ought to have appreciated the suggested deficiencies and fragility of CCC's business model, and that this appreciation should have informed their actions, the Defendants can equally obviously point out that it has not been suggested that it was negligent of them to adopt that business model and the assumptions that it incorporated, nor to run with such model, before 26th July 2007 at the earliest.

337. Similar points arise in relation to aspects of what was going on in the market prior to 26th July 2007, and in particular to events, and the behaviour of financial market counterparties of CCC, prior to the date of 26th July 2007, and especially in May and June 2007. This was a topic to which Advocate Wessels nonetheless devoted quite a significant part of his cross-examination of, in particular, Mr Stomber. There is, though, no pleaded complaint about the reactions of the Defendants to such events at that time, nor about any actions which they then took or did not take. At best, therefore, these matters are background and knowledge available to the Defendants, which it can be alleged should have influenced their actions during the later, relevant, period.

338. Fifth, and leading on from the above, it is not argued that it was negligent of the corporate Defendants as promoters of CCC to engage Mr Stomber to fulfil the role of CEO of the enterprise which was to become CCC because he was not competent – and should have been seen as not being competent - to take on the management of such an enterprise. The Plaintiffs' criticisms of his knowledge, experience and ability must be judged against that basic acceptance.

339. Sixth, this action is not a claim by repo financiers who provided repo to CCC at any time that this finance was obtained by misrepresentation, in particular misrepresentation as to the terms on which CCC was able to obtain similar finance from other repo lenders. This factual suggestion crops up periodically, but it is an allegation which, even if true, goes nowhere as regards the complaints of damage which are pleaded in this case.

340. Seventh, despite the fact that at certain points the Plaintiffs' characterise their complaints in fairly extreme terms (for example, that there was a "*plan to let CCC fail and blame it on the market*"), there is no claim of conspiracy to injure levelled against the Defendants or any combination of them.

341. There are probably yet other examples, but I make the above points to make clear that the ambit of the issues which I have to decide is defined and limited, not only by the scope of the Plaintiffs' pleaded Cause, but also by the logical materiality of any of the facts and evidence which I am invited to explore, and also by the legal analyses, where applicable, deriving from the authorities presented to me. I do not intend to decide more than is necessary for

determination of the matters comprised in the actual claims in this case if it can reasonably be avoided. I will be aiming not to decide points of law or academic legal analysis, interesting though these topics may be, unless they are part of the logical construct of a case which could ultimately entitle the Plaintiffs to the relief which they have claimed. If and insofar as any claim or complaint outside that legal ambit may have an indirect but material effect on matters which are within it, they may require some decision from me and I will of course give it, but this is centrally a judgment on the operative claims in this action. It is not a general report on the Defendants' conduct of CCC's affairs, nor is it a legal treatise on aspects of directors' duties to Guernsey companies as suggested by the facts and fate of CCC.

Matters included for forensic purposes

342. The second general point about the scope of the materials in the trial is that there is a very large amount of evidence and allegation which has been said by the Plaintiffs, rather coyly, to be there on "forensic grounds". The explanation for this is as follows.

343. In their Defences, the Defendants pray in aid the effect of various exoneration and indemnity clauses contained in CCC's Amended Articles of Association (as from 8th May 2007) at Articles 172-174, and also, as regards CIM, and the Entity Defendants as CIM's "affiliates", contained in Clauses 2 and 6 of the IMA. Article 172 relates to any director's liability and is framed as both an indemnity and an exoneration clause in respect of any loss caused to CCC by him except through his own "*wilful act neglect or default*". Articles 173 and 174 contain an indemnity and a limit of liability "*to the fullest extent permitted by Guernsey law"* in favour of CIM and its "affiliates" (thus including TCG and Holdings) and their respective officers and employees, except in respect of acts of "*bad faith, fraud, gross negligence or wilful misconduct*". The IMA contains similar indemnity and exoneration clauses but with the exception being framed to be in respect of the "*[wilful misfeasance, gross negligence (as determined in accordance with the laws of the State of Delaware), bad faith or reckless disregard]"* of the relevant person.

344. In other words, if the Defendants are guilty of "mere" negligence, or of any entirely innocent breach of duty, then the Plaintiffs' case will be defeated by the above clauses, unless they can argue that they do not apply.

345. The result has been that the Plaintiffs have gone to considerable lengths to formulate a case that (i) the conduct of the Defendants must be characterised as falling within the scope of the exceptions to the exoneration clauses (ie boiling down to: bad faith, improper purposes or, at least, gross negligence), or (ii) that the exoneration/indemnity clauses do not come into play at all. It is the assertions and arguments in support of this which are referred to as being there for "forensic purposes". It means that their inclusion has been dictated by the exigencies of the case.

346. The second aspect, the application of the clauses at all, is, of course, a matter of law. It depends upon the true construction of the clauses themselves, and/or their legal efficacy in Guernsey law (or possibly Delaware law), and the question of efficacy in Guernsey law leads in turn to two strands of argument regarding the construction and effects of s. 67F and s. 106, respectively, of the 1994 Companies Law, which I will examine in due course. None of these matters has taken up much of the case in terms either of paper or time.

347. The first aspect however - the characterisation of any proven breach of duty by a Defendant – is a lot of what has contributed to the Cause being formulated at great length, with relentless repetition, liberal use of pejorative and hyperbolic adverbs, and with allegations, often added by amendment, for the only apparent purpose of introducing yet another matter of criticism of the Defendants even though its consequences have no effect on the key matters alleged to have caused CCC loss, as I have already mentioned. Part of the reason for this great expanse of the pleaded case has been said to be the need for the court to have "context". It has felt more like an attempt to influence the mind-set of the reader, by the sheer volume of material and portentousness of the criticisms, into attributing extra gravity to the complaints being made.

348. With that, I now move on to the material legal principles and arguments.

5. Legal principles

The Law - Introductory

349. Apart from the contractual claim or a parallel claim in tort against CIM, the claims in the action all relate to the duties or obligations of the various Defendants as directors of CCC, and are thus matters of company law. Company law is the creature of statute, although, as with any legislation, enacted against the background of the local common law. Here, that is Guernsey's customary law.

350. It is well known that the concept of a limited company was imported into Guernsey law from English law. As the Guernsey legislation has been modelled on the English legislation, it is helpful to look at English law decisions in analogous cases, both for help in resolving any problems not directly covered by Guernsey statute or customary law (see *Flightlease Holdings (Guernsey) Ltd v Flightlease (Ireland) Limited* [2009-2010] GLR 38 per Southwell L-B at [91]) and for useful examples as to interpreting Guernsey legislation where this has been copied in identical terms from an English statute: see *In re Montenegro Investments Limited (in administration)* 2013 GLR 345 per Collas B, at [19]. English law decisions are persuasive, but no more, especially in the latter situation, because the context of Guernsey law and circumstance may well provide good reason for a different result. Where the Guernsey legislation is not in identical terms – and in this case it often is not - the assistance to be derived from English cases on similar but different enactments is much reduced.

351. I am satisfied that in general terms it is useful to consider English authority on matters which have a parallel in Guernsey, and I will certainly do so. However, I do not feel that I should give as much attention to authorities from further afield. In general, it seems to me that there is sufficient authority within the ambit of Guernsey law, possibly in Jersey law as a Channel Island jurisdiction of similar, although not identical, origins and development to Guernsey law, and in English law itself, to enable the guiding light of principle to be discerned.

352. The Plaintiffs have cited a veritable global library of authority, in particular from Australia and in connection with their submissions about directors' duties. I gained the distinct impression from the various citations in the course of the case, though, that Australian company law has different legislative provisions from those in either Guernsey or the UK, and has also developed on somewhat different lines, either as a result of this or simply because of different public policy considerations, or a different judicial ethos and approach. Many of the points of dispute between the parties are quite refined as to their detail. Deciding the weight which should attach to an authority from Australia (for example) in a Guernsey law context may well

properly require looking at the detail of its own context and the policy of Australian company legislation. The time and effort required to do so would generally be grossly disproportionate to the assistance which such authority might provide at the detailed level, even in a case of the magnitude of this one. This is especially so where, as is frequently the case, such authority generally seems to add little but confirmation, in a different form of words, of the broad legal principles expressed in other cases closer to home. Once it is possible to identify guiding principle, the further utility of authorities from other jurisdictions of common law origin but wider afield diminishes hugely, even though they may not be entirely irrelevant.

353. In dealing with the parties' competing submissions on the law, I will refer only to those authorities which have been directly material to my reasons; if I do not refer to an authority, then it is either because I do not regard it as expressing any sufficiently individual or material point of principle to be of influence, or because I consider it too far removed from either Guernsey law, or the facts and claims in this case, to be of more than a passing interest, insufficient to justify its inclusion in an undesirably lengthy judgment. I have therefore considered such non-binding authority very much only where it adds real value - and I certainly will not be dealing with all the hundreds (literally) of authorities, the majority cited by the Plaintiffs, which have been referred to or referenced in the course of the case.

354. It is convenient to consider the applicable law in this case under topics in the following order:

(1) Duties of directors:

a. Fiduciary duty;

b. Duty of care (negligence)

(2) "Insolvency"

(3) Wrongful trading

(4) Breach of contract/tort/unjust enrichment (against CIM)

(5) Statutory Misfeasance

(6) The impact of exculpation and indemnity defences

(7) The liability of the Entity Defendants.

General points

355. I mention first two general points. First it is common ground and indisputable that I am required to consider the positions of each of the Defendants individually when considering the claims made against them of breach of their duties as directors. There is no such thing as a "collective" breach of such duty. I therefore accept the Defendants' point that, where pleaded allegations are made against parties collectively for economy of expression, one must scrutinise the pleading carefully to extract what is actually pleaded against each Defendant in order to consider his or its liability. In practice, however, I do not think much will turn on this. With the very comprehensive pleadings in this case, and allegations levelled as widely as they have been, it seems to me to be unlikely that any Defendant has been unable to work out what allegations are being made against him or it, or that these differ very much.

356. Second, almost the Plaintiffs' opening submission is that the Defendants' duties to CCC under Guernsey law were "heightened" because CCC was a listed public company. I consider that this proposition owes more to rhetoric than legal analysis. The duties of a company director arise out of the nature of the office. The fiduciary duties are matters of loyalty and integrity. They are no different whatever the status of the company. The duties of skill, care and diligence are likewise no different in their nature, standard or description whatever the status of the company. The only difference which might arise in the case of a public company lies in the fact that the "ordinary" person who might be expected to become the director of a public company is obviously likely to be of a higher level of education and experience, if not intelligence, than the "ordinary" person who might be expected to become the director of a small local or family business.

357. No person should accept the role of director of any company unless he regards himself as having a sufficient basis of knowledge, skill and experience to be able to carry out the requirements of that role as needed by the particular company, but that is a different matter. It does not mean that the nature or standards of the duties themselves are in any way "heightened" in the case of a public or listed company, compared to a private one. A public or listed company will have additional legislative or regulatory requirements imposed upon it as a condition of that status. Compliance requirements thus add to the responsibilities of the company director, but it is only in that quantitative sense that the duties of directors of a public or listed company are increased. The supposed examples of such increased duty cited by the Plaintiffs are, as I read them, examples of this point.

358. Any increased weight of responsibility in the duties of the directors of CCC arises solely from the specialist nature, size and importance of the transactions with which it was involved. The fact that it was a public and listed company does not affect any judgment about whether its directors complied with the standards appropriate to themselves and to those particular circumstances.

359. The Plaintiffs' submission would involve that the duties of the Defendants as directors of CCC were suddenly changed in their intrinsic nature or standards on the day (4th July 2007) when CCC went public, even though its business did not change at all at that moment. To my mind, this shows that the Plaintiffs' submission has no basis in law.

(1) The duties of directors

General

360. It is common ground that the directors of a Guernsey company owe duties to the company which can be classed under the two heads of (1) fiduciary duties and (2) duties of skill and care. Breaches of both are alleged in this case.

361. However in my judgment, it is important for analysis purposes to keep the distinction between the two classes of duty very clear. I respectfully agree with the dictum of Mr Jonathan Crow QC in *Extrasure Travel Insurances Ltd v Scattergood* [2003] 1 BCLC 598 at [89]:

> *" Fiduciary duties are not less onerous than the common law duty of care: they are of a different quality. Fiduciary duties are concerned with concepts of honesty and loyalty, not with competence. In my view, the law draws a clear distinction between fiduciary duties and other duties that may be owed by a person in a fiduciary position.*

A fiduciary may also owe tortious and contractual duties to the cestui que trust: but that does not mean that those duties are fiduciary duties. Bearing all that in mind, I find nothing surprising in the proposition that crass incompetence might give rise to a claim for breach of a duty of care, or for breach of contract, but not for a breach of fiduciary duty."

362. A general review of principle emphasising this distinction was set out by Millett LJ in *Bristol & West Building Society v Mothew* [1998] 1 Ch 1 at pp16-18.

363. I thus agree that there is what Advocate Swan, appearing for the Carlyle Defendants, described as a "*bright line distinction between competence and loyalty*." It follows that where one finds - as one still does despite Millett LJ's deprecation of this - references in the authorities to a "fiduciary duty of care", I regard this as a misnomer. (It appears that such a concept may be recognised in Delaware law, but different jurisdictions may well permit different concepts and I am not concerned with Delaware law at this point.)

364. The importance of recognising the distinction is not just pedantry. Eliding the concepts of a breach of a fiduciary duty and a breach of a duty of care committed by a fiduciary can lead to unduly intricate or flawed analysis, because of a cross-fertilisation from the other field.

365. The Defendants emphasise the above distinction, whilst admitting that, as Directors of CCC, they owed to the company, in addition to their fiduciary duties, "a duty of care at common law or in equity".

366. I have some misgivings about the concept of an "equitable" duty of care, certainly in Guernsey law. Such a duality in English law is the product of the parallel development of systems of law and equity in the 18th and 19th centuries. The English common law recognised duties of care specific to certain common law relationships, and equity recognised obligations of care in the trust context, but this was all before the fusion of law and equity took place in 1875, and well before recognition of the overarching "neighbour" principle which underlies the English common law duty of care, pronounced in *Donoghue v Stevenson* [1932] AC 562. It is now a distinction without a difference, because redress for breach of a duty of care whatever its historical origin, is compensatory in nature and similar in the principles of quantification. In Guernsey law, though, there was never a distinction of origin, as Guernsey law did not develop in the same way as English law, with a historically separate concept of equity. Nothing, though, seems to turn on any supposed distinction in this case, because the Defendants' central submission remains that of the importance of distinguishing a director's fiduciary duties, which are duties of honesty and loyalty, from their other duties of care and skill, which are duties of competence.

(a) The Fiduciary duties - general

367. The Defendants stress, at the outset, that their case is that the claims made against them as regards breach of fiduciary duty fail at a very high level of analysis. They say that not only were the material decisions - ie those which might be argued to have caused any actual financial damage to CCC - arrived at bona fide by them in what they believed to be CCC's best interests, but that in any event those decisions were within the range of decisions which reasonable directors of CCC could have made in good faith, in all the circumstances. This is quite apart from their second high level argument, which is that the Plaintiffs have not proved that the impugned decisions in fact caused CCC any financial loss. Points of detail, though,

have been strenuously argued, with each side seemingly being concerned in case not refuting an apparently inconsequential proposition from the opposition might later be used as an unexpected basis for an adverse submission.

368. In practice, even at a greater level of detail, there are not many points of real substance between the parties. Matters in dispute seem to me to be mostly points of language, or emphasis, or how far authorities based on different factual situations, and often from other jurisdictions, are of any real assistance. In the end, I do not think that the refinements of detail on this topic which appear in the Cause, and more particularly in the Plaintiffs' subsequent legal arguments, have significant practical consequences. The Plaintiffs' legal submissions often seemed to me to labour the same point in different words, usually so as to justify introducing the supposed weight of another citation of authority, but I have indicated my views on authorities from other jurisdictions above.

369. The Plaintiffs submit, in their closing submissions, that the Directors owed the following four fiduciary duties to CCC.

1. A duty to act bona fide in the best interest of CCC, which they submit included

a. a duty to act in accordance with CCC's Articles of Association,

b. a duty to make full and frank disclosure to the Board of relevant matters, and

c. a duty to take into account the interests of creditors and prospective creditors in the event that CCC was insolvent or "in the zone of insolvency".

I will refer to this in short as the "duty to act in good faith".

2. A duty not to act for collateral or improper purposes in exercising their powers and discharging their duties.

I will refer to this as the "proper purposes duty".

3. A duty to exercise their own independent judgement in relation to CCC, not to fetter their discretion in the exercise of their powers and not to abrogate their responsibilities to CCC.

I will refer to this as the "own judgement duty", and

4. A duty not to act in relation to the affairs of CCC in circumstances where there was an actual or possible conflict between their duties to CCC and their other duties or interests, including owed to TCG Holdings , CIM or other Carlyle Group affiliates and to avoid such situations of conflict.

I will refer to this as the "no conflicts duty".

I do not think that the Defendants disagree in general terms, but they do dispute matters of detail, of varying significance. I will consider each of these separately.

1. The duty to act in good faith.

The duty is subjective

370. The duty to act in what the director bona fide believes is the best interests of the company is the essential fiduciary duty of a company director. Other such duties described as "fiduciary" duties are really particular applications of this essential duty.

371. This central duty is part of the foundation of the Plaintiffs' key ultimate complaint in the Cause that

> *"…….at all material times from July 2007 onwards, CCC's best interests required the selling down of RMBS assets in order to reduce leverage and enhance liquidity; and/or the raising of additional equity capital in order to reduce leverage and enhance liquidity; and/or a restructuring or orderly winding down of CCC."* (Cause Paragraph 418G.4)

The complaint is, of course, that the Defendants failed to take any of these steps.

372. The Plaintiffs cite this duty as the basis for other criticisms, such as of the "*imprudent and improper*" amendment or suspension of CCC's risk management measures in its Investment Guidelines, which, they assert, was "*plainly*" not in CCC's best interests "*on any view"*. However, this is just another aspect of the key complaint recorded above. As a breach on its own it caused no loss and adds nothing to that key complaint. It did not even provide the opportunity for the key complaint; it was just a part of the actions which surrounded it. Advocate Wessels for the Plaintiffs sought to argue that the suspension of the guidelines was causative of loss in that it caused CCC to continue to operate its business with (known) inadequate risk controls. I reject this as a matter of causation and logic. It does not pass even the "but for" test of causation in this regard. It is not the case that "but for" the suspension or removal of those Investment Guidelines CCC would not have suffered the claimed loss. The Directors would have been pursuing <u>some</u> course of action with regard to the actual conduct of CCC's affairs whatever the state of suspension, or otherwise, of the Investment Guidelines, and it is that course of action which falls to be judged, on its own merits. Of course, a decision taken in accordance with carefully fixed Investment Guidelines might provide a director with a defensive argument that that decision had not been negligent, but that is the opposite point, a different matter, and not applicable here.

373. This, though is digressing from the present point, which is that the duty of good faith is a subjective duty on the part of the directors. The Defendants admit that CCC's directors

> *"owed a duty to CCC to act in what they considered in good faith to be the best interests of CCC and its shareholders as a whole,"*

and they abbreviate this to "*duty of good faith*". This formulation is derived from Arden LJ in *Item Software (UK) Ltd v Fassihi* [2005] 2 BCLC 91 at [41]. I also note her general approach.

> *"I prefer to base my conclusion in this case on the fundamental duty to which a director is subject, that is the duty to act in what he in good faith considers to be the best interests of his company…….The duty is expressed in these very general terms, but that is one of its strengths: it focuses on principle, not on the particular words which judges or the legislature have used in any particular case or context. It is*

dynamic and capable of application in cases where it has not previously been applied but the principle or rationale of the rule applies."

374. The Plaintiffs accept this formulation, stressing the word "*fundamental",* but argue even so that there are objective aspects of the duty, and they seek to rely on these. I deal with this later. For present purposes, in my judgment, the authorities all point to the principle being that it is a subjective assessment of the director's conduct which is central to the formulation of this duty. It has recently been reiterated by Popplewell J in *Madoff Securities International Limited (in liquidation) v Raven* [2014] Lloyd's Rep F C 95 at [188] as the "core duty" of a director, in the following terms:-

> *"a duty to the company to act in what he honestly considers to be in the interests of the company"*

I endorse this as an appropriate modern formulation of the duty.

375. The Defendants also rely on *In Re Smith and Fawcett Limited* [1942] Ch 304 (CA), which they suggest is the leading English case on this core duty, and the dictum of Lord Greene MR, describing the duty of directors generally when exercising their powers (at p 306) as being that:

> "*They must exercise their discretion bona fide in what they consider – not what a court may consider – is in the interests of the company, and not for any collateral purpose.*"

376. This citation focuses on the supremacy of the directors' own bona fide decisions. It has firmly set the direction of later authority. The point is that the court will not interfere with, or second guess, a decision of directors which has been made properly and in good faith. It is, after all, the directors, and not the court, to whom the management of the company is entrusted.

377. The actual dictum from *Re Smith and Fawcett Ltd* introduces a reference to the "purpose" aspect of a director's fiduciary duty, but that is a distinct matter which it is appropriate to consider separately. The "proper purposes duty" can, in one sense, be said to be part of the duty to act in good faith because that must include acting honestly to effect what the director believes to be the proper purposes of the company. However, the "proper purposes" aspect of a director's fiduciary duty usually assumes key importance where what is in issue is the validity of a purported act by the directors rather than their liability for any adverse financial consequences.

378. Returning to the scope of the duty of good faith, the central point is therefore, in my judgment, that a management or governance decision of a director, honestly and responsibly made, amounts to due performance of that director's duty of good faith. That the test for this is subjective has plenty of recent expressions, certainly in English law: see, eg, *Regentcrest plc v Cohen* [2001] 2BCLC 80 at [120], per Jonathan Parker J; *Extrasure* (above) at [87] per Mr Jonathan Crow QC, and *Re Southern Counties Fresh Foods Ltd* [2008] EWHC 2810 CH at [53] per Warren J.

379. The Defendants therefore submit, with regard to the duty of good faith that a decision (whether right or wrong) reached by directors cannot be a breach of fiduciary duty if they have honestly made it in what they consider to be the interests of the company, and that therefore a claim for

breach of fiduciary duty will only lie where it is shown that the directors did not honestly consider their action to be in the best interests of the company. In my judgment that is correct.

The place of objective considerations

Evidence

380. The Plaintiffs argue that objective considerations nonetheless enter into an application of the duty of good faith, in three respects.

381. The first is that an objective view of the decision can be relevant to the issue whether the directors did honestly and genuinely consider their actions to be in the best interests of the company. The Defendants accept this, subject to stressing that it is an evidential point only. In other words, the apparent reasonableness (or otherwise) of a decision may be material to an inference as to the director's state of mind in making it. It does not, though, import into the actual test any requirement that the decision must be in the best interests of the company as determined objectively by the Court.

382. I agree with this last submission. If the relevant decision appears clearly and objectively not to have been in the best interests of the company, this could certainly cast doubt on a director's assertion that he genuinely believed that it was. However, in my judgment, that is as far as the relevance of an objective view of the actual merits of the decision itself can go. I do not read authorities such as *Shuttleworth v Cox Brothers & Co (Maidenhead)* [1927] 2 KB 9 as supporting the contention that an objective assessment of the merits of the decision goes directly to the question whether there has been a breach of the duty of good faith. If it were to be so read, then it is contrary to what I see as the preponderance of later authorities which have explained the ambit of a director's duty of good faith. There is no fiduciary duty to make an objectively "right" decision; under the duty of care it may (but only may) be a different matter.

Charterbridge

383. The second way in which the Plaintiffs argue that an objective assessment of the merits of the decision is material to a finding of breach of the duty of good faith is what has become known in the shorthand of this case as the "Charterbridge principle". This refers to the decision of Pennycuick J in *Charterbridge Corp Ltd v Lloyds Bank Ltd* [1970] Ch 62. It is the proposition that where the directors did not in fact consider the interests of the company at all (a matter which would have to be proved as a fact), then they cannot simply pray in aid their subjective honesty as a defence to a claim for breach of fiduciary duty.

384. The Plaintiffs express this principle as being that the court cannot defer to the subjective judgment of the directors where there was no such qualifying judgment. It might be simpler to express it as being that it is part of the fiduciary duty of a director to consider the company's best interests, and it is therefore a breach of that duty not to do so. The making of a flawed decision would then be the consequence of this. In such a situation, though, the test which the court will apply is to examine the relevant decision objectively, to see whether it was within the range of decisions which a hypothetical director, acting bona fide in the apparent best interests of the company, could reasonably have made in all the circumstances. If it was within that ambit, then the director in question will not be liable for consequent loss. If it was not, then the director will be liable for breach of fiduciary duty.

385. The Defendants accept that the Charterbridge approach can apply, but they dispute the factual situation which triggers its application. The Defendants say that this approach is only to be adopted in the case where the directors have given no consideration at all to the relevant interests of the company. If they have given some, but arguably inadequate, consideration, then the Defendants submit that, whilst that might be a breach of the duty of care, it will not be a breach of the fiduciary duty of good faith, because such a breach is, once again, in the realms of incompetence and not of disloyalty.

386. The Plaintiffs, however, submit that the principle comes into play where the Defendants gave no "meaningful" consideration to the relevant interests of the company. They argue that to give no "meaningful" consideration is not proper consideration, and for practical purpose it is therefore no consideration at all.

387. The Plaintiffs' formulation might be said to have the force of being purposive (an approach which has been in vogue for some years), and to be looking at substance rather than mechanism. I accept that it would not be unnatural to describe minimal, cursory, superficial or fleeting consideration, as "no" consideration, even though the very adjective "meaningful" admits that some consideration has been given. The difficulty which I see with the Plaintiffs' test of "no meaningful consideration" is that the word "meaningful" contains a value judgment, and one of insufficiently clear scope. In itself, it gives no indication of what degree of research, consultation, deliberation or cerebration is contemplated by the word "meaningful" and is therefore required, and any such concept could very easily mean different things to different people.

388. On the other hand I can see force in the Plaintiffs' argument that where any "consideration" can be shown to have been cursory in the extreme, it does not seem right that a director could still rely on it as discharging his fiduciary duty, such that the court would then be bound to find that he had done so. The difficulty with the Defendants' submission is that it reduces the scope of the test simply to the line between whether the matter was overlooked entirely, or was noticed but summarily dismissed.

389. The underlying principle of this concept seems to me to be whether the director actually turned his mind to the matter in issue. In my judgment the formulation which better gives the correct flavour of this, within the context of the subjective nature of the director's consideration, is that of the Defendants, i.e. that the director gave "no" consideration to the relevant question or interest, but with the caveat that simply thinking of the point but then dismissing it without some mental process of deliberation would still amount to "no" consideration within this test. In practical effect, this is recognising the formulation of the point adopted by Owen J in *Bell Group v Westpac Banking* (No 9), 2008 70 ASCR 1 at 265, that the consideration must be *"more than a mere token".*

390. I realise that it could be said that this is really describing a test of no "meaningful" consideration after all. My answer is that, if so, the issue has become one of emphasis only, and in my judgment the correct emphasis is to describe the test as "no" consideration, but to recognise the practical interpretation of "no" consideration which I have stated. My reason is that describing the test with a qualifier such as "meaningful" changes the emphasis from "no" actual consideration to some indeterminate quantum of consideration, and invites arid analytical argument as to what qualifies as "meaningful". It also risks, in my judgment, pitching the appropriate test too high.

391. However, whilst I have decided this dispute between the parties, I do not think it has any real practical consequence. The director who gives a matter some little, but inadequate, consideration might avoid being in breach of fiduciary duty but would surely still be likely to be in breach of his duty of care, and probably with identical consequences (although it is possible, in some circumstances, that the approach to quantification of loss might vary in its stringency; see later). There might be some distinction in his position dependent on the application of particular wording in an exoneration or indemnity clause, if those were applicable, but that is a different point.

392. A last point does arise, however. There is apparently academic dispute, particularly in the Australian authorities, as to whether the correct legal analysis of the situation where the decision was within the range of decisions which a reasonable director acting in good faith could have made even though the director in question did not consider the best interests of the company is that the director escapes liability because there is no breach of duty or because there is a breach of duty but no loss is caused. This dispute naturally leads into argument about the principle by which a director's judgment in identifying the best interests of the company is *itself* to be judged; is it simply his subjective honesty even if unreasonable (no breach of duty)? or is it the objective reasonableness of the decision (breach of duty but causing no loss)? The analytical argument thus becomes very rarefied, and fact-sensitive at a detailed level: see the discussion in *Bell Group v Westpac Banking Corporation (No 9),* 2008 70 ASCR 1 at [4593] – [4618]. The latter analysis also leaves open room for disagreement as to whether there should or should not be liability if the decision under attack was within the range of decisions which could reasonably have been viewed as being in the interests of the company, but was not the decision which the court would consider to be the best decision. This is one of the "tantalising questions" identified but not decided by Owen J at [4616-8] of *Bell No (9)* above.

393. Insofar as I need to decide the question here, the correct principle, in my judgment, is that a failure to consider the best interests of the company, whether total or partial, amounts to a breach of duty, but it is one as to which no consequences (no damage) flow unless the result is that the actual decision is outside the range of decisions which, viewed objectively, could reasonably have been made in the apparent best interests of the company. To take the latter requirement further, and hold that there is damage to the company unless the decision can be endorsed as objectively the best decision for the company is both to impose a higher standard of decision-making than that positively required of directors, and to tread in that dangerous area of the court's making a commercial rather than a legal judgment.

394. How far any decision which I actually have to make depends on the above principle, though, must await my findings of fact. I would just observe here that the area in which this issue arises most commonly, as the Defendants point out, is the situation of directors who are found to have failed to distinguish between the interests of the individual company with which they are concerned on the one hand and those of the group of companies to which it belongs on the other, and this situation has overtones of some of the Plaintiffs' complaints in this case. As I have said, the analytical point itself is likely to have no practical effect, but it draws attention to the overarching practical importance of the simple question: was the decision or conclusion under attack a decision or conclusion which a reasonably competent director of the particular company, in the same circumstances and with the same attributes as the relevant defendant, could have made in good faith in all the circumstances? If it was, then that will determine any

question of liability for damages in the negative, and there is no need to decide whether this is the result of there being no breach, or no loss.

395. What I do take away from the above consideration as a practical point is that the *Charterbridge* principle shows that there is one element which is a requirement of both the duty of good faith and the duty of skill and care, namely that each requires that one must actually turn attention to the question of what the best interests of the company are. In each case, however, one is saved from liability for not actually doing so if the decision made was nonetheless within the range of decisions that a properly loyal and competent director could reasonably have made in all the circumstances – which is an objective question. However, its determinative power means that in practice, it may well be most efficient to consider it first.

Wednesbury

396. The third way in which the Plaintiffs submit that objectivity is material to a judgment whether there has been an actual breach of duty is where it can be shown that the director acted "unreasonably or irrationally" in deciding what course of conduct would be in the company's best interests. The Plaintiffs' written argument merely says that in such circumstances directors will "*also*" be "*in breach of duty*". By implication this seems to be referring, still, to the duty of good faith, although I would again have thought it inevitable that such a serious finding would constitute a breach of the director's duty of care. I suspect that the Plaintiffs' insistence on arguing this point in support of their claimed breach of the fiduciary duty of good faith is with an eye to avoiding the application of exoneration or indemnity clauses.

397. The Plaintiffs rely, for their proposition that unreasonableness or irrationality is a breach of the duty of good faith, on the oft-cited dictum of Bowen LJ in *Hutton v West Cork Ry Co* (1883) 23 Ch D 654 at 671, that

> *"[b]ona fides cannot be the sole test, otherwise you might have a lunatic conducting the affairs of the company… in a manner perfectly bona fide yet perfectly irrational."*

398. They draw attention to dicta in other cases, such as that of Harman J in *In Re a company (ex p. Glossop)* [1988] 1 WLR 1068, suggesting that the principle of *Howard Smith v Ampol* [1974] AC 821 can be viewed as an analogous application of the *Wednesbury* principle of unreasonableness in public law. This principle is that a public law decision is void if it is so unreasonable or irrational a decision that the court concludes that no reasonable decision-maker, in the particular circumstances, could have made it. The Plaintiffs submit that this is judicial recognition of an analogy between the standards applicable to those exercising fiduciary discretionary powers (such as directors) and those exercising public law discretionary powers. They rely on a suggestion to this effect by Simon Mortimore QC in his book *Company Directors; Duties Liabilities and Remedies* (see now 3rd Ed (2017) at 12.21-22). They cite further cases, such as *Byng v London Life Associations Ltd* [1990] Ch 170, *Equitable Life Assurance v Hyman* [2002] 1 AC 408 and the Australian case of *Westpac Banking Corporation v The Bell Group Ltd (in liquidation) (No 3)* (2012) 44 WAR 1 for dicta apparently endorsing the proposition that the duties of directors bear comparison with public law duties, such that, notwithstanding that a defendant may have acted honestly and in good faith, he may still be found to be in breach of his fiduciary duty where he has acted "unreasonably or irrationally" (obviously in the eyes of the court) in considering what steps were in the best interests of the company.

399. The Defendants invite me to reject this approach as unsound, and departing from the bright line distinction between honesty (even if incompetent) and incompetence itself. They point out that the dictum in *Hutton* is over 130 years old, was not, in fact, concerned with lunatics (or even directors) running companies, was a passing expression of concern by the court, pre-dated the seminal recognition of a general tortious duty of care in *Donoghue v Stevenson* in 1932 and has never, apparently, been relied on to found any other decision. They point out that the decisions where dicta alluding to public law comparisons have emerged have tended to be cases where the courts were concerned with the "proper purposes" duty, and usually with a claim to have a decision set aside or declared invalid, rather than a claim for damages or compensation. In the former kind of case, comparison with grounds of challenge to a public law decision is not unnatural, because the issue is that of the *vires* of the decision rather than that of establishing a breach of the duty of good faith sounding in damages.

400. The Defendants also point out that endorsement of this approach is not universal, and that in *Re Edennote Ltd* [1996] BCC 718, in the context of the court's supervision of a liquidator (a situation which they submit has more in common with the scenario in this case), Nourse LJ rejected comparison with public law principles as potentially confusing. He commented that there was "*something unrealistic*" about the suggestion that one could apply the classic public law tests used in controlling public servants performing statutory duties to the oversight of businessmen engaged in commercial decision-making.

401. I unhesitatingly prefer the Defendants' arguments on this point. In my judgment, it is confusing, thoroughly unhelpful, and wrong in law, to introduce public law concepts into a determination of the liability of directors for their conduct in respect of their duty of good faith. The public law principles to which the *Wednesbury* test applies are concerned with the proper use or misuse of public powers. They are concerned essentially with *vires* and with a duty to act fairly. The director's duty of good faith in the private law stewardship of the assets of a corporate enterprise is concerned with upholding his duty of loyalty to that enterprise. The two concepts are different in their very nature, and I can see no useful analogy between them which would justify exporting the appropriate test for one into the other.

402. It is easy to have an intuitive feeling that a particularly egregious example of unreasonable, or even irrational, decision-making can be described as a breach of "fiduciary" duty. A fiduciary duty is a duty to perform a trust, and directors are appointed on the basis that they are trusted to make reasonable and rational decisions. However, that does not mean that such a general expectation turns the duty into a fiduciary duty to make decisions which pass the Wednesbury test, and in my judgment it would be an incorrect analysis to treat it this way. A director is also trusted to make skilful and prudent decisions, but that does not turn his duty of care into a fiduciary duty (see above).

403. It is also, in my judgment, quite unnecessary to introduce any such principles. A decision which, objectively viewed (which in effect means: in the eyes of the court), is grossly unreasonable or irrational or perverse will inevitably have been so judged by considering its consequences and other surrounding facts. These in themselves will tend to show either that it was not taken genuinely in the interests of the company but for some other, and consequently illegitimate, reason, or that it must have been taken without the exercise of due care and skill. (In fact, if no other such factors can be identified, then the underlying judgment that the decision is grossly unreasonable, irrational or perverse must be suspect, and would require revisiting.) If so, the decision will be a breach of the general duty of good faith or the general

duty of skill and care, in any event. It is thus unnecessary, as well as potentially confusing and dangerous, to construct some further analytical basis for attacking the decisions of directors based on public law analogies. Whilst it might be suggested that the remedies available to the company for breach of fiduciary duty are more extensive than for negligence, even if that is so (and I am not satisfied that it ever will be, in practice), that is not, in my judgment, a sufficient reason, let alone a good reason, to distort or ignore the difference between a duty of integrity and a duty of care, and to pass off the latter as being the former.

404. I agree with the Defendants' criticisms of the dictum in *Hutton*. I find as well that the later authorities cited by the Plaintiffs are either directly concerned with the different "proper purposes" duty, or have dubiously transferred comments appropriate to that duty into comments about the duty of good faith.

405. I note the text-book commentaries of Simon Mortimore QC (above) suggesting that such public law principles may be gaining a place in English law. I also note that courts in Australia similarly may regard themselves as no longer giving "*the deference they once did*" to the decisions of directors (apparently the view of Drummond JA on the appeal decision in *Westpac Banking Corporation v The Bell Group Ltd (in liquidation) No 3* (2012) 44 WAR 1 at [2029], although I also note that leave was given for a further appeal from this majority decision, but the appeal was presumably compromised, as it was withdrawn.). This, however, is not the approach in Guernsey, and in my judgment quite rightly, as it is a dangerous approach.

406. On careful reading, I do not understand the approach in the *Bell/Westpac* decisions actually to be extending the court's powers to grant relief in respect of decisions of directors on the grounds that they have been made for improper purposes into the realms of commercial merits, although it seemed to me that Advocate Wessels' arguments came very close to contending that it does. The decision in that case was that the directors had granted guarantees of other group companies' debts to the banks without proper regard for whether it was in the interests of their own companies to do so, objectively proven largely by their not having had or sought pertinent information, or devised a sufficient plan, as to material effects of their doing so. It was then concluded that the granting of such guarantees was therefore not, objectively, in the best interests of those companies, such that the acts of effecting the relevant transactions were a breach of the directors' fiduciary duties as stewards of the companies' assets. The central point in the case, however, was that the banks' own knowledge of such situation was then held to be sufficient to impose "accessory" liability *on the banks* with regard to the relevant transactions, and to result in an award of equitable compensation against them. Thus, the directors' breaches of duty were established as breaches of fiduciary duty on the analysis of *vires*. This was at times referred to as if acting for "proper purposes" of the company extended to or included "acting in the best interests of the company", but this has to be seen in context; in a sense, it does, but only as an expression of the purpose for which directors are given their formal powers of management of the company's affairs conferred by the company's articles and the general law.

407. It is unfortunately easy to use this expression of the apparent relationship of "proper purposes" and the "best interests of the company" to create an argument that, since the company's interests in "good" commercial decisions must be part of its best interests, making only "good" decisions is part of the "proper purposes" of the company for which it is the directors' duty to act - thus extending the scope of the "proper purposes" duty beyond the field of *vires* and into

the field of merits. This extension could then be argued to enable the court to intervene because it does not agree that the decision made was in the best business interests of the company, even in cases where the decision was conscientiously and honestly made by the directors; the court could characterise an ill-judged (but *bona fide*) decision as being not in the best interests of the company and ***therefore*** "improper", thus dubbing it a breach of *fiduciary* duty. Even if such an approach starts by being applied only on the basis of *Wednesbury* principles it can easily slip into being invoked where the court could be persuaded that a rather different decision on a serious commercial matter perhaps ought to have been made.

408. In fact, the decisions in *Bell*, both at first instance and in the Court of Appeal, whilst a judicial *tour de force*, are subject to limits on their usefulness in this case because of three matters. The first is the obvious one that they are decisions in a different jurisdiction which has pointedly developed itself separately from English law, and independently of the supervisory influence of the Privy Council, for decades. The second is that the *Bell* litigation itself was so hugely complex in its factual purview that it is unwise to draw any conclusions as to supposed parallels based upon it. The third is the more subtle point that by the time of the trial and the appeal, the claim was only being pursued against the banks involved in the transactions; the directors of the relevant companies were no longer parties. Thus, this was not a battle between injured creditors and misbehaving directors, but between injured creditors and money-lending banks. This explains the concentration in the case on breach of the directors' *fiduciary* duties; it was only if such a breach could be established that there would be any liability for the banks to be accessory to. However, it also means that the psychological dynamics of the claim were very different from the present.

409. Moreover, and once again, such an approach would tend to draw the court into making judgments on the merits of commercial decisions at an entirely inappropriate level of detail (an approach rejected by Owen J himself in *Bell Group v Westpac (No 9)* (above) at [4614].) This is a function which a court, and in particular a court of a small jurisdiction, is just not equipped to do efficiently or economically. For those reasons, not only is it not the approach of the Guernsey courts grandly to abandon the approach of "deference" to the bona fide decisions of company directors which has hitherto been a defining limit of the court's jurisdiction in this regard, but, in my judgment, it emphatically should not be. The admission of a direct application of *"Wednesbury"* principles in this context over-complicates simple principle, is a step in the wrong direction and is, above all, unnecessary (especially now that Guernsey law has legislated to prohibit the exclusion of company directors' liability for negligence and breach of duty in s. 157 of the 2008 Companies Law).

410. In reaching the above conclusion I have not ignored the fact that the particular duty "to act for proper purposes" (considered further below) may involve objective considerations of the effects and the reasonableness of a challenged decision. However, that is because there are two aspects to that particular duty. The first is the fiduciary aspect: did the director loyally seek to perform that duty? That is subjective. The second is the practical angle: did he actually perform the duty correctly, in the sense of: did he in practice act for the "proper purposes" of the company? That depends on the interpretation of those purposes and of the director's powers, and will be a matter of either general law or the true construction of the company's constitution. As that is not a matter of the director's judgment or discretion, the test is therefore rightly, objective. (In fact, it is to my mind highly questionable whether this aspect of a director's duty is "fiduciary" at all. There is a tendency to label any duty of a director "fiduciary" without regard to its nature, just because it is a duty imposed on a director

and it is trite law that his status is fiduciary. It is this generalisation which has led to the similarly confusing notion of a "fiduciary" duty of care: see above.) Thus, a director can be found to be in breach of his duty to act for proper purposes without any bad faith or disloyalty on his part, but simply because he acted under an honest misapprehension as to their scope. It is this very limited aspect of the director's general fiduciary duty in which it is possible that Wednesbury type considerations may assist, but that does not mean that the two aspects of the duty to act for proper purposes identified above can be blurred, and still less that Wednesbury type principles should be carried over into a director's duty of good faith generally.

411. I have also not overlooked the fact that public law principles have been extended into the private law realm in some cases, such as regarding the test for assessing the validity of the exercise of a discretionary power conferred by contract: see, eg *Braganza v BP Shipping* 2015 UKSC 17. That, however, is an example of a private law discretionary power the exercise of which will govern the rights of others, and there is thus a clear analogy with the public law requirement of proper process and fairness. The position can be analysed as an implied term of the contract that the discretion conferred will be exercised fairly and reasonably, and therefore on the same principle as a public law power. However, that is once again an entirely different situation from the present.

412. In summary, and coming back to the duty of good faith itself, I therefore accept the Defendants' proposition that if the court is satisfied, on all the evidence, that the Directors acted honestly, and gave consideration to the interests of CCC, then they would not be liable for breach of ***fiduciary*** (I emphasise) duty, even if their actions had been incompetent or arguably unreasonable. I reject the Plaintiffs' varied attempts to persuade me that directors can be in breach of their fiduciary duty to act in the best interests of the company on a purely objective judgment - except where the issue is one of the true extent or construction of the formal powers which they were purporting to exercise and in which case the epithet "fiduciary" is arguably inappropriate. I had been minded to comment that this is another dispute, the practical effects of which hardly justify the time and energy which has had to be devoted to arguing it, but that would be to ignore the importance to the Plaintiffs' case of side-stepping the effects of the exoneration and exculpation clauses in CCC's Articles of Association and the IMA.

Particular aspects of the duty of good faith

413. There are some further specific aspects of the core duty of good faith which the Plaintiffs rely on, and as to which I therefore need to indicate my views and approach.

(i) Duty owed to CCC alone

414. It is common ground that the duty of CCC's directors to act bona fide in the best interests of CCC - and indeed all their fiduciary duties - were owed to, and were to be performed in relation to, CCC and CCC alone. CCC's best interests were to be considered separately and independently of the interests of any other entity and, in particular, those of the Carlyle Group (ie, in particular, TCG and Holdings).

415. The Defendants accept this. They argue that as a matter of fact, CCC's interests were considered independently, but that it is relevant practical context for this point that CCC's interests were, in practice, aligned with those of the Carlyle Group; the interests of both lay in CCC's survival and success.

416. This point therefore gives rise to disputes of fact which I deal with later. It does so specifically in relation to the "no conflicts" duty considered below. I note here that, whilst the principle is clear and undoubted, the kind of questions to which it gives rise are not uncommon and are fairly obvious considerations in the context of groups of associated companies, and especially of partly-owned subsidiaries. Whilst CCC was not an actual subsidiary of either TCG or Holdings, its position was similar in practice.

417. An important point is therefore, in my judgment, that whilst directors of the subject company are, of course, bound to act honestly in the best interests of that company and that company alone, the mere fact that they are either appointed by, or known to, or associated with, a holding company or another company in the group does not mean that they are *ipso facto* to be suspected, still less assumed, not to be performing their duty to the subject company, or to be incapable of doing so. The conduct in question must be examined on the usual principles of evidence and proof.

418. Further, the requirement to act in the best interests of the subject company does not mean that a course of action cannot be in the best interests of the subject company simply because it happens also to benefit, or even be in the best interests of, its parent or another associated company. The vice at which this rule of duty is aimed is that of subordinating the best interests of the subject company to those of another entity, or allowing the interests of another entity to influence a decision adversely to those of the subject company to whom the duty of good faith is owed. Any impugned decision must be examined with that principle in mind, but it goes no further. The association of a director with, for example, another corporate entity in the same group may mean that his state of mind should be carefully examined rather than assumed, but it does not affect the standard of evidence or of proof by which any finding of breach must be made.

419. Indeed, it seems to me that this aspect of the duty is what is being highlighted by the rather curious but ubiquitous description of the duty as one to act *"bona fide"* in the best interests of the company. The words "bona fide" are plainly not used as contrast to *"mala fide"*, but are equally plainly regarded as adding something significant to the mere words "in the best interests of the company", even though these would seem at first sight to express the duty adequately on their own. What the addition of the words *"bona fide"* does, I think, is to emphasise that the motivation to act in the best interests of the company must be genuine and actual, and not colourable or opportunistic. In other words, the best interests of the subject company must be central to the reasons for any action, not just incidental, fortuitous or conveniently arguable.

(ii) Duty not to cause (or permit) contravention of statutory or regulatory obligations

420. The Plaintiffs submit that it is a breach of a director's duty to act in the best interests of the company (and also of the duty of skill and care and the duty to exercise powers for proper purposes) to cause the company to contravene statutory or regulatory obligations which apply to it. They cite this in relation to a group of allegations of breaches of Dutch regulatory law such as, for example, an alleged improper failure to make public disclosure of the suspension immediately when it occurred, of CCC's minimum liquidity cushion Investment Guidelines.

421. As I understand it, the Defendants accept that this duty exists as a matter of principle, but they deny any breach in point of fact, as a matter of Dutch company law and regulation. I think they may also dispute whether the duty is properly seen as absolute or whether it is discharged

by taking all reasonable steps to secure compliance, and/or honestly believing that one has done so.

422. I readily accept the proposition that it is a private law duty of a company director to seek to ensure that the company complies with statutory or other regulations which properly apply to it, quite apart from any statutory sanctions for not doing so. It also seems reasonable to classify this as falling under the duty of good faith. It appears intuitive, at any rate at first blush, that complying with lawful regulations must be in the company's best interests, and I have not in fact been called on to grapple with the potentially difficult question, what the position would be if the directors of a company formed the honest view that complying with regulations, eg as to publicity, would in fact have some serious adverse side effect on the company.

423. However, and leaving aside any arguments as to whether the director's efforts are to be viewed subjectively or objectively, this is one of those duties of which a breach is of only peripheral importance, if any, in this case, because it is not claimed that the alleged breaches caused any loss to CCC.

424. The Defendants object that the Plaintiffs have tried to construct a case in this regard, by finding another claimed breach of duty to add to their criticisms of the Defendants, and then trying (unsuccessfully) to attach some colourably relevant consequence to it.

425. At one time, the Plaintiffs did appear to be asserting a claim that loss had occurred as a result of this particular alleged breach, suggesting that if various public disclosures had been made as they properly should, this would have had the consequence of causing CCC to be wound up earlier than it in fact was. Since the Plaintiffs' case has generally been that CCC ought to have been wound up (or down) earlier than it in fact was, this might have appeared to be another string to that bow. However, this line of argument was not pursued in the event, possibly because of the point that any involuntary winding down of CCC would seem likely to have been no less disorderly and causative of loss than that which in fact occurred.

426. Ultimately the point was deployed as an assertion that, insofar as the Defendants' strategy for the future involved non-compliance with regulatory obligations, it was not a "valid" or "legitimate" strategy. Where that would get the Plaintiffs in the present action, though, is unclear. It amounts to little more than a rebuke. No consequences sounding in financial damage are alleged, and none are apparent.

427. If at any point it seems that this aspect of the Defendants' duties as directors of CCC has any materiality to the claims in the action, I will give it due consideration, but I cannot, at present, see that it does, and at this point I observe only that the authorities cited by the Plaintiffs (*Akai Holdings Ltd v Thanakharn Kasikorn Thai Chamkat* [2010] 3 HKC 153 and *Ampol Petroleum Ld v RW Miller (Holdings) Ltd* [1972] 2 NSWLR 850) suggest to me that such culpable matters have been regarded as evidential points, relevant to testing directors' assertions of their motives in the context of other duties, rather than, as the Plaintiffs submit "*support[ing] the conclusion that the relevant transactions were effected in breach of fiduciary duty*" in the directly operative sense and for the purpose of founding a claim in damages.

(iii) Duty to comply with CCC's Articles of Association

428. This is the first sub-duty expressly mentioned by the Plaintiffs, and again I do not understand the Defendants to deny the duty; they simply deny that such duty has been breached, or breached in any respect beyond the nominal or *de minimis*. It is, once again, a matter which, even if demonstrated, has not been pleaded to have caused any loss to CCC in itself. Again, I will consider it only if it seems necessary.

(iv) Duty to "make full and frank disclosure to the Board of all relevant and material matters".

429. This is the second expressly mentioned sub-duty. An example of where it has been invoked is the allegation that Mr Conway wrongfully failed to disclose to the remainder of CCC's Board matters such as the full extent of financial support for CCC which he procured Carlyle Group to offer to Citibank in August/September 2007. A second is that, at about the same time, Mr Conway failed to disclose to CCC's Board that he had a personal interest in achieving the best price for the sale of a part interest in TCG to Mubadala.

430. Once again, the Defendants deny that the facts surrounding any of these matters did amount to any breach of duty on Mr Conway's part (or that of any other director in similar respects), and I will review this submission as to the facts, where it arises. Once again, though, it is an allegation as to which no further plea of directly resulting loss to CCC is made, and its materiality is therefore entirely contextual, at best evidential, and not of any proportionate worth to the attention which has been devoted to it. For example, it has led to discussion about the scope of the duty of a director to disclose his own wrong-doing, which, whilst academically very interesting, seemed to me to have no consequences for the issues of substance in the case.

431. Again, therefore, I do not think any discussion of the point is necessary here, and I will deal with it if and when it may seem material.

(v) Duty to give proper regard to the interests of creditors and prospective creditors of CCC as a whole in the event that CCC was "insolvent or in the zone of insolvency".

432. This is the third sub-duty specifically mentioned by the Plaintiffs, but this is in a different class and it <u>is</u> a point of substance. First, it affects the scope of the actual duty "to act bona fide in what appears to him to be the best interests of the company" and, second, it is a founding feature of the claim for wrongful trading, which is discussed later.

433. The authorities show that when a company gets into serious financial difficulty the duty to act in the best interests of the company extends to include a duty to consider and act with proper regard for the interests of its creditors. I have tried to use neutral language to describe this because, whilst the broad point is common ground, the parties agree neither its correct formulation nor its application in the circumstances of this case.

434. In fact, I think it is actually somewhat misleading to talk of the duty to have regard to the interests of creditors as if it only <u>arises</u> when the company gets into a particular degree of financial difficulty although for convenience I will continue to refer to it in this way. The interests of the company's general body of shareholders lie in the company using its assets to carry on its business activities and make profit. The interests of the company's general body of creditors lie in the company having, or having access to, sufficient liquid assets to be able to pay off the creditors' debts and do so in a timely manner. The directors of a company are actually always having regard to this latter interest, even when the company is solvent, because

meeting it is an obligation of the company which is part of the continued conduct of its business. When the company is solvent, though, this simply goes without saying. The creditors' interests are protected without any need for separate consideration, because they are automatically satisfied in the course of the ordinary proper everyday conduct of the company's business.

435. The duty to look out for creditors' interests therefore only has any practical implications where the interests of creditors and shareholders as to the course of the company's future activities begin to diverge. This happens when the company's ability to meet its debt obligations begins to come into question, obviously with the possible approach of insolvency. The duty to have regard to the interests of the company's creditors does not so much "arise" by coming into existence at that time, as acquire separately discernible influence because of these changing circumstances. This emphasises, though, that the arrival of this situation is not necessarily, or even usually, a sudden event, but develops, often gradually, so that identifying a clear point when the duty "arises" is not easy. How the duty then requires to be fulfilled is also very fact-dependent, because of the huge variety of company businesses, business environments and individual circumstances. This is all why, it seems to me, the courts have had difficulty in formulating both a precise test for the point at which a director's duty to consider the creditors' interests "arises", and a general test for the weight to be attached to those interests when that duty is being implemented.

When does the duty "arise"?

436. This aspect of a director's duty is subsumed into the duty of good faith, because the authorities have described the basis of such duty as being that when a company is, or is nearly, insolvent, the reality of the situation is that such assets as it has no longer belong to the shareholders but belong to the creditors, because they have first call on those assets towards the satisfaction of their debts, and this will translate into hard practicality if there is a liquidation.

437. Both sides refer to the most recent pronouncements on this topic by the English Supreme Court in *Bilta (UK) Ltd v Nazir (No 2)* [2016] AC 1 in which Lords Toulson and Hodge (with whom the remainder of the court agreed) said, at [123]:-

> *"It is well established that the fiduciary duties of a director of a company which is insolvent or bordering on insolvency differ from the duties of a company which is able to meet its liabilities, because in the case of the former the director's duty towards the company requires him to have proper regard for the interest of its creditors and prospective creditors. The principle and the reasons for it were set out with great clarity by Street CJ in Kinsela v Russell Kinsela Pty Ltd [1986] 4 NSWLR 722, 730.*
>
> > *'In a solvent company the proprietary interests of the shareholders entitle them as the general body to be regarded as the company when questions of the duty of directors arise. If, as a general body, they authorise or ratify a particular action of the director, there can be no challenge to the validity of what the directors have done. But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanism of liquidation, to displace the power of the shareholders and directors to deal with the company's assets. It is in a practical sense that their assets and not the shareholders' assets are under the management of the directors pending either liquidation, return to solvency, or the imposition of some alternative administration.'*

and at [126]

> *".....the protection which the law gives to the creditors of an insolvent company while it remains under the directors' management is through the medium of the directors' fiduciary duty to the company, whose interests are not to be treated as synonymous with those of the shareholders but rather embracing those of the creditors."*

438. The latter reference in particular is to an "insolvent" company. I am here concerned with a company which is arguably approaching insolvency. The first question is therefore when this extended duty is established. It is common ground that the tipping point can be something short of actual insolvency (whether viewed as inability to pay debts or on the basis of the balance sheet test for solvency), but the parties differ as to the proper description of the legal test for the onset, short of insolvency, of such duty.

439. The Plaintiffs have consistently referred to being "in the zone of insolvency". The Defendants point out, as far as I can see correctly, that "zone of insolvency" is not a concept known to Guernsey or English law (though it may well be used in Delaware law), and that the English cases have used a wide variety of formulations. These are described as "imprecise indications" by the authors of <u>*Gower's Principles of Modern Company Law*</u> 10th Ed at para 9-13. The Supreme Court's latest formulation is "*bordering on insolvency"*: see *Bilta* above. *"Prospectively insolvent", "borderline insolvent", "on the verge of insolvency", "of doubtful solvency"* and *"of marginal solvency"* have all been used in cases and text books.

440. The Plaintiffs accept that these expressions are all feeling for the same idea, and they do not seem to me to dissent from these being the same as their "zone of insolvency". Advocate Wessels was content, in argument, to accept the paraphrase of "bordering on insolvency". During the hearing, phrases such as being on the "brink", or the "border", or the "verge" of insolvency were variously used. Advocate Swan's preference was "teetering on the brink of insolvency". The phrases seem to me to be interchangeable, and each to convey, adequately, the appropriate sense of imminence.

441. This is a situation which it is easier to recognise than to define, but the various descriptions above convey that significant closeness to insolvency is required, such that in most of the actual cases it has been found that the company was in fact already insolvent. For that reason I prefer the phrase "on the brink of insolvency" or "bordering on insolvency" to "in the zone of insolvency", as originally proposed by the Plaintiffs, because, to me, the latter is capable of conveying a rather more distant relationship than that is conveyed by the words "border", "verge" or "brink".

442. I am fortified in this view by the recent decision of Rose J in *BTI 2014 LLC v Sequana SA* [2016] EWHC 1686 (Ch) at 483. At [473] she rejected the test formulated by Mr John Randall QC in *Re HLC Environmental Projects Limited (in liquidation)* [2013] EWHC 2876, who had suggested an underlying principle that *"directors are not free to take action which puts at real (as opposed to remote) risk the creditors' prospects of being paid without first having considered their interests rather than those of the company and its shareholders".* This is a dictum on which the Plaintiffs here had placed some reliance, but Rose J held that the authorities suggested a "*far more pessimistic*" situation than that simply of a "real", as opposed to a "remote", risk of the company becoming insolvent.

443. Rose J's approach to this test was very much fact-specific, and emphasised the need to have regard to the particular nature of the business, the state of the company's balance sheet, and all the overall circumstances. This supports that the actual test as applied in this area is, quite rightly, flexible and fact-dependent, even though the underlying principle is uniform.

444. The Defendants themselves rely on the dictum of Rose J at [478] of her judgment that:

> *"the essence of the test is that the directors ought in their conduct of the company's business to be anticipating the insolvency of the company because, when that occurs, the creditors have a greater claim to the assets of the company than the shareholders".*

445. They point out, though, that in considering whether the duty to have regard to creditors' interests had been triggered at all and concluding that it had not, Rose J emphasised the "*very different*" situation of the company in the *Sequana* case from those in previous authorities on this topic, and she pointed out material differences which are in many respects (they suggest) similar to those on which the Defendants themselves rely in this case.

446. I hold that the duty to have regard to the interests of creditors arises when it can be seen that decisions about the company's actions could prejudice the creditors' prospects of recovering their debts in a potential liquidation. The next question is how such duty then has to be approached.

447. The Plaintiffs submit that the triggering of the "creditors' interests duty", in English law, "*oblige[s] the Defendants to consider the interests of [the company's] creditors and prospective creditors as paramount"* and they submit that the same approach should apply in Guernsey.

448. The word *"paramount"* comes from the decision of Mr Leslie Kosmin QC sitting in the English High Court in *Colin Gwyer & Associates Ltd v London Wharf (Limehouse) Ltd* [2003] 2 BCLC 153, in summarising his interpretation of previous decisions including *Kinsela* (quoted above) and *Brady v Brady* [1988] BCLC 20. This latter was the case in which the principle was first expressly pronounced (by Nourse LJ), that the creditors' interests required to be considered when a company was "*insolvent or even doubtfully solvent"* (p 41i), because then *"the interests of the company are in reality the interests of existing creditors alone"*. The word *"paramount"* was taken up from *Colin Gwyer* (above) by Norris J, without comment, in *Roberts v Frohlich* [2011] EWHC 257 (Ch). It was also used by Mr John Randall QC in the *HLC Environment* case above, but in relation to a different point from that of Rose J's earlier noted criticism.

449. The Defendants dispute the word "*paramount*" if it is intended to suggest that recognition of the interests of the creditors requires the directors then to have regard to those interests alone, to the entire exclusion of the interests of the shareholders or others. They urge in preference, the dictum of Lewison J in *Ultraframe (UK) Ltd vs Fielding* [2005] EWHC 1638 at [1634], to the effect that the directors' duty to consider the interests of the company becomes

> *"extended so as to encompass the interests of the company's creditors as a whole, as well as those of the shareholders"*

450. They also point to the rejection of "paramountcy" as a general proposition in the Australian case, elsewhere often heavily relied on by the Plaintiffs, of *Bell v Westpac* [2008] WASC 239

(above): see [4438-9]. They submit that whilst directors should not act so as to leave creditors in a worse position than would a liquidation, honest attempts to save a business should not be judged by an overly strict standard, citing Hoffmann J (as he then was) in *Re Welfab Engineers Ltd* (1990) BCC 600 at 640C.

451. *Welfab* is an interesting case in which the court took a sympathetic view towards directors of an ailing company which was under pressure from its debenture-holding bank to reduce its borrowings. Without any bad faith, they had pursued the objective of selling the company as a going concern in order to protect jobs (albeit including their own), and they were pursued – unsuccessfully - for misfeasance by the company's liquidator on the grounds that they could and should have sold the premises alone for a higher figure and thus realised more for the unsecured creditors. Hoffmann J was of the view, first, that it was not the directors' duty to act as informal liquidators of the company and in effect set about a liquidation regime. He also placed considerable weight on the imponderables which attended the course of action which the liquidators said should have been undertaken, coming to the conclusion that they meant that it was doubtful, even speculative, that the creditors would have been any better off if a different course had been pursued. He held that in consequence the directors were not in breach of duty. He would in any event have been willing to absolve the directors from liability for misfeasance on the statutory grounds (s 727 of the English Companies Act 1985) that they had "*acted honestly and reasonably and ought fairly to be excused*". The Defendants submit that one can at least take from this case that it is acceptable to have regard to the interests of others and thus even shareholders, at least so long as the interests of creditors are not directly harmed.

452. I generally prefer the submissions of the Defendants with regard to the weight to be given to the interests of creditors. In my view, the English line of authority which proposes that the interests of creditors become "paramount" over-states the true position. Even in English law, on closer review, there is a more fluid and fact-dependent approach than is implied by the absolutist connotations of the word "paramount".

453. In the recent Supreme Court case of *Bilta* (above) the word "paramount" is not used; the word is "*<u>proper</u> regard*" (emphasis added). The Plaintiffs submit (I think) that the "proper" regard referred to by the Supreme Court is in fact that of "paramount" regard. With the line of authorities already in existence it would have been very easy to use that word if it had been intended, but, in any event, I do not think that the suggestion is correct.

454. The chosen epithet of "proper" consideration imports the possibility of some degree of judgment of appropriateness according to circumstance. Rose J in *BTI* (above) does not adopt the word "paramount" but leaves its application open at [462], where she says that the question is whether the requirement is

> *"to give paramount consideration to the interests of creditors or only to take their interests into account in some lesser way"*.

It is right that at [483] she then refers to

> "*a situation in which the directors are required to run the company in the interests of the creditors <u>rather than</u> the interests of the shareholders of the company"* (emphasis added),

which appears to say that the creditors' interests displace those of the shareholders and is thus in effect saying that they are "paramount". However, that was in the context of a finding that the creditors' interests duty, whatever standard it was, had not yet arisen in any event. This dictum is thus *obiter* on the precise point, and in any event appears to me to be shorthand, rather than to be a carefully composed formulation of the relevant duty.

455. In my judgment the principle, as it applies in Guernsey law is that once it is recognised that the company is "on the brink of insolvency", the directors' duty to act in the best interests of the company extends to embrace the interests of its creditors, and requires giving precedence to those interests where that is necessary, in the particular circumstances of the case, to give proper recognition to the fact that the creditors will have priority of interest in the assets of the company over its shareholders if a subsequent winding up takes place.

456. I formulate the principle in this way to take account of differences, according to particular circumstances, in what it may be reasonable and responsible for directors to do when they find that the company is in a sufficiently weak financial situation that a conflict of interest between its creditors and its shareholders appears to arise. The company is not – yet – in insolvent liquidation and remains under the management of the directors. Their duty is to decide what is in the extended best interests of the company in the particular case. It may well be that in some, possibly even most, situations, the company should thenceforth be run with regard to the best interests of its creditors alone, but that will not necessarily be true in all cases, and it is for that reason that I reject the word "paramount".

457. I agree with the Defendants that this possibility is apparently recognised in the English cases, such as *Facia Footwear Ltd v Hinchliffe* [1998] 1 BCLC 218. It was there acknowledged that being on the brink of insolvency does not necessarily require immediate cessation of trade and realisation of the company's assets – probably at fire sale prices and therefore losses – and that attempting to trade out of difficulty may be an appropriate course for the directors to take, depending on circumstances. The example in that case was that the directors honestly believed that, even though it carried some further financial risk, trading on provided a reasonable chance, and the best chance, of the creditors being paid <u>in full</u> rather than suffering losses. This was held to be a view which could reasonably justify carrying on.

458. I agree with the view of the authors of *Gower's Principles of Modern Company Law* at 9-14 that the prospect, if bona fide and reasonably held, of the company returning to profitability and solvency may justify trading on, even though, if the interests of the creditors in being paid were the only thing to be taken into account, those would obviously be best advanced by simply liquidating the company immediately and realising its existing assets to pay them. The propriety of any particular decision may well depend on the extent to which trading on would seem actually to harm the creditors' interests, as contrasted with merely not advancing them. On any basis, though, the decision is fact-specific. A balancing exercise has to be undertaken, and whilst the interests of the creditors will be of very great weight – and the more parlous the state of the company the greater that weight will be – they are not always and absolutely the only thing which the directors are obliged or entitled to take into account in deciding what to do in the then "best interests" of the company.

Other aspects of "duty to creditors"

459. Those are the two main issues between the parties with regard to this aspect of the duty of good faith, and I can deal briefly with the remaining points made on both sides.

460. The Plaintiffs emphasise that the extended duty of the directors is owed to the general body of CCC's creditors and prospective creditors as a whole; the directors can neither prefer specific classes of creditors, nor ignore them.

461. This proposition is certainly good at the level of individual creditors; it is obviously the directors' duty to be even-handed between such creditors. It is no part of a director's duty to decide which creditors are more deserving of payment and it would no doubt be a wrongful preference if they did so: see eg the *HLC Environmental Products Ltd* case (above).

462. The main authority relied on by the Plaintiffs is *Re Pantone 485 Ltd* [2002] 1 BCLC 266, which was a case which sought to extend the directors' duty to have regard to the rights of creditors into having regard to the potential rights of creditors *inter se* in insolvent liquidation. The argument was advanced by the UK Revenue, who would stand as a preferred creditor in a liquidation, and would therefore take precedence over ordinary trade creditors. This attempt was rejected by the court, on the legal grounds that the directors were not conducting a liquidation, and were therefore concerned only with their duty to the amorphous "general body" of creditors and not with the special rights or priorities that would apply between any such creditors amongst themselves in a winding up. This authority has no direct relevance in this case. It supports only the proposition - which is not in dispute – that the duty to have regard to the interests of creditors is to have regard to the interests of the general body of creditors as an abstract class.

463. However, it is pertinent to make the point that it is, in my judgment, the general body of the company's unsecured creditors as an abstract class. I consider that this follows from the very reason for the interests of the "company's creditors" coming to the fore, namely that because it is in a parlous state, the company is trading at the risk of its creditors not getting paid. It is therefore the creditors who are at such risk whose interests are to be protected, and they are the unsecured creditors. Secured creditors - at any rate those with fixed security - are not at the same risk as unsecured creditors. They have first call on their security whatever risks or actions the company takes and they have a degree of control through whatever powers of realisation their security confers on them. This is the benefit as against unsecured creditors for which they have bargained, but it means that their interests are fully protected by their security as long as it is adequate. This security is not being risked whether the company continues trading or does not, and the secured creditors' interests therefore do not require the protection of being recognised in the same way as unsecured creditors. In my judgment, it is the interests of the general body of unsecured creditors (although of course this includes secured creditors to the extent of any unsecured balances) which are the object of the protection afforded by the duty imposed on directors of a near insolvent company to have regard to the "interests of creditors".

464. This point is material because of the peculiar position of CCC's repo lender creditors. The Plaintiffs have criticised the attitude shown in their evidence, they say, by Mr Conway and Mr Allardice in particular, towards CCC's repo lenders. Mr Conway, for example, said that he thought that the repo lenders could "*look after themselves*". The Plaintiffs have cited this as evidence of an attitude which was not consistent with a director's duty to have regard to the interests of his company's creditors.

465. The Defendants appeared to submit, at least at one point, that although the repo lenders were treated as loan creditors - but secured loan creditors - for accounting purposes, they were

never (except at the very moment of a repo roll) actual creditors of CCC at all. Between rolls, they had title to their securities and CCC currently owed them no money. At best, therefore the repo lenders were contingent future creditors. The repo (repurchase) contract gave them the right to demand the relevant payment from CCC on the specified date in the future and upon their performing their concurrent obligation to redeliver the securities.

466. The Defendants submit, therefore, that, in fact, the only actual creditor of CCC at the material times (this must mean in general and ignoring any short term contractual debts created by margin calls) was TCG, by virtue of the unsecured subordinated loan of $100Mn which it made to CCC in August 2007 and which was later converted to a credit facility, as briefly mentioned above. CCC had no trade creditors and no other ordinary creditors (such as utility or service providers). The only other potential creditor was CIM for fees under the IMA, but no such fees were either demanded or owed during the relevant times. The question whether the repo lenders were current, or only future contingent, creditors of CCC has particular materiality for applying the test whether CCC's directors ought to have concluded that CCC stood no reasonable prospect of not going into insolvent liquidation, discussed later.

467. In fact, in closing submissions, the Defendants appeared to me to adopt the position that CCC's repo lenders were to be treated as currently secured creditors of CCC. It may be that this concession is correct, as the repo transaction appears to resemble a security bill of sale transaction rather than an absolute transaction. I note that CCC continued to receive the income on the relevant bonds, albeit the repo lender obtained sufficient title to the bonds to be able to use them as security for its own shorter term repo borrowing transactions, usually of overnight duration, during the 30 day period of CCCs repo. The precise legal analysis of a repo transaction at this level has not been investigated or argued in this case (although I certainly make no complaint about this).

468. In the circumstances I will approach the matter on the basis that CCC's repo lenders did, indeed, obtain the transfer of title to the RMBS bonds in question by way of security only, insofar as that may be material, and for present purposes I will assume that they were creditors of CCC, but secured creditors.

469. The second point, though, is that identifying the relevant group of creditors to whose interests CCCs' directors were obliged to have "proper regard" is actually of little consequence for deciding this case in practice. If CCC's directors had no regard to the interests of any creditors, then any need to identify the proper composition of the pool of creditors entitled to the benefit of such regard would not arise, and the *Charterbridge* principle will apply. The only potential materiality of the true composition of the pool of such creditors would be if it were shown as a fact, both that the Defendants actually had regard to a pool of the wrong (in law) composition, and that this mistake affected the decision which they made. If it did not affect their decision, it is again, irrelevant. If it did affect it, then it might render the subject decision a breach of duty - but then the *Charterbridge* principle would again apply. Thus, any criticisms of the Defendants' conduct based on their views about consideration of the repo lenders' interests really becomes just another evidential point, going to inferences about the relevant mental state of any Defendant for any purpose.

470. The Defendants' additional submissions, not already dealt with, are that the duty to consider creditors' interests, if triggered, remains a subjective duty, and that the court must be careful not to apply hindsight, citing Scott V-C in *Facia Footwear* (above). Whilst they also

emphasise his observations regarding (i) the difficulty there may be, at the time, of distinguishing between an acceptable entrepreneurial risk and an unacceptable risk which constitutes misfeasance: see [1998] 1 BCLC 218 at 228); (ii) the fact that being on the verge of insolvency does not inevitably mean that only a decision to cease trading is right (see above and *Facia Footwear* again); and (iii) the application of the objective *Charterbridge* principle in a case where it is found that the directors have given no actual consideration to the relevant creditors' interests: *Colin Gwyer Associates v London Wharf (Limehouse) Ltd* (above) at [87], these are points which I have already considered. I accept all these propositions.

471. Lastly, when considering any implications of this point, it needs to be firmly recollected that it is an aspect of the directors' fiduciary duties of good faith, which are duties which are owed to the company. They are not even owed to the shareholders as such, even though the company's best interests may be seen to be reflective of the shareholders' interests: see the detailed analysis by Owen J in *Bell Group Ltd v Westpac Banking Corporation* 70 ASCR 1 at [4396]-[4422]. Although it may be helpful, as a broad approach, to think in terms of duties to shareholders and to creditors, that is only a crude analysis, and should not be allowed to obscure the fundamental philosophy.

Other fiduciary duties:

2. Duty to act for proper purposes/not to act for collateral or improper purposes

472. These are the opposite sides of the same coin and the Defendants accept that this is one of the recognised fiduciary duties of directors. It has been touched on above, but I need expand on it a little.

473. As indicated already, the "proper purposes" duty is traditionally treated as a separate head of duty from that of good faith, but its important focus is on *vires* rather than on loyalty. The directors' powers are, by definition, conferred upon them only for the purpose of acting for the proper purposes of the company, but what those purposes are is a matter of law, or mixed law and fact, and/or the construction of the company's memorandum and articles of association, and is not a matter dependent on the directors' opinion, although they may of course have to interpret those documents. Their honest opinion may go to their bona fides but it does not go to the issue whether they actually had power to do what they did, (apart perhaps from where they are clearly given some discretion expressly). This is why directors can be held not to have acted for proper purposes without any want of honesty or good faith on their part: see for example, *Howard Smith v Ampol* (above) in which, notwithstanding the bona fides of the directors, they were held to be in breach of the separate duty to act for proper purposes because the relevant power had been exercised for the purpose of encouraging a takeover bid which, it was found, did not (objectively speaking) "*involve any considerations of management within the proper sphere of the directors"* . The fact that the ambit of this duty is essentially one of construction of the instrument conferring the power was recently confirmed by the Supreme Court in the speech of Lord Sumption in *Eclairs Group Ltd v JKX Oil & Gas plc* [2016] BCC 79 at [30] – [31].

474. However, what will be the consequence of any determination that the directors did not, whether subjectively or objectively, act for the proper purposes of the company but rather for some collateral or (in context) improper purpose, depends on the nature of the case and the relief sought.

475. Whilst accepting the existence of the duty, the Defendants point out, citing the speech of Lord Wilberforce in *Howard Smith v Ampol* [1974] AC 821, that an issue to which this duty is relevant is often that of whether the directors' assertions of their motives for making the decision in question should be accepted. This, though, is the process of testing the directors' professed subjective *bona fides* by reference to objective circumstances. The courts are at pains to emphasise that that process does not involve the court either substituting its own opinion or judgment for that of the directors, or of questioning a decision bona fide arrived at.

> *"……[I]t would be wrong for the court to substitute its opinion for that of the management, or indeed to question the correctness of the management's decision, on such a question, if bona fide arrived at. There is no appeal on merits from management decisions to courts of law: nor will courts of law assume to act as a kind of supervisory board over decisions within the powers of management honestly arrived at.*
>
> *" But accepting all of this, when a dispute arises whether directors of a company made a particular decision for one purpose or for another, or whether, there being more than one purpose, one or another purpose was the substantial or primary purpose, the court, in their Lordships' opinion, is entitled to look at the situation objectively in order to estimate how critical or pressing, or substantial or, per contra, insubstantial an alleged requirement may have been. If it finds that a particular requirement, though real, was not urgent, or critical, at the relevant time, it may have reason to doubt, or discount, the assertions of individuals that they acted solely in order to deal with it, particularly when the action they took was unusual or even extreme."* ([1974] AC 821 at p832D-H,)

476. The parties are, I think, in agreement that if there are multiple purposes behind any particular decision, the test for determining the purpose for which the power to make that decision was exercised is by reference to the "substantial", "primary", or "dominant" such purpose. What is meant by a "primary" purpose may still be a matter of debate in the Supreme Court (see *Eclairs* above), a fact which itself illustrates just how rarefied discussions in this area can become. If I need to resort to distinctions at this level, I will refer further to any necessary authority at that point.

477. I observe here, though, that in *Eclairs*, after adverting to the practical difficulties and unreality of analysing a businessman's true state of mind by trying to single out the effects of any particular motivating factor, Lord Sumption suggested that the practical test was, rather, to look at it the other way, and ask whether the decision would still have been the same if the particular allegedly vitiating motivating factor had not been present. This is an approach which I find attractive. In the case of multiple alleged motivating factors, it may still leave room for refined arguments about the effects of combinations of such factors, but it seems to me that it is a good principle of common sense, at least from which to start.

478. Lastly, though, in view of some of the submissions made in the case, I would reiterate my comments as to how far the directors' fiduciary duty of good faith is tested objectively rather than purely subjectively which I considered above, in the particular context of whether the "Wednesbury" test applies, and of the approach to such objectivity in the Australian cases of *Bell Group Ltd (in liquidation) v Westpac Banking Corporation (No 9)* 2009 70 ASCR 1 and *Westpac Banking Corporation v The Bell Group Ltd (in liquidation) No 3* (2012) 44 WAR 1. These comments strayed into the relationship between the directors' duty of good faith and the

particular duty to act for proper purposes. Now that I am considering this latter, it is appropriate to make clear here, at the risk of repetition, that in my judgment, there is no principle of company law, certainly in Guernsey law, that the directors' duty to act for the proper purposes of the company can found an argument that making "bad" commercial decisions is not in the best interests of the company and thus not for its proper purposes, and therefore is a breach of fiduciary duty. This is tantamount to arguing that a director has no authority or power to make a "bad" commercial decision, or else it is a back door method of making an appeal to the court from a management decision on its merits, and as such is simply wrong; see the citation from *Howard Smith v Ampol Ltd* at [1974] AC 823 at 832 (above). (Such an argument can be countered analytically by regarding the purposes of the company for which directors' management powers are conferred as being "to act in what they, as directors, bona fide believe to be in the best interests of the company", thereby removing any erroneous injection of an objective judgment.) The scope of the "proper purposes" duty is properly focused on matters simply of *vires* in the formal and structural sense, and does not extend into areas which are properly the province of the separate duty of skill and care.

3. Duty to exercise own independent judgement

479. This duty is expanded as including (i) not to fetter their discretion in the exercise of their powers and (ii) not to abrogate their responsibilities. The Defendants admit the duty expressed in the main first limb above. The two further limbs in the expansion seem to me to be simply the articulation of different ways in which the main duty may be breached.

480. The Plaintiffs raise this issue particularly as regards the acts of the three Independent Directors, and their independent powers of oversight and separate approval.

481. The Plaintiffs submit (and I accept) that the broad principle behind this duty is that the company is entitled to the benefit of an actual and freely arrived at decision or judgement from those who are its directors. A director will therefore breach this duty if he merely does what he is told by others for whatever reason, or acquiesces without question or consideration in what he is asked to do or told by others. Directors have a duty to make a decision, and their own decision, on all matters where decision is required of them *qua* director. They have a duty, which the Plaintiffs rightly describe as an "irreducible" minimum, to oversee and keep themselves sufficiently informed about their company's affairs in order to do so.

482. However, in my judgment a duty to exercise an independent judgement does not mean a duty to act entirely alone, nor to act without taking into account any views expressed or even decisions which are made by his fellow director. A director must exercise his own judgement according to his own assessment of the facts but where, for example, a director does not possess a particular expertise but is aware that one of his fellow directors does, there is nothing in this duty which obliges the first director either to make a decision without ascertaining the views of the expert director or without having regard to them, or to make himself a sufficient expert in the area that he can assess the opinions of the expert director from a position of expertise. He must, of course, exercise the necessary degree of skill and care in assessing all relevant considerations which he does perceive, but if it is the case that more expert fellow directors propose or support a particular course of action, the non-expert director does not, without more, act in breach of his duty to exercise his own independent judgement because he is influenced by that fact. This is always provided, of course, that he has weighed that fact

critically, according to his own level of skill, expertise and general intelligent common sense, in permitting such influence.

483. The real issue here is, once again not so much a matter of law, but a matter of whether the Plaintiffs plead and prove facts which amount to a breach of any such duty and, again, whether any such breach of duty as may be proved did in fact cause any identifiable loss to CCC. It is thus fact-sensitive and no more need be said at this stage.

4. Not to act in relation to the affairs of CCC in circumstances where there was an actual or possible conflict between their duties to CCC and their other duties or interests, including owed to TCG Holdings, CIM or other Carlyle Group affiliates, and to avoid such situations of conflict.

484. The Defendants do not admit this duty in the form stated above, but do admit, in their Defences, that the Directors owed a duty to CCC:

> *"to avoid a situation in which [they] had an interest which conflicted or might conflict with the interests of CCC and to manage such conflicts or potential conflicts in accordance with CCC's Articles of Association".*

485. The first piece of common ground is that both sides agree that the assessment of whether there is a material conflict of interest is an objective test. Once again, the Plaintiffs therefore point out that this means that it is not necessary to make any finding of dishonesty in order to find a fiduciary party guilty of acting under a conflict of interest, citing *Regal (Hastings) Ltd v Gulliver* [1967] 2 AC 134 at 137.

486. Once again, though, whilst this is no doubt true, it seems to me to be mostly of relevance in different situations from this case, such as where the issue is whether a transaction effected by the defendant director can or cannot be allowed to stand, or whether the defendant director should be obliged to disgorge the benefit of a transaction to the company, or possibly at the ultimate stage of an argument as to whether a director may be excused liability on the grounds that he acted "*honestly and reasonably and ought fairly to be excused*" see section 522 of the 2008 Companies Law.

487. It is further common ground that a material conflict can arise as between either the fiduciary's duty and his personal interests ("conflict of duty and interest"), or duties owed by the fiduciary to two different principals ("conflict of duty and duty"). It is yet further common ground I think, (but I so hold if necessary), that in such latter situation the fiduciary must serve each principal "*as faithfully and loyally as if he were his only principal*" (Millett LJ in *Bristol and West Building Society v Mothew* [1998] Ch 1 at 19D). I say "I think" because this pithy quotation is derived from a "double employment" case, namely that of a solicitor acting for two parties to a conveyancing transaction, rather than that of a director of two companies, although the Defendants appear to accept that the same principles would apply by analogy.

488. The Plaintiffs suggested that there was a dispute as to whether the rule covered only actual existing conflicts of interest, or also possible or potential conflicts of interest. However, I did not understand the Defendants to exclude mere potential conflicts. As I understood their position, a potential or possible conflict was simply a matter to be weighed as part of all the circumstances, in considering whether there really was an active conflict of interest and duty.

489. In practice, the difference between the parties is largely one of emphasis, arising out of their positions in this dispute.

490. The Plaintiffs emphasise the strictness of the rule against acting under an apparent conflict, citing in particular the Singaporean case, *Ng Eng Ghee v Mamata Kapildeve Dave and others* [2009] 3 SLR 109, which gave three reasons for the rule, at [143] – [145]. These are

(i) the need to "*extinguish all possibilities of temptation and to deter fiduciaries who may be tempted to abuse their positions*",

(ii) the difficulties of inquiring into either a person's state of mind or motives so as to ascertain whether an actual conflict of interest has occurred, and similarly,

(iii) the practical difficulty of detecting actual conflicts of interest where a fiduciary is likely to be able to disguise these.

491. In their closing argument the Defendants accept the basic principle of the "no conflicts" rule, dating back to as long ago as 1854: *Aberdeen Railway Co v Blaikie Brothe*rs (1854) 17D (HL) 20, and being that

> *"….no-one having [fiduciary] duties to discharge shall be allowed to enter into engagements in which he has, or can have, a personal interest conflicting or which may conflict, with the interests of those whom he is bound to protect"*

but they point out the qualification identified by Lord Upjohn in *Boardman v Phipps* [1967] 2 AC 46 at 124B that

> "…. '*possibly may conflict' …. means that the reasonable man looking at the relevant facts and circumstances of the particular case would think that there was a real sensible possibility of conflict; not that you could imagine some situation arising which might, in some conceivable possibility in events not contemplated as real sensible possibilities by any reasonable person, result in a conflict."*

In other words, whilst accepting that the test is objective (see the words "or can have" in *Aberdeen v Blaikie,* above), their emphasis is that the appearance of a conflict of interest must be real and not fanciful.

492. Whilst I acknowledge the reasons for the no conflicts rule, I am not over-impressed by the dramatic descriptions of it given in the *Ng Eng Ghee* case. In my view the evaluation of a conflict or potential conflict of interest is amenable to the influence of common sense, as suggested by the Defendants.

493. The written submissions by the parties contained much reference to the "director of two companies" or "double employment" situation which, as I mentioned above, arises frequently in cases of groups of companies. The Plaintiffs refer to the dual involvement of, in particular, Mr Conway, in the running at Board level of both CCC and TCG/Holdings.

494. The Defendants point out, and this appears to be correct, that there is no rule in English law, at any rate, that a person may not be a director of more than one company, even if both companies are in competition. This supposed laxity in the rule has been criticised, and in this more modern day and age, and untrammelled by binding authority, it might be reconsidered.

However, this specific point has not been argued to apply in this case. The only "competition" point which appeared to arise was the position highlighted in the CCC PPM and OM documents, that where CCC was investing in a particular asset and other Carlyle entities managed by CIM might also be investing in it, CCC would not get favoured treatment and its interests might even be apparently subordinated to that of the other entity. That, however, is a different point from the present one.

495. As far as I am aware it has never been suggested that the position in Guernsey law is or should be different from that in English law, and with the large part played in Guernsey's economy by trust and corporate services provision, it is reasonable that this should be so. Even in English law though (and it would therefore likely follow in Guernsey law) the rule is subject to the proviso, first, that the director who is in that position will have to arrange his affairs so as to enable himself to discharge his duties to both companies as loyally as if each was his only principal. The burden of achieving this falls on him. It is also subject to the further proviso that any such conflict may be properly avoided by the director's making full disclosure of the position, and obtaining the consent of each principal to his also acting for the other. This proviso is no doubt the basis for the Defendants' formulation of the second limb of the duty as they would accept it, set out above.

496. The Plaintiffs emphasise the point that the "no conflict" rule can be avoided, but only by informed consent being given. They observe that whilst CCC's Articles of Association permitted an interested director to vote upon any arrangement in which he or she had an interest (Article 120 (2)), this was always provided that the director complied with the duty of full disclosure expressly referred to in Article 120 (1). In the absence of such full disclosure - which they say was not given in this case with regard to various competing personal interests or double duties - they say that the relevant director was obliged to abstain from voting or acting in the matter in which he was conflicted. The Defendants, whilst maintaining that in fact there were no relevant conflicts of either duty/interest or duty/duty in this case, emphasise that a party cannot complain of such a conflict if he was aware of it when he appointed the relevant fiduciary to his position, that such consent to appointment in a conflicting role can be implied as well as express, and that that is plainly the position in this case as far as the "Carlyle" Defendants are concerned.

497. I do not think I need recite any more of the supporting arguments on this point. The dispute here is, once again, about the application of an accepted principle to the facts of this case, with the Plaintiffs, understandably, contending for a more broadly encompassing and more rigid approach than the Defendants agree is correct or appropriate.

498. The Plaintiffs say that this duty is material because there was a conflict between the corporate and reputational interests of Carlyle and the personal financial interests of Mr Conway, Mr Hance and Mr Zupon on the one hand, and the interests of CCC on the other. The interests of CCC required (they say) a "*prompt restructuring*" of its business, but the reputational interests of Carlyle and CIM, the corporate interests of Carlyle, and the personal interests of Messrs Conway, Hance and Zupon - in particular for there to be the most advantageous conclusion of the private sale agreement of TCG shares to Mubadala - all conflicted with this, and effectively made them wrongfully cause CCC to continue too long with "business as usual", so as not to jeopardise these other interests. The allegation by the Plaintiffs is that the decisions taken by the Defendants after July 2007 in pursuit of what they have termed (but the Plaintiffs say, colourably and opportunistically) their "capital preservation strategy" for CCC, were not

dictated by any real consideration of the best interests of CCC including also the interests of its creditors, but by the conflicting interests of Carlyle, CIM and those three individual Defendants, with Mr Conway in particular effectively dictating such alleged "strategy" to the other directors. These are allegations of fact, therefore, to be considered later where appropriate.

499. However, this allegation by the Plaintiffs eventually became extended to assert that those Directors who, the Plaintiffs complain, had such conflict of interest should have abstained from acting in the decisions complained of. The purpose of this allegation is mysterious, since it must involve an implied allegation that the decisions complained of would have been different if that had happened, in order to found an assertion of loss. That is the only logically available causal link between the alleged breach of duty and loss, proof of which is necessary to complete a cause of action. No such allegation is made, however, so far as I can see. This particular legal dispute about the scope of the "no conflicts" duty therefore appears to be another inconsequential diversion, in practice.

(b) Duty of Skill and Care

500. The Plaintiffs primary case against the Defendants, they say, is for breach of one or more of the Defendants' respective fiduciary duties. However, in the alternative they rely on breach of the Defendants' respective duties to carry out their functions as directors of CCC with proper skill, care and diligence.

501. It is of course common ground that there is such a duty and the formulated standard of care is also common ground. It is that of a reasonably diligent person having both (a) the general knowledge skill and experience that may reasonably be expected of a person carrying out the same functions as those of the relevant director with regard to the company and (b) the actual knowledge skill and experience of that director: see *Re d'Jan of London Ltd* [1993] BCC 646 at 648B per Hoffmann J). It is further common ground that this is therefore a combined objective and subjective test, and that the subjective element is capable of raising, but not lowering, the standards to be expected of an individual director.

502. However, the Plaintiffs submit that this second, subjective element is capable of imposing a higher standard of care on a Defendant who had particular capabilities, qualifications or responsibilities within CCC (emphasis added). They suggest that Mr Hance and his position as Chairman is an example. They cite *Re Barings plc; Secretary of State for Trade and Industry v Baker* [1998] BCC 583 per Scott V-C at 586E:

> *"….the higher the office within an organisation that is held by an individual, the greater the responsibilities that fall upon him"*

503. I disagree, and the citation does not support the proposition. It is talking about the scope of the responsibilities which the individual director has undertaken, not the standard to which he must perform them, still less the subjective element of that standard. The subjective element of the standard test refers to the particular attributes which a director is expected to bring to the Board for the benefit of the company and a "responsibility" is no such a thing. Particular responsibilities within CCC simply impose upon the relevant director the duty to discharge those responsibilities, assuming that they are undertaken as a director, in accordance with the standard of care to be expected of a director in general, and himself in particular, performing such functions.

504. The Plaintiffs also submit that whilst the application of the duty of care may differ as regards the particular function of a director, in this case the formal designation of directors as either executive or non-executive is a matter of form and not substance and is to be ignored. They further submit that the designation of the Fifth to Seventh Defendants as "independent" directors likewise carries no weight in their favour, as their function was, it is submitted,"far from merely supervisory", bearing in mind their special powers and functions as CCC's Audit Committee.

505. I agree, but I do not understand these points to be particularly contentious. It seems to me that each director's position is to be looked at according to actual factual circumstances, whatever his title may have been. I will proceed on that basis. It leads to the next point.

506. It is common ground that the scope of the duty and whether or not it has been duly performed by the particular director depend on the facts. The Plaintiffs mention five factors which they submit are material. The first four of these are:

(i) the particular role of the director in the governance and management structure of the company,

(ii) the particular skills which he has or has held himself out as having,

(iii) his level of remuneration, and

(iv) the size of the company and the nature of its business.

507. I do not understand these to be in dispute. The Defendants themselves cite the first. The second is the acknowledged subjective standard of a director's duty of care. It did not seem to me, in practice, to feature greatly in the Plaintiffs' propositions, although at one stage it seemed that it might figure in a line of criticism as to Mr Stomber's experience and expertise in dealing in floating rate RMBS as contrasted with purely fixed rate securities. However, this did not ultimately appear to be persisted in, and I do not think it had even been pleaded.

508. There was no submission, argument or investigation of the third factor, ie the level of remuneration of any of the Defendants and I assume from this that there is no contention that this affected the standard of care to be expected from any of them. The fourth factor is obvious and needs no comment.

509. The fifth factor is:

(v) the circumstances of the company at the time of any alleged breach.

Whilst I accept that this is a factor going to liability, it does not seem to me to affect the standard or scope of the director's duty of care, so much as what action is appropriate to discharge it. Once again, I do not think this is in dispute, but it really does no more than state the obvious, namely that the director's duty is to exercise due skill, care and diligence according to all the circumstances of his action or decision.

510. The Defendants, whilst not disputing the above, stress, firstly, that the courts have been assiduous to pay due respect and regard to the fact that directors are charged with making decisions, and they do so in the context of the facts as they appear at the time. The skill, care and diligence of their acts are therefore to be judged without the benefit of hindsight.

511. They go on to submit, though, that the test for whether there has been a breach of duty is a "*high one"*: see the Court of Appeal in *Optaglio Ltd v Tethal* [2015] EWCA Civ 1002. It is that a director will be in breach of his duty of skill and care only if the court is satisfied that no reasonably diligent director with the material degree of knowledge, skill and expertise could have acted in the way in which the particular defendant director did act. They cite *Roberts v Frohlich* [2012] BCC 407 at [108] for both propositions. The point is that the court must be satisfied that the decision complained of went beyond a mere error of commercial judgment.

512. I accept these propositions. The Plaintiffs' case has always been, on this score, that the decisions of which they complain with regard to the conduct of CCC's business from July 2007 were so obviously "wrong" as to go beyond mere errors of judgment. They were either improperly motivated or negligent, and in fact, grossly negligent.

513. The Defendants also submit that mere risk-taking is not negligence in the context of judging commercial decisions (again citing *Roberts v Frohlich)* because risk-taking is part of business activity; indeed the correlation between risk and reward in commercial activity has been alluded to frequently in the evidence, especially the expert evidence, in this case. This means that the mere fact that loss has been suffered is not, *per se*, evidence of negligence.

514. Finally, the Defendants submit that the issue of whether negligence has been proved is very much fact-dependent and they warn against seeking to construct principles or rules of law from the facts of any particular authority. They remind me of the well-known passage in the judgment of Jonathan Parker J in *Re Barings plc (No 5)* [1999] 1 BCLC 433 at 489a-c:

> *"In summary, the following general propositions can, in my judgment, be derived from the authorities to which I was referred in relation to the duties of directors:*
>
> *(i) Directors have, both collectively and individually, a continuing duty to acquire and maintain a sufficient knowledge and understanding of the company's business to enable them properly to discharge their duties as directors.*
>
> *(ii) Whilst directors are entitled (subject to the articles of association of the company) to delegate particular functions to those below them in the management chain and to trust their competence and integrity to a reasonable extent, the exercise of the power of delegation does not absolve a director from the duty to supervise the discharge of the delegated functions.*
>
> *(iii) No rule of universal application can be formulated as to the duty referred to in (ii) above. The extent of the duty and the question whether it has been discharged must depend on the facts of each particular case, including the director's role in the management of the company."*

Again, I accept these general propositions and do not understand any of them to be in dispute.

515. The Plaintiffs rely, in particular, on the first of these factors in their claims against Messrs Allardice, Loveridge and Sarles, complaining that they took too passive a view of their roles and regarded these as mere oversight and supervision, failing to inform themselves adequately and to acquire a sufficient knowledge of CCC's on-going affairs and state of business such that they failed to discharge their duty of care. This is, of course, a fact-dependent allegation, and I will consider it in due course where necessary and in context.

Particular points regarding duty of care:

(i) Gross negligence

516. As will by now be apparent, the Plaintiffs face the fact that the Defendants may have the benefit of exoneration and indemnity provisions in CCC's Articles of Association. These do not, however, cover "gross negligence", and the Plaintiffs do assert that the matters of their complaints can be classified as such.

517. The Plaintiffs stress – and this is obviously accepted – that negligence and even gross negligence does not involve *mala fides.* They also submit, rightly, that the difference between gross negligence and ordinary negligence is one of degree and not kind. Whilst they cite external authority for such propositions, I think the matter is neatly encapsulated in the implicit approval of the Guernsey Court of Appeal in the recent case of *Investec Trust (Guernsey) Ltd v Glenalla Properties Ltd* (2015)(Guernsey (CA) Judgment No 35/2015) at [118]-[119] of the dictum that

> *"gross negligence meant a serious or flagrant degree of negligence, not equating with reckless or intentional fault or the like".*

Thus, distinguishing "gross" negligence from "mere" negligence is a matter of degree. "Gross negligence" is simply extreme or egregious negligence. Figuratively and colloquially it is jaw-dropping negligence. Whilst it does not equate with recklessness, it is of a quality which is well on the scale towards it.

(ii) Delegation

518. It is common ground that a director is generally entitled to delegate his functions, to some degree, although he cannot delegate his "irreducible minimum" duty to oversee and monitor the affairs of the company even in areas where he may permissibly have delegated particular functions. It is also common ground that the permissible degree of delegation in any situation is fact-sensitive. The court will determine the dividing line between (in effect) permissible efficiency and impermissible abdication of responsibility. The dispute between the parties is thus, once again, a fact-dependent matter to be considered later in the context of the material evidence.

519. It suffices to note here that the Plaintiffs stress the persistence of a director's duty of oversight and supervision, which itself has to be performed with the requisite degree of skill and care. This is particularly pertinent (they say) to their complaints against the Independent Directors.

520. They also submit that the degree of delegation and reliance upon management that is permissible is significantly less when the company is "on the brink of insolvency" than otherwise, such that the Defendants' obligation to examine, test and satisfy themselves about the appropriateness of any particular course of action was "heightened" . However, it seems to me that there is no rule of law to this effect, and where it may appear to be the case on any particular authority, this is really the result of the application of the ordinary director's duty of care to a perilous factual situation. It is also largely stating the obvious.

521. The Plaintiffs also submit, under the general aspect of "duty to supervise", that the Defendants ought to have sought professional advice and guidance at various times from August 2007

onwards, and that their "*decision not to do so*" (although I am not sure that there is any evidence of any actual such decision) was a breach of their duty to CCC. Once again, if this is being advanced as a proposition that it is a rule of law regarding a director's duty of care and skill, that he should seek insolvency or other advice in such circumstances, I reject it as too prescriptive. Although it is a proposition included in the Plaintiffs' section of argument on legal principles, I think it is again just an aspect of the evidence in any specific case.

522. The law does not lay down particular steps that a director must take to discharge his duty of care. Rather it sets a general standard of care and diligence against which the director's conduct in any particular case is to be measured. Of course if directors do take, and follow, relevant expert professional advice, that may go a long way towards demonstrating that they were not in breach of a duty of care to the company. Indeed it may even be decisive in their favour. It does not follow, though, that the converse is the case, and that if they did not do so, they were in breach of their duty of care. Indeed a relevant factor may well be whether the taking of any professional advice would be likely to have produced advice to take any different course from what they did.

523. The Defendants make some more general submissions on the topic of delegation, and the related topic of reliance on others. They first submit that it is a general principle that directors are entitled to regard information provided to them by fellow directors and management as accurate unless there are reasons to doubt it. They cite the observation of Romer LJ in *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 at 429 that

> *"Men in responsible positions must be trusted .... until there is reason to distrust them."*

and they note that Hart J said in *Re Landhurst Leasing plc* [1999] 1 BCLC 286 that this is taken to mean that

> *"a director may rely upon his co-directors to the extent that (a) the matter in question lies within their sphere of responsibility given the way in which the particular business is organised and (b) that there exist no grounds for suspicion that that reliance may be misplaced."*

524. I accept this proposition subject to the qualification that the director must examine the situation sufficiently rigorously and critically as to satisfy himself that there are no matters giving grounds for caution, enquiry or suspicion. He should be considering whether any questions, particularly awkward ones, require to be answered. It seemed to me that the Defendants also accepted this qualification.

525. The Defendants submit similarly that a director is entitled to rely upon the advice of fellow directors and management in areas in which those other directors, or management, may be reasonably seen by the director to have greater skill, expertise or knowledge than he does himself. They refer me to the decision of Park J in *Re Continental Assurance Co of London* [2007] 2 BCLC 287 at [399] – [401] when considering a submission that non-executive directors should have intervened more forcefully in regard to the preparation of the company's accounts:

> *"I accept that one of the duties of non-executive directors is to monitor the performance of the executive directors. I accept that the managing director of a*

company … has a general responsibility to oversee the activities of the company, which presumably includes its accounting operations. But I do not think that those responsibilities can go so far as to require the non-executive directors to overrule the specialist directors, like the finance director, in their specialist field. The duty is not to ensure that the company gets everything right. The duty is to exercise reasonable skill and care up to the standard which the law expects of a director of the sort of company concerned and also up to the standard capable of being achieved by the particular director concerned….."

526. They submit that a director is not obliged to supervise every aspect of his delegate's activity, nor to be responsible for day-to-day management decisions. What is reasonable in the circumstances will depend upon how the particular company's business is organised and the part that the director could reasonably have been expected to play (*per* Hoffmann LJ in *Bishopsgate Investment Management Ltd v Maxwell (No 1)* [1994] 1 All ER 261 at 264).

527. Once again, the difference between the Plaintiffs and Defendants is that the former stress the limits on the ability of a director to delegate and the extent to which he may permissibly rely upon others, whereas the Defendants stress the extent of the permissibility of so doing, the law's recognition of the possible impracticalities and unreasonableness, in the modern world, of demanding that every director have full and equal knowledge of all aspects of a company's business, and that what is reasonably required of any particular director as regards informing himself of the company's affairs, relying on others, or supervising the performance by others of the company's activities depends on the particular facts and circumstances.

528. I prefer the Defendants' approach, but it does seem to me that it includes, with appropriate room for judgments of fact and degree, all the aspects of a director's duty which the Plaintiffs seek to stress.

(iii) The Importance of Board Meetings and Informed Deliberation - Duty to hold Board Meetings.

529. One last matter has been the subject of particular emphasis by the Plaintiffs and it merits individual mention. This is because, in my judgment, it illustrates the dangers of focusing too closely on criticism of individual aspects of directors' conduct rather than having regard to an overall view of that conduct as a whole. It is the holding of Board Meetings, and the Plaintiffs' allegation that CCC's board was "dysfunctional" because they say it did not hold enough of them.

530. The Plaintiffs submit that having regard to the directors' "*collegiate and collective responsibility*" (per Woolf MR in Re *Westmid Packing Services Ltd* [1998] 2 All ER 124 at 130A) to manage the affairs of a company, the holding of regular Board meetings is of vital importance, because it is this which provides "*the mechanism for collective deliberation and informed decision making*." Whilst accepting that the frequency with which Board Meetings ought to be held depends on the circumstances, the Plaintiffs submit that CCC's Board met only infrequently (it was intended to be once every three months, in July, November, February and May, although there was an exceptional emergency Board meeting in August 2007), and that at the material times this was not frequently enough.

531. This is alleged by the Plaintiffs as a discrete breach of duty on the Defendants' part, although I think put on the basis both of breach of fiduciary duty and as an aspect of breach of duty of care. They submit that the reason for the requirement of Board Meetings is to enable actual

deliberation between the directors to take place, so that a requisite "meeting of minds" (which I will call a "consensus") of the Board can take place. The authority cited in support of this is *Re Bonnelli's Telegraph Co* [1871] LR 12 Eq 246 at 258.

532. 1871 was well before the invention of email and even the general use of the telephone. Nothing more modern is cited except for a reference to such a consensus being described as "essential" in the *Bell (No 9)* case (above: (2008) 70 ACSR 1) at para [5587-9]. However examination of the facts of that case shows that the issue there was whether the minutes of a board meeting were accurate and, in that context, what were the requirements for a "meeting" where, under Australian law at the time, a valid Board resolution could only be made at and by a "meeting". Thus the particular point was not directors' liability for breach of duty but, once again, the validity (and thus the effectiveness) of an apparent act of the board. Of course if the law lays down that certain acts of a board of directors have to be effected by resolution at a meeting in order to be valid, then the directors have, in practice, a duty to hold such meetings in order to carry on the business of the company lawfully and effectively. However, that is not the same thing as saying that there is a general duty to hold meetings as part of a duty of care in conducting the business of the company.

533. In my judgment, apart from any legal requirement of an actual meeting either under statute as above or to comply with the company's articles of association, there is no legal requirement to hold meetings, even though it will be common practice and probably most efficient to do so. Any suggested "rule" that the holding of meetings is part of a director's duty of care (or fiduciary duty) is simply expressing a facet of the directors' duty actively to join and participate in the conduct of the company's affairs as entrusted to its board. Holding meetings is not an end in itself. It is a means to an end, namely the arrival at considered and appropriate decisions on relevant aspects of the conduct of the company's business by those to whose charge it is confided.

534. Of course if something has gone badly wrong in the event, then a subsequent investigation into the reasons for this, and the question of any liability of the directors, will involve a review of any meetings of the board, and of course lack of such meetings may be evidence from which it can be inferred that the directors did not give sufficient, or sufficiently conscientious, regard to the company's affairs. However, that is, once again, an evidential point only and not a substantive one. Indeed, in a time of crisis, it may be that devoting the time and attention of the directors to the holding of meetings for collective deliberation purposes, rather than carrying out other actions to run or save the company, is not even in the company's best interests, because it would be a diversion. It might even be that in such a case the holding of meetings was more in the personal interests of the directors themselves, to protect themselves from potential future criticism, rather than in the best interests of the company with urgent needs of the moment. This illustrates that the convening of board meetings is a tool, to be deployed appropriately to the circumstances, and the effects of holding or not holding meetings must be judged in the context of those circumstances.

535. The Plaintiffs' proposition that there is a duty to hold board meetings (and to do so with increasing frequency if and as the company's financial position deteriorates) is said to arise from the "collegiate and collective responsibility" to hold deliberations for decision making purposes. However, this proposition requires closer examination.

536. First, and as is common ground, the duties owed by a director to the company are owed individually, and not jointly or collectively. It follows that the essence of the duty has to be something which can be carried out by an individual. Translating an alleged "duty of collegiate deliberation" into practical fact comes down to an acknowledgement that part of the duty of exercising independent judgement and understanding the company's business involves reception and discussion of the views of one's co-directors as relevant material. Attendance at convened meetings of the directors may well be the most efficient way of achieving this, but it is not necessarily the only way, and it seems to me that an individual director may well be able to fulfil his duty in this area, at least some of the time, by other means. This will depend on his role in the company, the governance structure and systems of the company, and the availability both of company lines of communication and modern methods of communication.

537. I would therefore describe the individual director's duty in this regard as being a duty to gain and maintain a sufficient understanding of the company's business and to inform and keep himself informed as to the surrounding facts and circumstances of such business, sufficiently to enable himself to participate effectively in the making, together with his co-directors, of such decisions as the board is required to make, in whatever manner is effective, and in accordance with his own role in the company's governance and with the effective deployment of the skill-sets which are distributed amongst its board.

538. Second, and leading on from this, the "consensus" at which the board is required to arrive with regard to a board level decision is a consensus as to the course of action which the company should take, and not a consensus either as to reasoning or as to the reasons (slightly different), for doing so. Different members of the board may well reach the same conclusion as to what is best for the company, for different reasons. Coincidence of thought is not a requirement. They do not have to agree on the reasons for an agreed decision as long as the result is agreed. An obvious example is that the expert director may propose a course of action because of a judgment arising from his own expertise, and the non-expert director in that field may reach the same conclusion because he sees no reason to doubt the reliability of the propositions put forward by his fellow expert director. In the general case, unanimity of the board is not even a requirement. A valid board decision may be arrived at by a majority vote - a consideration which makes it quite obvious that the "consensus" will then be confined to agreement as to what the company will do in all the circumstances, including the division of opinion and the effect of the vote.

539. Third (a point for later, but leading on from both of the above points,) bearing in mind that liability is individual, but that a board decision is collectively taken, it becomes apparent that the liability of a director for any breach of duty is dependent both on his having been in breach of his own duty and also on that breach of duty having been causative of the actual collective decision taken, because it is this last which has caused the company the loss. Thus, the personal liability of an individual director in respect of any decision or action may well be highly fact-sensitive as to the part he played or ought to have played in the taking of the decision or action. To illustrate, if a decision is made which turns out to be catastrophic, but six out of seven of the directors are found to have taken it in good faith and without negligence, then the fact that one director was in clear breach of duty through having failed to read the papers or think about the company's interests is immaterial. *Ex hypothesi*, the decision which he made or subscribed to was a decision which *some* reasonable directors could have made. On an alternative, and probably preferable, view, his breach of duty caused the company no loss. On the other hand, if the director was in breach of duty because he failed to

disclose a material conflict of interest which, if he had done, would have caused his co-directors to take a different decision, then he and he alone will be liable as the other directors were *ex hypothesi* not in breach of duty on the facts reasonably (it is assumed) known to them.

540. In my judgment it is apparent from the above that the great range of the nature of decisions, how they were taken, business circumstances, corporate governance systems, directorial roles and individual skills which directors may be required to use, produces so many permutations of where liability may or may not come home that it is unfruitful and of little utility to attempt to formulate abstract "rules" that any particular aspect of conduct in regard to a director's participation in the decision making process is a definite, or even a likely, element of culpability, and I will not be taking such analysis any further. I will consider such matters as the impact of holding or not holding board meetings simply as part of the factual matrix going to any alleged breach of duty, applying the broad proposition which I have formulated, and the logical considerations, mentioned above, as appropriate.

(iv) No business judgement rule

541. Lastly, the Plaintiffs make the point that there is no "business judgement rule" either in Guernsey or in England, in contrast to other jurisdictions.

542. I understood this submission to be made in refutation of a supposed defence with regard to the claim for breach of the duty of care, but I note that the Plaintiffs interpret it as being raised in relation to fiduciary duties, either alone or as well. This appears to arise from the *Colin Gwyer* case (above), where it actually seems to me to be difficult to decide which duty the court was relying on; Mr Kosmin QC simply seems to have found on the facts that the director's failure to inform himself at all of the facts which would enable him to form a judgement as to what were the best interests of the company was so obvious, that it was clearly a breach of duty on any basis.

543. In fact, I accept the Plaintiffs' submission, as I think the Defendants do as well, but there seems to me to be nothing in the point. I will not be examining its application in other jurisdictions, but my impression is that the "business judgement rule" is simply shorthand for the principle that the court will pay respect to the decisions of directors honestly and conscientiously arrived at, and will not substitute its own judgment as to the rightness or wrongness of the decision, absent some vitiating factor which can be classified as breach of fiduciary duty or negligence. Guernsey law may not recognise an express "business judgement rule" but it recognises all the features which would feed into any such shorthand rule in other jurisdictions. For my purposes the exercise is to consider and apply the appropriate constituent elements of liability (or not) in Guernsey law. Whether or not they can compositely be referred to as a "business judgement rule" is immaterial.

(c) The practical relationship between the fiduciary duties and the duty of skill and care.

544. As a final point, it is helpful to strip away all the refinements of the legal analysis above, and summarise the practical relationship between these two categories of directors' duties. The core fiduciary duty, the duty of good faith, is a duty of loyalty. It is performed primarily and centrally by subjective honesty and conscientiousness, but if it is not so performed, it will still be discharged if the material decision or action is objectively within the range of decisions or actions which a reasonable and competent director acting in good faith could have made or taken in all the circumstances pertinent to the relevant director and decision. This is the

Charterbridge principle. The "own judgement" duty and the "no conflicts" duty, although sufficiently individual in their content to be separately identifiable, are really particular sub-categories of the duty of good faith.

545. The "proper purposes" duty is slightly different in that its scope is objectively defined rather than subjectively defined, and it can therefore be breached despite the director's acting in perfect good faith. However, where "proper purposes" is really just a synonym for the best interests of the company itself, this duty is either co-extensive with the duty of good faith or, in effect, a sub-category of it. It is dangerous and liable to lead to confusion not to recognise this difference, and thereby to assume that tests for the application of the proper purposes duty can simply be transferred or implied into the application of the duty of good faith. The consequences of the difference between the two duties mainly arise with regard to issues about the formal validity and legal effectiveness of decisions or actions (not the subject of this case) rather than claims for damages for breach of duty. Once again, though, this duty will be discharged if the material decision or action is objectively within the range of decisions or actions which a reasonable and ordinarily competent director acting properly could have made or taken in all the circumstances pertinent to that director and decision.

546. The duty of skill and care is an objective duty to perform all directorial acts in relation to the company with the skill and care objectively to be expected of any ordinarily competent director of such company performing the role ascribed to the particular director, but also, if applicable, to any higher standard reasonably to be expected of a director with such enhanced skills, knowledge or expertise as the particular director actually possesses. There is apparently no express authority as regards this latter qualification in Guernsey law, but it evolved in English law as a matter of interpretation of basic principle, and I am therefore satisfied that this must apply similarly in Guernsey law. Once again, however, there will be no liability if the material decision or action is objectively within the range of decisions or actions which any reasonably competent and careful director could have made or taken in all the circumstances pertinent to that director and decision. This is because the actual decision or action would then have caused no damage to the company, as contrasted with there having been no breach of duty, and the suffering of damage is a requisite of the cause of action itself. The test is thus materially the same as the *Charterbridge* principle.

547. As a matter of practicality, therefore, if any decision or action by a director is challenged, the most economical approach to determining the issue of liability is to apply the *Charterbridge* principle first, because it is only if the decision or action fails on this test that it is necessary to decide whether, on the facts, it was actually the product of a breach of any aspect of the director's fiduciary duties - or indeed of the duty of skill and care, although plainly in that case such a finding is likely to flow from the first point.

(2) What is "insolvency"?

548. It is necessary at some stage, - and the point of moving on from directors' duties to liability for wrongful trading is as good as any, - to deal with a further and fairly basic dispute of law between the parties, namely what was the test for insolvency in Guernsey law, at the time with which this case is concerned, ie under the 1994 Companies Law?

549. The point is material, first, to the application of the issue discussed above as to the scope of a director's duty to have regard to the interests of the company's creditors, and second, in regard to wrongful trading, where there arises the question whether the directors of the company

ought to have seen that there was no reasonable prospect of the company's avoiding insolvent liquidation. The Plaintiffs also submit that it is material to the "propriety (reasonableness or rationality) or otherwise" of the Defendants' continued operation of CCC in the manner which they deprecate, but I do not see this adds anything to the two points above.

550. Although the word itself does not appear in the legislation, the question what is "insolvency" for present purposes is a matter of the true construction of ss. 94(e) and 95 of the 1994 Companies Law.

551. It is important to bear in mind that this point is now historic. The test for a company's insolvency under the 2008 Companies Law is contained in ss 407 and 527, and has been modified such that the discussion which follows no longer arises today.

552. Section 94(e)of the 1994 Companies Law says that

> *"A company may be wound up by the Court if the company is unable to pay its debts."*

and under s.95 a company is

> "…..*deemed to be unable to pay its debts if –*
>
> *(a) a creditor to whom the company owes a sum exceeding £750 then due has served on the company through the office of the Sergeant at the company's registered office a written demand for payment, and*
>
> *(b) the company has, for a period of 21 days immediately following the date of service neglected to pay the sum or to secure payment to the reasonable satisfaction of the creditor;*
>
> *or it is proved to the satisfaction of the Court that the company is unable to pay its debts."*

Thus, there is provision for a statutory demand, failure to comply with which suffices as proof that the company is "unable to pay its debts", but that situation can also and alternatively be proved by any evidence which satisfies the court of that proposition, on the usual evidential tests. The statute itself gives no further guidance as to what is meant by the state of being "unable to pay its debts".

553. The Plaintiffs submit, referring principally to *BNY Ltd v Eurosail* [2013] 1 WLR 1408, *Bucci v Carman (Liquidator of Casa Estates (UK) Ltd)* [2014] EWCA Civ 383, and latterly *In re Weavering Macro Fixed Income Fund Limited (in liquidation)* (18th November 2016: Cayman Island Court of Appeal CICA No 2 of 2016) as well as Goode: *Principles of Insolvency Law* (4th Ed 2011) at paras 4-16 and 4-23, that being "unable to pay its debts" requires taking into account not only the present debts of the company, but those which will, or are likely to, fall due in the reasonably near future. They submit that this test is properly described as being whether a company can pay its debts "as they fall due". They submit that this entails looking at the ability of a company to pay its debts falling due in the "reasonably near future" as well as the present. They go on to submit that whilst looking at the "reasonably near future" requires looking at commercial realities and is a matter of fact and circumstances, the appropriate period in this case is a period of twelve months looking forward, based on

evidence of CCC's own forward projected planning and general accounting and regulatory standards.

554. The Defendants submit that this interpretation is wrong at the outset. Sections 94(e) and 95 say nothing about debts "as they fall due" and the statutory words are merely the bald test that the company is "unable to pay its debts". That test, they submit, is only whether the company is able to meet its liabilities which are actually due, and it is not concerned with future or contingent debts. Whilst this may not be in accordance with the tests in other jurisdictions – and indeed Guernsey law has now been amended, in the 2008 Companies Law at ss 407 and 527(1)(a), to correspond largely with the present test in English insolvency law - this court is concerned with construing the 1994 Companies Law, which was applicable at the material time for this action.

555. The Defendants point out that in *BNY v Eurosail* (above) the Supreme Court (Lord Walker) noted the history of the English authorities on equivalent statutory provisions, the first of which was the Companies Act 1862 s 80(4). This contained the same wording as the 1994 Companies Law of Guernsey, ie

> "*….proved to the satisfaction of the court that the company is unable to pay its debts.*"

556. This provision was interpreted as referring to "*debts absolutely due*" by James V-C in 1869 in *Re European Life Assurance Society* (1869) LR Eq 122, and this was in turn summarised by Nicholls LJ in *Byblos Bank SAL v Al-Khudhairy* [1987] BCLC 232 at 248 as meaning debts *"for which a creditor might demand immediate payment".* Briggs J in *Re Cheyne Finance Plc (No 2)* [2008] BCC 182 at [31], described this as debts "*actually due*".

557. In 1907, subsequently to James V-C and the *Re European Life Assurance Society* decision, s 28 of the English Companies Act 1907 introduced an addition to this basic wording, by adding

> *"and in determining whether a company is unable to pay its debts the court shall take into account the contingent and prospective liabilities of the company".*

This was the wording used in all successive English Companies Acts up to and including s 518(e) of the Companies Act 1985. However, in s. 123(1)(e) of the Insolvency Act 1986, this test was revised to be "*unable to pay its debts <u>as they fall due</u>*" (emphasis added), and the additional words previously added and quoted above, were transferred to a second and separate test in s. 123 (2) of the Act, which provided that a company should also be

> "*deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities taking into account its contingent and prospective liabilities".*

558. In examining s. 123 in *Eurosail*, Lord Walker, at [25], characterised the words "as they fall due" in s.123(1)(e) as *"words which look to the future as well as the present".* The Defendants stress that Lord Walker was concerned, in *Eurosail*, with the English legislation, and whilst the Companies Law 2008 of Guernsey is now in similar terms, it was not in force at the material time. Consequently the test for insolvency under the 1994 Companies Law remained that of being "unable to pay its debts" in unvarnished terms. It therefore referred to actual debts currently due, with no forward looking considerations.

559. The Plaintiffs argue that Lord Walker in *Eurosail* (above) also said at [37] that the words "as they fall due", introduced by the 1986 Act, did not connote any change in meaning from the previous legislation but merely "underlined" the forward looking element in the test. This is true, but, as the Defendants point out, it does not seem to me to assist, because the previous English legislation (the Acts from 1907 until 1985) had already been amended to add words looking to the future, so that Lord Walker's comment was not a comment on the interpretation of the bare words "unable to pay its debts". The Plaintiffs contest this on the basis that the statutory injunction in the 1907 and later Acts, to take into account the contingent and prospective liabilities of the company, was only appropriately applied to the "balance sheet" test for insolvency and not to the "cash flow" test, so that Lord Walker's statement that the 1985 Act made no change to the effects of the immediately preceding statutory provision was recognising that the qualification "as they fall due" had been previously implicit in applying the "cash flow" test. I just disagree. Such an interpretation is too convoluted. The 1907 Act stipulated "*tak[ing] into account contingent and prospective liabilities*" in relation to the whole and entirely general test of whether a company was "unable to pay its debts", by whatever route this was approached.

560. The Plaintiffs point out that Warren J in *Re Casa Estates Ltd* [2013] EWHC 2371(Ch) at [27] suggested that the only test under the "old section" (ie s 518 of the Act of 1985) was *"Is the company unable to pay its debts?*" continuing that *"implicit in that ... was the phrase 'as they fall due'"*. However it seems to me, either the judge has simply overlooked the added words in s 518 which expressly introduce this effect, or, and I think more likely, he was just using shorthand expression for the whole clause, including the additional words. The point was not directly relevant to his decision in any event. Either way, I do not consider that it assists the Plaintiffs in terms, and it is also, at best, the view of a judge of another jurisdiction on the construction of legislation of that jurisdiction in different terms from those of the relevant Guernsey Law. It is therefore of little assistance in construing the 1994 Companies Law.

561. In my judgment the Defendants' submission is correct, and the question whether CCC was "unable to pay its debts" at any material time, in accordance with the then current Guernsey legislation, is to be determined according to whether or not it could pay its debts actually due. That this is the meaning of the words of the section is mildly supported, in my judgment, also by the specific reference in s 95 (a) of the 1994 Companies Law to a debt of £750 "then due", although I accept that that is only as a matter of colour, and not direct interpretation. The point of s. 95(a) was to provide a practical clear-cut evidential test for being unable to pay debts, apart from proof by any other evidence.

562. The Plaintiffs' argument on this point has to be that the words "unable to pay its debts", used in the 1994 Companies Law carried an implicit reference to debts which were not currently due but would or might fall due in the future. It may be that, with the more modern approach to legislative construction being "purposive" and less black letter than in the 19th century, the bare words "unable to pay its debts" could today be construed as allowing some eye to the future, even bearing in mind that the test is clearly rooted in the present. However, that is not the issue. The issue is, what did the Guernsey legislature mean when enacting the 1994 Companies Law?

563. I do not think that anything useful with regard to the interpretation of the bare words "unable to pay its debts" can be derived from Lord Walker's speech in *Eurosail.* It is an unsound case on which to found arguments as to the meaning of Guernsey company law in 1994. It was

concerned with construing the two separate limbs of the English Insolvency Act 1986, ss 123 (1) (e) and 123 (2), which were part of an overhaul of English insolvency law from an earlier state of law which was not even, itself, in the same terms as the 1994 Companies Law of Guernsey, as explained above. Indeed, Lord Walker's criticism of James V-C's judgment seems to me to imply that he accepted (even if he regretted) that James V-C had held that the test of "unable to pay its debts" *tout court* was confined to present debts only. It also seems to me to be clear that this interpretation was not questioned either by Nicholls LJ in *Byblos* (above) or, and more recently still, by Briggs J in *Cheyne Finance (No 2)* (above).

564. But the strongest supporting reason for my conclusion is that the framers of the 1994 Companies Law must have been aware of the additional words then to be found in the English equivalent legislation, and did not incorporate them into the Guernsey law. The provision for proving inability to pay by an unsatisfied statutory demand is adapted from that very legislation. They must also have been aware of the interpretation placed on the unqualified words by James V-C in *Re European Life Assurance Society* since this was well known as the authority on that very point. They nonetheless selected, or re-enacted, the bare words used in the earlier English legislation, without any addition such as that found in either the English Act of 1907 or even the later act of 1986. By implication, this was deliberate. It cannot, therefore, be assumed that they "must have intended" some element of regard to future debts to be inherent in the bare words "unable to pay its debts".

565. This may well be a strange and even counter-intuitive result to an English trained lawyer, for whom (because of familiarity with the parallel concepts in the English legislation) the notion that "cash flow" inability to pay debts requires also having regard to future and contingent liabilities is so standard as to go without saying. If so, that only emphasises that lawyers need to be careful not to allow preconceptions from other jurisdictions unconsciously to influence their interpretation of Guernsey law, which is a separate and individual jurisdiction in its own right, with its own legislative priorities and policies.

566. For completeness, I add that I do accept that the test for being "unable to pay its debts", whilst looking only at actual debts, must take account of the practical consideration of payment, and possibly requiring a short time – a matter of days - to comply with a demand, (compare the 21 days given for due compliance with a statutory demand for £750). However, that is simply the reasonable time which is always allowed to a debtor to comply with a demand for a debt currently due. It is, in my judgment, the only element of any "futurity" implicit in the definition, but it relates to what is meant by "pay" as a matter of mechanics, and not what are the relevant "debts".

567. Since the hearing of this case concluded, the Plaintiffs have cited to me another decision on this point, this time in the Court of Appeal of the Cayman Islands, given on 18th November 2016: *In re Weavering Macro Fixed Income Fund Limited (in liquidation)* CICA No 2 of 2016. They point out that s. 93 of the Cayman Islands *Companies Law (2013 Revision)* is in the same terms as s. 95 of the 1994 Companies Law of Guernsey, providing that a company is deemed to be unable to pay its debts if

> "*it is proved to the satisfaction of the Court that the company is unable to pay its debts*".

568. In *Weavering* the issue was whether the Plaintiff liquidators could recover as a preference certain payments made to a Scandinavian Bank by way of redemption of its investment in the

company but within 6 months before its insolvent liquidation, on the grounds that the company was insolvent at the time these payments were made. The redemption notice had given the required one month's notice to redeem at 1st December 2008, and the company's articles provided that redemption would then be effected by payment, within 30 days, of a sum equal to the notice giver's pro rata share of the Net Asset Value of the company as certified on the day before the redemption date. That valuation had been made, but on the assumption that certain derivatives owned by the company had value, when they were in fact worthless but were included as supposedly valuable assets through the fraud of the main founder of the company.

569. The central issue in the case was whether the inflated NAV which had been certified could be said to be in accordance with the articles of the company, it having been procured by a fraud internal to the company. A subsidiary point, however, was whether the company was "insolvent" within the meaning of s 93 at the time of the payments, because these had been made during the 30 day grace period for payment following the redemption date. The Bank argued that the procedure for payment meant that the debts constituted by the acceptance of the redemption notice were not due and therefore not payable until the end of that period. The Court of Appeal rejected that argument, following a previous Cayman case (*Culross Global SPC Ltd v Strategic Turnaround Master Partnership Ltd* 2008 CILR 447) which had distinguished between a debt which falls due but for which a period of grace for payment is allowed, and a debt which does not fall due until a later date. In a very similar factual situation, it had held that the analysis was the former, and not the latter. Both the judge and the CI Court of Appeal held that this meant that the debts had become due on 1st December 2008. That was enough to dispose of the issue of insolvency in *Weavering*, because it meant that the redemption obligation was an actual debt, and the company had clearly been unable to pay all the redemption debts which fell due on the 1st December 2008.

570. However, the Court of Appeal went on to consider "very briefly" the alternative argument that the status of "being unable to pay its debts" without further qualification permitted regard to the future, and it held that under s.93 of the Cayman law, it did. The unqualified phrase was held at [40] by Martin JA, with whom the other members of the court agreed, to look not only to debts immediately due and payable but also to debts which would or might become due in the "reasonably near future", relying on the judgment of Lord Walker in *BNY v Eurosail* (above), and noting his disapproval of James V-C in *Re European Life Insurance Society* (above): "*It may be unfortunate that his judgment has come to be regarded as a leading case".*

571. Having looked at this further authority, it does not cause me to change my previous view, for the following reasons. First, in view of the court's conclusion that the company was insolvent at the relevant time on the test of debts actually due, this is an *obiter dictum*. It is, of course, also in relation to another jurisdiction even if the words of the two laws are the same. Second, it would seem from the brief references made by Martin JA to the judgment of Lord Walker in *Eurosail* that he assumed, in the same way as the Plaintiffs in this case have invited me to assume, that Lord Walker's reference to the position in English law prior to 1985 was a reference to the unqualified phrase "unable to pay its debts", whereas it was in fact a reference to the expressly qualified position which had been enacted in the UK since 1907. It does not appear from the judgment that the CI Court of Appeal had the benefit of the research and the arguments which have been advanced here on behalf of the Defendants by Advocate Swan. Finally, though, it does nothing to displace my main reason for coming to the conclusion which I have done, namely that those who framed the 1994 Companies Law must have done so

by reference to the position as it was then widely known and understood to have been in English law, that the bare phrase "unable to pay its debts" for insolvency purposes referred only to current debts.

572. It follows that I will approach any issue to which the matter of CCC's insolvency or potential insolvency is germane on the basis of the above scope of the definition of insolvency in the law of Guernsey at the time.

573. It also follows that the lengthy and elaborate argument subsequently made by the Plaintiffs in support of their submissions as to what would be meant by an inability to "*pay its debts as they fall due"* are beside the point. However, in case I am wrong in my interpretation of ss 94(e) and 95 of the 1994 Companies Law, and s.94(e) does, on its own, import some element of regard to debts accruing in the future, I will also consider that test at the relevant juncture, where it is material. As to legal principle, I will therefore make only the following comments here.

574. The reasons why the test for insolvency has been allowed to have regard to future and prospective debts in other jurisdictions (and also in Guernsey under the 2008 Companies Law) is pithily summed up in the dictum of Briggs J in *Re Cheyne Finance plc (No 2)* [2008] BCC 182 at [51], in the context of the "as they fall due" test.

> *"It is clear… that … cash flow or commercial insolvency is not to be ascertained by a slavish focus only on debts due as at the relevant date. Such a blinkered review will, in some cases, fail to see that a momentary inability to pay is only the result of a temporary lack of liquidity soon to be remedied, and in other cases fail to see that due to an endemic shortage of working capital a company is, on any commercial view, insolvent, even though it may continue to pay its debts for the next few days, weeks or even months before an inevitable failure."*

I note the word "inevitable".

575. The Plaintiffs submit, (and it seems to me to follow anyway) that the element of forward looking implicit in the test of being "able to pay debts as they fall due" (if that were applicable in this case) involves looking to the "reasonably near future" (see *Bucci v Carman (Liquidator of Casa Estates (UK) Ltd* [2014] EWCA Civ 383, and also the approach in *Re Weavering* in the Cayman Islands, referred to above), in the context of applying a judgment of commercial reality as to the company's ability to pay the succession of inevitable, or likely, debts which it will incur. I accept the Plaintiffs' submission that, if this is the test, it focuses on ability, and therefore potential future ability, to pay the series of future debts which can be anticipated to be incurred by the company.

576. As to what is meant by such a "commercial" approach, in *Bucci* (above) Lewison LJ identified at [30] that this required the court

> *"not to stop automatically at the answer to the question: is the company for the time being paying its debts as they fall due? In an appropriate case it must go on to inquire: how is it managing to do so?"*

577. This last question is plainly aimed at the further aspect of futurity which is within the test imported by the words "as they fall due", and I note also that the words "in an appropriate case" indicate the flexibility of fact-sensitivity.

578. The purpose of this enquiry is thus to identify whether, even if the company is currently managing to pay its debts, it nonetheless appears that there is going to come a time when it will cease to be able to do so, because if that time is sufficiently imminent as to appear inevitable, the company is thus insolvent now, on the basis of the "debts as they fall due" test. If any such time is sufficiently far off, or sufficiently imponderable that its eventuality might be avoided, the company's inability to pay debts "as they fall due" is therefore speculative, and the test is not met. It seems to me that the "reasonably near future" test is an attempt to define the dividing line between those two positions, and in practice it is the dividing line between the prospect of inevitable failure and its possible avoidance.

579. The assessment of "inability to pay debts as they fall due" involves considering all the company's circumstances on the potential liability side, and also on the potential asset and resource side. It is a question of fact to be determined on evidence in the usual way. What would be the "reasonably near future" also depends, once again, on the particular facts of the case, and especially the nature and circumstances of the particular business.

580. However, the Plaintiffs submission, from all this, is that it is necessary for the court to determine as an anterior question, the period which represents the "reasonably near future" in the particular case, against which it will then make the assessment of whether the company can or could pay its debts within that period, and hence "*as they fall due"* as thereby defined. They submit that in this case, the appropriate period is twelve months. A broad summary of their reasons for this is that CCC's management papers show budget forecasts and suchlike for periods of at least twelve months, internal communications contain instances of reference to looking forward for such a period, some of the Defendants had agreed in cross-examination that they had been looking at CCC's future for the next twelve months, and finally, that this is the period that accountants and suchlike habitually use and used in this case in their assessment of a company as a "going concern" for accountancy and audit purposes.

581. I do not consider this approach to be of any help whatsoever, and in fact, I find it to be dangerous and potentially confusing. The test of ability to "pay debts as they fall due" is impressionistic. Inevitably, once it is accepted that considering this ability involves looking to the future to some extent, the natural question is "how far?", but in my judgment the answer to that question is so imponderable and case sensitive, that no further attempt at precision is either appropriate or useful as a matter of rule or definition.

582. The "reasonably near future" test has apparently been picked up in England from Australian law, where the cash flow test for insolvency (which there uses the similar expression "[debts] *as and when they become due")* seems to have been extensively applied and rigorously analysed by the courts, possibly because the legislative context contains no prescribed "balance sheet" test for insolvency, as it does in English law, as already mentioned. The "reasonably near future" test answers the question "how far?" in the time-honoured way: it is all a matter of reasonableness.

583. I therefore do not think that it is helpful to attempt to reduce this question to a mechanical process of trying to fix an appropriate timescale from suggested *indicia* in the facts, and then to examine the position with reference to the timescale thus selected. Of course a particular

judge, in a particular case may find that approach useful in helping him or her to come to a conclusion about the application of the broadly stated test of "as they fall due", but to elevate this to part of a necessary process of reasoning, in the way the Plaintiffs do in this case, seems to me to be too rigid. It is translating what should be a tool of analysis into a rule of application.

584. In short, this seems to me to be putting the process of reasoning round the wrong way. The first question is whether the company is able to pay its current debts. If it is in fact doing so – it has not defaulted – then the next question is, does it appear that it will be able to continue to do so in the future, taking into account its apparent future and prospective liabilities? This will mean examining how it proposes to continue paying the debts which are anticipated. If there is uncertainty about giving a positive answer to the second question, then the final question is: how soon is any such inability likely to occur? If this likelihood is within the "reasonably near future", then the company cannot now pay its debts "as they fall due"; if it is outside that impressionist timescale, then it can, because future failure is not inevitable but speculative. The place of the "reasonably near future" therefore lies in this last stage of the reasoning process – how far off does it seem that failure is inevitable?

585. In other words, the "reasonably near future" relates to a description of the view the court has already formed of the strength of the company's apparent continuing ability to keep paying its debts – how long it looks as if it will be able to carry on doing so, and whether that is the "reasonably near future"? It is not a test which requires first determining an applicable time period and then asking whether the court is satisfied that the company can continue paying its debts during that determined period.

586. I find that this point assumes particular importance because of the nature of CCC's business, and I consider it more closely at the appropriate point later, (with regard to August 2007).

587. Finally on this point, it is important not to lose sight of its limited materiality. I am not hearing a petition for the compulsory winding up of CCC. The question whether it was "insolvent" or not at any time is of no direct relevance in itself. The two areas where the question of CCC's insolvency is germane to issues which I do have to decide both relate to the Defendants' knowledge or state of mind, and, importantly both have an element of forward looking already built into them, which largely renders the distinction between the test of insolvency being an inability to pay (current) debts or an inability to pay debts as they fall due, irrelevant.

588. The first issue is with regard to the Defendants' fiduciary duties; it is whether the prospects of "insolvency" were sufficient to require the Defendants, as directors, to proceed thenceforth to conduct CCC's affairs with proper regard to the interests of its general body of creditors (see above). The second is with regard to wrongful trading; it is whether the Defendants ought, at some earlier point than they did, to have concluded that there was no reasonable prospect of CCC's avoiding going into "insolvent" liquidation, ie getting into a situation where it was in fact unable to pay its (relevant) debts. Both these states of mind require an assessment of the future prospect of the company being able or unable to pay its debts. Whether that assessment judges the prospect of being unable, at some point in the future, to pay debts then actually due, or the prospect of being unable, at some point in future, to pay debts as they would then prospectively fall due, is reaching a level of refinement which seems to me to have no practical utility or effect. It is hardly a distinction which any normal businessman would devote any

time to, and could scarcely be decisive with regard to the propriety of any business decision likely to be being taken in practice. The law needs to have some regard for reality.

(3) Wrongful trading

589. The third basis of liability claimed by the Plaintiffs is that of the statutory liability for wrongful trading, under s 67C of the 1994 Companies Law, as introduced in 1996 by the Companies (Amendment) (Guernsey) Law 1996. Section 67C(1) provides for the court to make a declaration of a liability to contribute to the assets of a company in certain circumstances. Section 67C(2) states those circumstances as being that

> *"…… (a) the company has gone into insolvent liquidation; and*
>
> *(b) at some time before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect of the company avoiding going into insolvent liquidation; and*
>
> *(c) that person was a director of the company at that time; "*

The "time" referred to in s. 67C(2)(b) has been graphically referred to as the "moment of truth": see Palmer's *Company Law* (Rev Jan 2016) at 15.599.30, cited by the Plaintiffs.

590. As mentioned above this is one point where the test for what is insolvency under ss 94(e) and 95 of the 1994 Companies Law might theoretically make a difference to the scope or application of this provision in Guernsey as compared to jurisdictions where the test is different. The practical effect of s. 67C(2)(b), reading into it the Guernsey law test for what is deemed to bring about a cash flow insolvency in Guernsey law, is that the relevant person "knew or ought to have concluded that <u>there was no reasonable prospect that there would not come a time when the company could not pay its debts then actually due</u>". The alternative formulation using the broader wording of English law interpretation would have to be along the lines that the relevant person "knew or ought to have concluded that <u>there was no reasonable prospect that there would not come a time when the company could not pay its debts as they would then be falling due</u>."

591. The difference is subtle. The former could be a slightly more generous test to directors than the latter, in theory. The former is certainly more clear-cut and therefore probably easier to judge in any particular case. As I have just said, though, I doubt if it would make any practical difference to any decision which directors might have to take, but the point remains that the former is the effect of the Guernsey law wording which I consider it appropriate to apply.

592. Moving on, s. 67C(3) provides a defence that, after any such time as is identified in subs.(2), the director took "*every step with a view to minimising the potential loss to the company's creditors ….that he* [then] *ought to have taken*". I note this, and the apparent stringency of the test, to which the Plaintiffs draw attention.

593. Section 67C(4) lays down that the standard to be applied in testing whether the director ought to have known or ascertained facts (or come to the relevant conclusion or taken particular steps) is the same standard of skill and competence by which a director's duty to his company is judged generally. This has been discussed above. It comprises the basic objective standard

to be reasonably expected of a person carrying out that director's functions in such a company, uplifted, if applicable, by virtue of any enhanced material attributes of the actual director.

594. I do not need to recite the supplementary provisions of s. 67C(5)-(8), at any rate at this point, except to note that the Entity Defendants accept that, by s 67C(7), the wrongful trading provisions are expressly applied to shadow directors. They also concede that by virtue of s 117 of the 1994 Companies Law, *de facto* directors are within the definition of a "director" for the purposes of the 1994 Companies Law, and therefore within it with regard to liability for wrongful trading under s 67C.

595. Moving on, being satisfied of the specified facts justifies the court in ordering the director in question (and, again, liability has to be considered individually) to make such contribution "*as the court thinks proper*" (s.67C(1)) to the assets of the insolvent company in its liquidation. It is common ground that the principle behind this is that of compensation, and it is not intended to be penal. The starting point (see, eg *Re Ralls Builders Limited (in liquidation)* [2016] Bus LR 555 at [238]) is that the director(s) should make good the "increased net deficiency" of the company, ie the additional losses which have been suffered by the company as a result of its wrongfully continuing to trade. Thus, the deficiency in the actual liquidation is to be compared with an assessment of the position - putatively a lesser deficiency - which would have resulted if the directors had taken the steps they should have done, which would either be a more prompt liquidation or some other steps towards winding down the company and/or realising its assets. The director(s) are *prima facie* liable for the difference, although the court has a discretion to mitigate any such liability if appropriate to the justice of the case under s.67C(1).

596. As regards the application of s 67C, the Plaintiffs first submit, and I accept, that this is a public interest provision, the object of which is to discourage directors, when a company is in the vicinity of insolvency, from taking "*excessive*" risks by continuing to trade in the hope of the company "*escaping from its financial troubles*", but knowing that if this "*gamble*" is unsuccessful limited liability will mean that the additional losses will fall on the creditors.

597. The above-quoted words are used in the textbook *Gower's Principles of Company Law*, and require comment as they have been controversial. First, the reference to "excessive" risks illustrates that a degree of risk may be permissible, and the decisions remain a value judgment of the directors, obviously according to actual circumstance.

598. Second, the Plaintiffs light on the fact that the phrase "*escaping from its financial troubles*" was paraphrased in the Hong Kong Court of Final Appeal, in *Moulin Global Eyecare Holdings Ltd v Mei* (2014) HKCFAR 466 at [50], (commenting on the equivalent provision - s. 214 - of the English Insolvency Act 1986,) in the words "*in the hope of riding out the crisis*". This, they then say, describes exactly what the Defendants did here.

599. I would not regard a paraphrase of a textbook as particularly persuasive on any basis, but any persuasiveness recedes to vanishing point when it is noted that the comment was in the context of noting that there was no equivalent statutory provision in Hong Kong law.

600. Third, the word "gamble" in itself contains a pejorative value judgment, which is fine for emphasising the point of the provision, but does not seem to me to advance a dispassionate consideration of the application of legal principle. Any decision of which the outcome is not certain can be described as a "gamble" to some extent.

601. The Defendants refer to the recent case of *Re Ralls Builders Ltd* (above) as a useful recent review of the principles of liability under the English equivalent of section 67C of the 1994 Companies Law, namely s. 214 of the Insolvency Act 1986.

602. They submit that the mere fact that a company is insolvent, whether on a balance sheet or cash flow basis, and even that a director knows that to be the case, does not mean that the director will be liable for wrongful trading if the company fails to survive. This is because the test is whether it is or ought to be apparent to the director(s) that the company "*stands no reasonable prospect of avoiding going into insolvent liquidation*". A company may show a balance sheet deficit or experience cash flow difficulties at some time, but still have a reasonable prospect of trading out of that difficulty, or otherwise taking measures which stand a reasonable prospect of restoring it and avoiding an insolvent liquidation: see, for example, *Re CS Holidays Ltd* [1997] 1 WLR 407 at 414:

> "*The companies legislation does not impose on directors a statutory duty to ensure that their company does not trade whilst insolvent; nor does that legislation impose an obligation to ensure that the company does not trade at a loss. ... Directors may properly take the view that it is in the interests of the company and of its creditors that, although insolvent, the company should continue to trade out of its difficulties. They may properly take the view that it is in the interests of the company and its creditors that some loss-making trade should be accepted in anticipation of future profitability. They are not to be criticised if they give effect to such view. But the legislation imposes on directors the risk that trading while insolvent may lead to personal liability. Section 214 imposes that liability where the director knew, or ought to have concluded, that there was no reasonable prospect that the company would avoid going into insolvent liquidation."*

and *Re Cubelock Ltd* [2001] BCC 523, at [72]:

> "*What makes trading wrongful is not the bare fact of a balance sheet insolvency, but the continuation of trading at a time when the directors either knew or on any realistic view ought to have known that there was no reasonable prospect that the company's creditors would ever get paid…. The law has to leave room for cases where it was acceptable for the directors to take the view that their company, although insolvent in balance sheet terms for the present, was going to trade its way back into credit so that all creditors would be paid … [and] there has to be room for cases like that even if in the event the directors turn out to have been wrong*."

603. The Defendants draw particular attention to this point, and that the test is whether the decision to trade on was not unreasonable at the time, and not whether it was vindicated in the event.

604. The Defendants also submit, however, that whilst it may not be a *sufficient* condition for liability that the company be insolvent at the relevant time, this may be a *necessary* condition. The Plaintiffs dispute this, on the basis that this is not what the section actually says, and that the test is the actual or constructive state of mind of the directors. I accept the Plaintiffs' submission on this point. The section says nothing about the actual position of the company at the time, merely about what its future may look like.

605. The Defendants stress that the assessment of what the directors "ought reasonably to have concluded" is a matter which must not be decided with the benefit of hindsight, citing Lewison J in *Re Hawkes Hill Publishing Co Ltd (in liquidation)* [2007] BCC 937 at [41] and [47]:

> "*The answer to this question does not depend on a snapshot of the company's financial position at any given time: it depends on rational expectations of what the future might hold. But directors are not clairvoyant and the fact that they fail to foresee what eventually comes to pass does not mean that they are guilty of wrongful trading*."

and

> *"Of course, it is easy with hindsight to conclude that mistakes were made. An insolvent liquidation will almost always result from one or more mistakes. But picking over the bones of a dead company in a courtroom is not always fair to those who struggled to keep going in the reasonable (but ultimately misplaced) hope that things would get better*."

606. They also rely on Park J in *Re Continental Assurance Company of London Ltd (in liquidation)* [2001] WL 720239 at [281]):

> "*An overall point which needs to be kept in mind throughout is that whenever a company is in financial trouble and the directors have a difficult decision whether to close down and go into liquidation, or whether instead to trade on and hope to turn the corner, they can be in a real and unenviable dilemma. On the one hand, if they decide to trade on but things do not work out and the company, later rather than sooner, goes into liquidation, they may find themselves in the situation of the respondents in this case – being sued for wrongful trading. On the other hand, if the directors decide to close down immediately and cause the company to go into an early liquidation, although they are not at risk of being sued for wrongful trading, they are at risk of being criticised on other grounds. A decision to close down will almost certainly mean that the ensuing liquidation will be an insolvent one. Apart from anything else liquidations are expensive operations, and in addition debtors are commonly obstructive about paying their debts to a company which is in liquidation. Many creditors of the company from a time before the liquidation are likely to find that their debts do not get paid in full. They will complain bitterly that the directors shut down too soon; they will say that the directors ought to have had more courage and kept going. If they had done, so the complaining creditors will say, the company probably would have survived and all of its debts would have been paid. Ceasing to trade and liquidating too soon can be stigmatised as the cowards' way out*."

607. The Defendants submit that the essence of situations in which directors have been held liable for wrongful trading is where the court forms the view that what they really did was to close their eyes to the reality of an obvious situation, and to continue in business when there could be no reasonable or rational belief that the company would or could pull through the situation, return to health and, most importantly, pay its creditors: see eg *Re Ralls Builders* (above) at [174]. The Plaintiffs do not seem to dissent from this; it is their proposition that any such professed belief by the Defendants in this case was neither reasonable, nor indeed (I think) rational.

608. The Plaintiffs rely on Palmer's *Company Law* (Rev Jan 2016 at 15.99.30) for the proposition that the "moment of truth" occurs when

> *"it was known or ought to have been realised by the director that an insolvent liquidation was inevitable or, at least, that it was a reasonable probability."* (emphasis added)

and stress that a director cannot escape responsibility by asserting that he

> *"honestly but unreasonably believed that the company would somehow avoid insolvency"* (emphasis added).

609. I accept the latter proposition, which follows from the words of s. 67C(2)(b), but the former is an attempt to paraphrase in a positive form the double negative of the statutory words "*no reasonable prospect of …avoiding insolvent liquidation*", and I do not think that it is accurate. In my judgment there is no need to apply anything but the actual words of the section, which are not only unambiguous, but appear to have been deliberately and carefully formulated.

610. I do accept, however, the Plaintiffs' further submission, relying on an interlocutory decision of the Court of Appeal in this case (*Carlyle Capital Corpn Ltd (in liq) v Conway* (2011-12) GLR 562) that in applying the test, it does not avail a director to say that some measure could have been taken which would have avoided an insolvent liquidation if the director made no attempt or had no intention of taking it. It seems to me that this follows from the nature of the statutory test. The test is what the director(s) ought reasonably to have concluded would happen. This is a matter of anticipating the future. It necessarily, therefore, implies inputting some hypotheses as to future circumstances. In other words, the state of mind, or belief, of the directors which falls to be examined necessarily has an element of conditionality about it. It may well contain an implicit "if [x] is done (or not done)", but that would then have to be followed through.

611. The Plaintiffs also emphasise, as regards the defence afforded to a director under s. 67C, that the burden of proving this is high, as the director must show that he took "every" (not just "some") step that he ought to have done to "minimise" (not just "reduce") the prospective additional losses to creditors. I take due note of this.

612. At the end of the day, in my judgment, all the above submissions, and their various case citations, including others not mentioned, go to show that the words of the statute have to be interpreted according to their natural (and to my mind reasonably clear) meaning, but very much on a fact-sensitive basis, and I will so apply the test in due course. Matters such as whether or not the director(s) sought professional advice, and how they instructed any advisers whose views they did seek and which they seek to rely on, all fall within the ambit of such fact-sensitivity.

613. Finally, the Defendants submit, and the Plaintiffs accept, that it is necessary for causation of loss from any proven wrongful trading to be proved in order for actual liability to be imposed. The Plaintiffs therefore agree that it is for them to establish that CCC's losses were increased because of the continued trading.

(4) Breach of contract/tort/unjust enrichment (against CIM as manager)

614. This can be dealt with very briefly. Leaving aside the separate allegations that CIM constituted itself a *de facto* director of CCC or a shadow director of CCC, CCC's relationship with CIM was contractual and was constituted by the IMA. This was an agreement governed by Delaware law. The Plaintiffs allege that the conduct of all the Defendants which they criticise generally under other causes of action, insofar as it can be analysed as actions by CIM or as conduct to be attributed to CIM, was a breach of the IMA, either of express terms, or of duties of trust implied into it, or of contractual duties of care. The scope of the complaints against CIM are therefore apparently accepted to be co-extensive with the matters of complaint already raised, whether of breach of fiduciary duty or of duty of care, and the central issue is therefore simply whether such breaches can be attributed, as regards CIM, to actions referable to the IMA, so as to give rise to an alternative cause of action in contract.

615. In principle, the claim is therefore for breach of contract (or a parallel duty in tort insofar as any such duty may existg in Delaware law, but which would be indistinguishable in content or scope), and for alleged damage co-extensive with the claims for damages mounted in respect of other causes of action. However, the Plaintiffs also maintain an alternative cause of action against CIM by way of a claim of unjust enrichment. They accept that this depends on establishing their other claims for breach of duty alleged against CIM, and that it will operate only as an alternative quantification of CCC's claimed damages in respect of such other alleged breaches of duty.

616. This secondary claim is for the return of all the fees which CCC paid to CIM during its existence. These comprise: quarterly regular management fees paid ($12,517,000), quarterly irregular performance-benchmarked "incentive" fees, insofar as these were actually paid ($4,682,000), incentive compensation comprising shares in CCC (whose attributed value was $54,479,593 at the time of deposit), rent, furniture and office supplies ($270,000) and payments for overhead services provided by TCG ($900,000) thus totalling $72,848,583.00.

617. The claim to recover these fees and payments is based on the doctrine of total failure of consideration. The Plaintiffs argue that it is well established that where professional services are of such shortcomings that they are rendered valueless (as they say was the case here) then such fees or other remuneration can be recovered, and indeed recovered according to their value when paid over.

618. This alternative claim is obviously very much a secondary case, maintained as a fall back from the primary case advanced by the Plaintiffs which seeks compensation for alleged losses, rather than for the very much smaller quantum of fees and expenses paid over. The usual place of this kind of fall back claim is where proving the quantum of loss on a damages claim is problematic. The application of the principles underlying such an unjust enrichment claim have not been investigated or argued other than on a broad basis in this case so far. I have to say that they would seem to me to be *prima facie* governed by Delaware law, although the Delawar law experts were not asked to give opinions on this topic, and both Advocates Wessels and Davies addressed the point on the basis of Guersey law and authorities. Given the peripheral relevance, only, of the legal principles relating to unjust enrichment, I will not, therefore, discuss these at this juncture, but will return to them if and when it may be appropriate to do so.

619. Matters of Delaware law may, of course, become pertinent in relation to both the primary and secondary aspects of the claim against CIM for breach of contract/tort. + However, for my

purposes, Delaware law is to be treated as a matter of fact, and I will again defer any necessary consideration of this until the appropriate later point.

(5) Statutory Misfeasance, and

(6) Exculpation and Indemnity Defences

620. I will deal with these two aspects of the claims together here, because they are inextricably linked. The issue which links them is whether, as the Plaintiffs contend, the several exculpation and indemnity provisions contained (a) in CCC's Articles of Association at Articles 172 and 174(b) and (b) in Clauses 2(b), and 6(a) of the IMA are available to be invoked by the Defendants. The relevant points also include arguments that these provisions are avoided by certain provisions of Guernsey legislation, amongst which are the provisions relevant to the scope of liability for "statutory misfeasance".

621. The relevant indemnity and exoneration provisions in CCC's Articles are those at Articles 172 – 174. They are lengthy and intricate, drafted in what has sometimes been described as the "torrential" style. For present purposes their material parts read that

> *"172 The Directors Managing Directors, managers agents… for the time being of the Company… shall be fully indemnified out of the assets and profits of the Company from and against all … liabilities which they may... incur by reason of any… act in and about the execution of their respective offices… except such (if any) as they shall incur by or through their own wilful act neglect or default……and none of them shall be answerable for……any loss misfortune or damage …….which may happen in or about the execution of their respective offices or trusts except the same shall happen by or through their own willful act neglect or default"*
>
> *"173 The Company shall indemnify to the fullest extent permitted by Guernsey law [CIM] and any of its respective affiliates (and their respective officers, directors* [etc]*)….. against all… liabilities* [etc] *arising from any and all claims demands, actions suits or proceedings, incurred by* [them] *in connection with the Company's business, investments and activities or by reason of their holding such positions, except to the extent that the claims, liabilities* [etc] *are determined to have resulted from* [their] *bad faith, fraud, gross negligence or wilful misconduct……"*
>
> *"174 (1) The liability to the Company of [CIM] and any of its respective affiliates (and their respective officers, directors, agents, shareholders, partners, members and employees)…… is hereby limited to the fullest extent permitted by Guernsey law, except to the extent that their conduct involves bad faith, fraud, gross negligence or wilful misconduct,…."*
>
> *"174 (2) Any matter that is approved by a majority of the Independent Directors will not constitute a breach of any duties stated or implied by law or equity, including fiduciary duties…."*

The relevant sections of the IMA read:

> *"2…(b)…..[CIM] shall not be liable for any act or omission, error of judgment or mistake of law or for any loss suffered by [CCC] in connection with matters to*

which this Agreement relates except a loss resulting from willful misconduct or gross negligence (as determined in accordance with the laws of the state of Delaware) in the conduct of its duties under this Agreement…..

"6(a) [CCC] hereby agrees to indemnify and hold harmless, solely out of assets of [CCC] [CIM] and its affiliates and the officers, directors [etc] of any of them…. from and against any loss .. judgment,[etc]… or damages…… [arising out of or in connection with] *services provided by [CIM] to the fund unless such act or failure to act was the result of the willful misfeasance gross negligence (as determined in accordance with the laws of the State of Delaware), bad faith or reckless disregard of* [the indemnified person] *with respect to the obligations of [CIM] hereunder.*

"(b) To the fullest extent permitted by law, no [indemnified person] *will be liable to [CCC] or any Shareholder for any act or failure to act on behalf of [CCC] unless the act of failure to act resulted from the willful misfeasance, gross negligence (as determined in accordance with the laws of the State of Delaware), bad faith or reckless disregard of* [the indemnified person]".

622. The Plaintiffs first make what appears to be a perfectly general submission that the effect of these provisions is avoided in all respects in relation to the Plaintiffs' claims, by s 67F of the 1994 Companies Law, referred to below, but in fact, (and correctly) this submission is subsequently limited to the Plaintiffs' claims for statutory misfeasance, under s 106 of the 1994 Companies Law. This narrowing of their submission is correct because s 67F is confined to operating on claims made under any provision of the 1994 Companies Law. It is convenient, therefore, to deal with s 106 and its interplay with s 67F at this point.

The 1994 Companies Law

623. The Plaintiffs are assiduous, throughout their pleadings and submissions, to allege that the Defendants are not only guilty of breaches of duty (generally amalgamating breaches of fiduciary duty and duty of care) but also to add that the same factual circumstances render them "guilty of misfeasance". This is an allusion to the claim brought as co-Plaintiffs with CCC <u>*by its Liquidators*</u> under s 106 of the 1994 Companies Law, and described as "statutory misfeasance". (The Plaintiffs also plead a similar invocation of s 433 of the 2008 Companies Law which is in materially similar terms, but this specific assertion has not been argued, presumably - and rightly - because the 2008 Companies Law did not come into force until 1st July 2008.)

624. Section 106 reads:

"(1) *Where in the course of the winding up of a company it appears that any person described in subsection (2)-*

(a) has appropriated or otherwise misapplied any of the company's assets;

(b) has become personally liable for any of the company's debts or liabilities; or

(c) has otherwise been guilty of any misfeasance or breach of fiduciary duty in relation to the company;

the liquidator or any creditor or member of the company may apply to the court for an order under this section.

(2) *The persons mentioned in subsection (3) are*

(a) *any past or present officer of the company;*

(b) *any other person who, directly or indirectly, is or has been in any way concerned in or has participated in the promotion, formation or management of the company."*

(3) *On an application under subsection (1) the court may examine the conduct of the person concerned and may order him:*

(a) to repay, restore or account for such money or such property

(b) to contribute such sum to the company's assets;

(c) to pay interest upon such amount at such rate and from such date as the court thinks fit in respect of the default whether by way of indemnity or compensation or otherwise".

This claim is not, therefore, available to the company (CCC) itself. However, the Liquidators seek on their own behalf to make, in substance, exactly the same claims against the Defendants under this section, for the same breaches of duty as are claimed by CCC under common law in the action generally. This is because there appears to be a forensic advantage in doing this.

625. Section 67F of the 1994 Companies Law, added by amendment in 1996, renders void any

"*....provision term or condition in whatever words and whether contained in a company's articles or in any contract with the company or otherwise, from exempting any person from, or indemnifying him against, any liability which, pursuant to sections 67A – 67D or any other provision of this Law under which personal liability may be imposed or incurred, would otherwise attach to him....."* (emphasis added).

626. It follows that if the Defendants can be held liable under s 106 of the 1994 Companies Law they would (it is argued by the Plaintiffs) be unable to claim the benefit of any exculpation or indemnity clause contained either in CCC's Articles or in any contract (such as the IMA), which might otherwise be invoked against CCC itself as a plaintiff.

627. Section 106 is modelled on a similar provision in successive English companies legislation, with a long history. In England, the equivalent section was introduced as a more quick, efficient, cheap and simple means of pursuing the claims to which it applied in the context of a liquidation (not necessarily an insolvent one), than would be the case if the claim had to be pursued by writ of action, with more elaborate procedure, and the possibility of bringing in third parties. It was thus an aid to the efficient process of liquidation, and it can be seen that the flavour of the claims to which the section applies is that of gathering in assets which either belong, or ought to belong, to the company and therefore be available to be administered in the liquidation.

628. Both Guernsey originating process and Guernsey liquidation processes are different from those of England. It may well be that s 106 actually provided no such procedural benefit in the Guernsey context, and subsequent changes in English civil procedure in 2000 have done away with some of the original advantages even in England. The provision is still retained in England, however, in the shape of s 212 of the Insolvency Act 1986.

629. Importantly, though, it is common ground that s 106 creates no new or discrete substantive right. It is an alternative process for enforcing rights (causes of action) which already exist apart from s 106. The statutory discretion conferred on the court by s 106(3) provides other, and potentially more flexible, remedies than would be available in a conventional action at law. However, the court's discretion is required to be exercised judicially, and is therefore limited by the principle that any order for relief should be compensatory in nature. A discretionary order under s. 106 can possibly reduce the payment ordered, according to the justice of the case, below the level of full compensation, (compare per Lord Hope in *HMRC v Holland* [2010] UKSC 51) but it cannot increase it above a compensatory level; Section 106 is not a penal provision. In principle, therefore, any award under s.106 is likely to be the same as under a common law action in respect of the same conduct, but can be tempered, or otherwise structured, if the court thinks fit.

630. Four points therefore arise in relation to s 106 in this case. The first three are as to the scope of the section. They are

(i) whether the term "misfeasance or breach of fiduciary duty" in s 106(1)(c) (which is the subsection the elements of which are pleaded by the Plaintiffs: see Paragraph 511, 514 and 519 of the Cause) is wide enough to cover all the claims in both fiduciary duty and breach of duty of care which the Liquidators seek to bring;

(ii) whether claims within the section can be brought against (a) *de facto* or (b) shadow directors; and

(iii) whether claims within the section can be brought against an investment manager such as CIM.

631. The fourth point is a *res judicata* point, regarding the interrelationship of s 106 and s 67F of the 1994 Companies Law. It is whether I am bound to hold that the Defendants are unable to rely on any exoneration or indemnity clauses which might otherwise operate in their favour in answer to a claim capable of being advanced under s 106, because this point has already been decided against the Defendants by decisions of the Royal Court and the Guernsey Court of Appeal in the course of earlier applications in this case.

632. I will deal with each of these in order.

633. The Plaintiffs submit that the expression "misfeasance" in s 106 is very wide and encompasses any breach of duty which results in the misapplication of the company's property, even indirectly. They cite English authority to this effect on the equivalent section of the Companies Act 1948 (s. 333), namely *Re B Johnson & Co Builders Ltd* [1955] Ch 634 at 650, (Evershed MR), itself citing Lopes LJ in *Re Kingston Cotton Mill Company (No 2)* (1896) 2 Ch 279 at 288.

> *"The object of this section of the Act is to enable the liquidator to recover any assets of the company improperly delt with by any officer of the company, and must be interpreted bearing that object in ivew. It doubtless covers any breach of duty by an officer of the company in his capacity of officer resulting in any improper misapplication of the assets or property of the company"*

Thus far, there is common ground.

634. However, the Plaintiffs further submit that the word "misfeasance", properly construed, is wide enough to cover all breaches of duty owed by a director to his company, including the duty of skill and care. They cite tentative textbook suggestions of this proposition by way of authority, see, eg Taube: *International Asset Tracing in Insolvency* (2009) at [4.88].

635. Their arguments in support of this broad proposition, other than suggesting that it would be convenient and accord with the philosophy of modern legal interpretation, rest on the fact that a "misapplication of the company's property" is an undefined concept in the dictum of Lopes LJ (above). Advocate Wessels therefore sought to persuade me that the word "misapplication" covers matters wider than simply an unlawful disposition of the company's property (such as paying a dividend out of capital), and extends to any application of the company's property caused by a wrongful decision, such as a decision not made in good faith, or made for improper purposes. He further submitted that a negligent decision to dispose of the company's property in a particular way would, through the taint of such negligence, be a decision for improper purposes and hence within the relevant concept of "misfeasance". Extending the argument one step further, and with more particular focus, he submitted that this meant that the concept of "misapplication of the company's property" would include not merely disposition, but the wrongful <u>retention</u> of CCC's RMBS pursuant to a decision made in breach of duty, whether fiduciary duty or duty of care.

636. In answer to the point that merely retaining the same investment did not have the flavour of an "application" of property at all, he pointed out, without abandoning his contention that simply continuing the status quo with regard to the company's property was an "application" of it, that the retention of the RMBS in fact required a positive re-"application" of it (the company's property) with every repo roll, which was further support for his submission.

637. This argument seems to me to be tantamount to arguing that making a bad investment decision is misfeasance, or (worse still) that it can, in some circumstances of unclear and rather arbitrary effect, be classified as misfeasance. In my judgment that is not a course justified by either authority or principle. It is either an attempt to extend misfeasance to mere negligence by a back door route, or, alternatively, it rests on an argument that a director has no power to make a bad (ie "wrong" or "ill-advised") decision, such that it is outside his powers to do so, and it is thus "misfeasance" to do so. I was struck at the time by the thought that this convoluted argument resembled the now discredited rationale of the rule in *Re Hastings Bass* (see *Pitt v Holt* [2013] 2AC 108) as to justification for asking the court to declare that a decision of trustees with unfortunate unintended consequences was "void", because they did not have power to make a bad decision. I have previously discussed and rejected this kind of argument in the context of considering the scope of fiduiciary duty, above.

638. I therefore accept the Defendants' submission that the Plaintiffs' second proposition, as to "misfeasance" having an extended nature which would, or could, encompass mere negligence, is wrong, but I explain further as follows.

639. In fact, the Defendants point out that the full phrase in s 106(1)(c) is "*misfeasance or breach of fiduciary duty*", whereas, by comparison, the phrase in s 333 of the English Companies Act 1948 was "*misfeasance or breach of trust*". They also point out that the successor phrase to s.333, contained in s. 212 of the English Insolvency Act 1986, is "*misfeasance or breach of fiduciary or other duty".* Whilst the latter plainly includes claims under a duty of care, (this being an "*other duty")* the former English phrase did not do so, save insofar as a duty of care might be held to be within the general concept of a "breach of trust". This distinguishes even the previous English position from the Guernsey position where the phrase is "breach of fiduciary duty".

640. Since the qualifying culpability in Guernsey under s 106(1)(c) is "*misfeasance or breach of fiduciary duty*", and the distinction between a fiduciary duty and a duty of care has already been adverted to, it is clear, in my judgment, that the Plaintiffs can only be correct if the word "misfeasance" itself includes breach of a duty of care. However, the amendment made in England to the 1948 Act by the 1986 Act shows that it does not. In *Re d'Jan of London Ltd* [1993] BCC 646, Hoffmann LJ, dealing with an application made against a director, referred to the procedure of s 212 of the 1986 Act as *"a summary procedure which used to be called a misfeasance summons but has been extended to include breaches of any duty including the duty of care"* (emphasis added).

641. In my judgment, therefore, the Defendants are correct in their interpretation of the scope of s 106(1)(c). The question is whether either of the expressions "misfeasance" or "breach of fiduciary duty", as understood in Guernsey law in 1994, extend to include breach of a duty of care, ie negligence. There has been no Guernsey authority on this point. Taking the words in their natural meaning, the distinction in quality between a fiduciary duty and a duty of care existed in 1994 even though it may only later have come to be expressed with the clarity of cases such as *Extrasure* (above). Breach of a "fiduciary duty" does not include negligence. Neither, in my judgment, does the term "misfeasance" include negligence. Misfeasance carries the connotation of a culpable deed ("mis-feasance") rather than the connotation of a non-deed, or neglect to act ("negligence"). Indeed, prior to the change made by the Insolvency Act 1986, the distinction between "misfeasance" and "non-feasance", and that the former did not include the latter, certainly in this context, was well understood in English law. It is that recognition which underlay judicial dicta in cases such as *Re B Johnson & Co Builders Ltd and Re Kingston Cotton Mill Company (No 2)* (above), where the issue whether "misfeasance" embraced negligence was in point, and which certainly do not support the Plaintiffs' argument.

642. When the 1994 Companies Law was enacted, even if it was a re-enactment of earlier legislation, the changes which had been effected in English insolvency law in 1986 would have been perfectly apparent, and the extension of the phrase used in the English legislation so as directly to cover simple negligence could have been adopted. It was not adopted either in the 1994 Companies Law, or its amendment in 1996, or in the 2008 Companies Law. This must be taken to have been intentional.

643. I conclude that the scope of the 1994 Companies Law, specifically s 106(1)(c), was limited to (a) misdeeds resulting in improper application or improper diversion of the company's property, or (b) breaches of fiduciary duty. It did not extend to a right to recover damages for breach of a duty of care. It may be that improper diversion of the company's property includes the diversion of assets which ought to have come to the company and did not, but in my judgment that is the furthest potential extension of the scope of "misfeasance or breach of

fiduciary duty" available. It does not extend the underlying concept to mere negligence. It also does not extend to a claim for breach of contract.

644. Neither, in my judgment, is the application of the concept retrieved by Advocate Wessels' ingenious argument that at the execution of each repo roll – more accurately the several transactions which went to constitute each roll – there was a material "application" of CCC's assets, by posting its RMBS as security for the relevant repo finance. This is because, even if the concept of misfeasance extended to negligent conduct which brought about a "misapplication" of the company's property, as Advocate Wessels suggests is the correct interpretation of *Re Kingston Cotton Mills* (above) (although I disagree, and in the event the dicta are merely obiter, because the Court of Appeal held that the auditors had not been negligent), there still has in my judgment, to be some misapplication, in the sense of an improper or *ultra vires* application of the assets; a mere negligent application of the assets is not enough, as it is mere common law negligence: *Re B Johnson Builders Ltd* (above).

645. Before this argument could begin to succeed, therefore, it would be necessary for Advocate Wessels to satisfy me that the execution of the relevant repo transactions had actually been "improper" in the required sense. At a general level, this strikes me as a strained application of the concept of "misapplication", and very difficult to analyse satisfactorily in the light of the facts. The position was that although the RMBS in theory "came back" to CCC at each repo roll, they did not then stand as CCC's unencumbered property available for beneficial disposal, but were constrained to be immediately re-used as security for the obtaining of the finance necessary for CCC to pay off the previous repo loan, and thus avoid losing the assets to repo creditors by seizure. Taking the action necessary to sustain the roll-over sequence of funding does not naturally feel like a "misapplication" of CCC's assets by any means, whether or not caused by an (assumed) negligent decision to maintain this sequence. However, as this is a fact sensitive assessment, I will reconsider the point later if it becomes material to do so.

646. As regards whether s 106 can be invoked against either *de facto* or "shadow" directors, in my judgment the words of s 106(2)(b) certainly embrace the former. For persons to be found to be *de facto* directors of a company it is required, by definition, that they have "*been… concerned in or ….participated ….in the management of"* the company. With slightly less confidence, I am also of the view that the section applies to a "shadow" director as well, bearing in mind that the section is, as I have held, concerned essentially with misapplication of the company's property or assets, and that a person who has procured this, by being a person "*in accordance with whose directions or instructions the directors of the company are accustomed to act*" in the relevant respect, would appear to be within the scope of the intention of the section.

647. As regards whether the section would apply to an investment manager, such as CIM, the Plaintiffs submit that a person in the position of CIM is "concerned… in the management" of the company (ie CCC) within the meaning of s 106(2). The Defendants point out, though, that the phrase is "management of the company" and this is, and has been held to be, distinct from management of the property of the company.

648. I think the point of construction here, taken in isolation, is a difficult one. Although the requisite involvement in the "management" of the company appears, on the face of it, to be aimed at actual officers or quasi-officers or executives of the company, the language of subs. 106 (2) (b) shows an intention to extend this very broadly. It extends to "any other person", to direct or indirect involvement, by way of being "concerned", or "participating", and to such

involvement being "in any way". As this phraseology is also applicable in respect of the "promotion or formation" of the company as well as its "management", it is apparent that it can naturally extend to persons other than actual officers or quasi-officers of the company itself. On that basis, I would be inclined to think that the section is wide enough to cover an investment manager. The result would though, it seems to me, depend on whether the obvious intention that the section should have a wide application as far as the persons subject to it is concerned, would prevail against any argument that a valid distinction could and should be drawn between the management of the company and the management of its property.

649. I would observe, though, that if it is correct, as I have held above, that the subject of the section is limited to misapplication of the company's property and breaches of fiduciary duty, and does not extend to claims in negligence, then construing it as covering the widest possible categories of potential defendants including investment managers makes perfect sense, and is eminently reasonable.

650. However, it is not necessary for me to decide that particular point in this case. The only operative claim against CIM other than as *de facto* or shadow director (dealt with above) is for breach of contractual (or tortious) duty of care. It follows from my earlier decisions that this is not within the scope of "misfeasance or breach of fiduciary duty" and consequently the question whether s 106 would apply to a claim against a contractually engaged investment manager in respect of any of the matters within the ambit of s106 does not arise.

651. This leaves the final *res judicata* point, with regard to the effect of the decisions of Collas DB, and the Court of Appeal in *Carlyle Capital Corporation Ltd (in Liq) v Conway and others* (Guernsey Judgment 29/2011 and (2011-12) GLR 371, respectively.

652. These were the first instance decision in this case, and the appeal therefrom, upon (so far as material) an application by the non-resident Defendants, (ie all of them save Mr Loveridge) to set aside an order for leave to serve these proceedings upon them out of the jurisdiction, or for a stay of these proceedings on the grounds that the more convenient forum for trial of the action was Delaware. The learned Deputy Bailiff's decision, shorn of the complications arising from current but inchoate applications to amend the Cause at the time, was that he refused to set aside the order for leave to serve out, on the grounds that, whilst the Royal Court had jurisdiction over the disputes in the action, Delaware was the more convenient forum for determination of the substantive issues, but he stayed the proceedings in this jurisdiction pending the conclusion of the proceedings in Delaware, ruling that claims under s.106 or s 67C of the 1994 Act, which were obviously peculiar to Guernsey, and other issues if necessary, could and should be determined subsequently to the Delaware proceedings insofar as not there determined. The Court of Appeal reversed the second part of this order and allowed the action to proceed in Guernsey, on the grounds (in essence) that Guernsey was the only jurisdiction in which all the issues in the action could be tried, fragmentation of trials was highly undesirable, and Guernsey was therefore the most convenient forum.

653. In the course of their judgments, both the learned Deputy Bailiff and the Court of Appeal commented on the effects of s 106 in conjunction with s 67F of the 1994 Act. Collas DB said (at [62])

> *"….Section 106 is more than procedural; it does provide a remedy requiring a delinquent officer to contribute to a company's assets. An order made under the Section requiring a delinquent officer to pay money or to contribute to the assets of the*

company does, in my view, "impose" a personal liability on the delinquent officer and hence come within S.67F That is the natural meaning of the words in the Law."

654. The Court of Appeal approved the Deputy Bailiff's interpretation of the operation of s 106 as "imposing" a liability: see [51]. They did so whilst at the same time endorsing the analysis that s106 "is procedural only" (see [45]). They considered the effects and nature of s 106 itself in paragraphs [46] – [50], qualifying the statement at [45] in paragraph [49]:

> "*Section 106, therefore, whilst being procedural in the sense of not establishing a new or independent liability, does establish a new discretionary remedy available upon liquidation to the liquidator and others.*"

655. Thus, the Court of Appeal considered that whilst s.106 created no new right or correlative liability, it did create (or impose) a liability correlative with the grant of a new remedy, made available in the particular circumstances stated in the section.

656. The Court of Appeal then went on to consider the further impact on the arguments before them of the amendment to the 1994 Companies Law in 1996, to introduce s 67 and in particular s 67F, and stated, at [51]:

> *"Upon an ordinary interpretation of this provision, as the Deputy Bailiff used, it will embrace s.106, which imposes a liability"*

adding that it made no difference that the same liability might be imposed at common law; Section 106 still

> "*impose[d] a liability if sought by certain persons in certain circumstances and if deemed appropriate by the court in the exercise of its discretion."*

657. Proceeding on the basis, therefore, that the "ordinary interpretation" of s 106 had the result that s 67F would apply to it, the Court of Appeal then went on in paragraphs [51]- [57] to consider arguments apparently directed at the proposition that this could not be the case, because s67F could not have reasonably been intended to remove the benefit of pre-liquidation contractual provisions which lawfully conferred immunity from liability under common law (see the end of [52]). The Court of Appeal rejected all the arguments to this effect in [53]-[56]. In [57] they say that if there are "procedural advantages" attaching to proceeding under s 106 rather than by ordinary action, then the liquidators are entitled to do so. The clear implication from the context is that the Court of Appeal viewed the advantage of avoiding the effects of such immunising provisions to be such a "procedural advantage", and that this would be an example of "*[taking] advantage of the remedy which is most advantageous to him*".

658. The Court of Appeal therefore held that the s 106 claims in the Cause

> *"….cannot be said to be without any possible prospect of success. They must be recognised, at this stage of the proceedings, as proper parts of the whole case brought against the various respondents"*

and they subsequently dismissed the Defendants' appeal against service out of the jurisdiction and allowed the Plaintiffs' cross-appeal against the stay of proceedings imposed by the Deputy Bailiff.

659. The issue between the two sides, therefore, is really: what did the Court of Appeal decide?

660. The Plaintiffs submit that the Court of Appeal actually decided, as a point of law, that s 106 did "impose a liability" on the Defendants within the meaning of s67F. That section therefore applied in respect of the liquidators' claims brought under s 106 and had the effect of avoiding, as against the liquidators, any exoneration or indemnity clauses of which the Defendants might otherwise claim the benefit, whether in CCC's Articles of Association or (as regards CIM) in the IMA.

661. The Defendants submit that the Court of Appeal did not decide that point either at all, or not as a final decision and for all purposes. They submit that the Court of Appeal was concerned only with the tests for service out of the jurisdiction, which required consideration only of whether the Plaintiffs' Cause (a) disclosed at least one serious issue to be tried on its merits, (b) as to which there was a good arguable case that it fell within at least one of the classes of case for which permission to serve out may be given, and (c) that Guernsey was the most appropriate forum for the trial of the dispute: see *Seaconsar Far East Ltd v Bank Markazi Jomhouri Islami Iran* [1994] 1 AC 438 at 453-7. The Court of Appeal was here concerned with the first "gateway" point, that of seriously arguable issue. The Defendants had attacked the service of proceedings on the grounds that the s 106 claims were not seriously arguable, because the effect of the exoneration and indemnity clauses of which the Defendants had the benefit was, in law, to eliminate the causes of action against them to which they applied. As s 106 created no new causes of action, but merely provided an alternative process for obtaining a statutory remedy for an already extant cause of action - and there was none - s106 never came into operation. Neither, therefore, could s 67F, as its operation was confined to a "personal liability imposed….under [a] provision of [the 1994 Companies Law]".

662. I need to digress for a moment to say that, for the sake of argument on this point only, I will assume that the effect of both an exculpation clause, (ie deeming liability never to arise or be incurred with regard to defaults), and an indemnity clause, (whereby the wronged party agrees to indemnify the alleged wrongdoer against any liabilities, even liabilities to the indemnifier, which do arise), is to negate the arising of what would otherwise be a cause of action. I have no difficulty accepting this proposition in the case of an exculpation clause in the common terms that the exculpated party shall "not be liable for" the relevant complaint, as that seems to me to be engaged at the very outset and prevent any cause of action arising at all. I have more difficulty with regard to an indemnity clause, since it seems to me, on a natural reading, that this provides the wrongdoer only with an immediate and responsive cross claim equal to any liability found to attach on the original claim.

663. However, Advocate Swan, referred me to authority (*Viscount of the Royal Court of Jersey v Shelton* [1986] 1 WLR 985, *Farstad Supply AS v Enviroco Ltd* [2010] UKSC 18, and the most recent and nearest to home case of *Emerald Bay Worldwide Ltd v Barclays Wealth Directors (Guernsey) Limited* (Guernsey CA: Judgment 02/2014)) which he said showed that even in the case of indemnities, because of the court's aversion to circuity of action, it had been ruled that no cause of action ever arose upon a liability as to which the plaintiff had the benefit of an indemnity from the defendant.

664. I am not convinced that the authorities do clearly demonstrate this proposition, although I note that in *Farstad* it seems that the court took the view that the expression "hold harmless" meant the same thing as "indemnify", and I can see that one does not hold a party harmless from a

suit if one brings that suit at all, in the first place. On the other hand, Lord Clarke in *Farstad* also apparently approved (at [33]) the analysis that no remedy would be given because it was "*useless to give judgment*" in such circumstance, which, once again, draws attention to remedy rather than cause of action.

665. Unfortunately for the point itself, owing to the limits on time for closing submissions, it was not possible for it to be thoroughly argued, and at one stage it appeared to be descending into an arid (on day 67 of a trial) pleading point as to whether the Defendants were entitled to take the point at all that the cause of action was extinguished by an applicable exculpation or indemnity clause, because they had admitted that they owed duties to CCC. I would have ruled that they were so entitled if it had been necessary to do so, not least because it seems to me to be a pure point of law and construction of the clauses in question, and the Plaintiffs can scarcely claim to have been taken by surprise or to have relied in any irremediable way on the admission that duties were owed. However, I have not found it either easy, or proportionate, or necessary to attempt to reach a firm conclusion on this point. If it becomes pertinent in practice then I will invite further argument in a more focused context. This is not least because it also seems to me from the authorities that this point, whether it is invoked in respect of exoneration or indemnity clauses, is very sensitive to nuances in the drafting of the relevant clause, and these have not been fully examined.

666. However, and returning to more broad points of law and analysis which are material at this stage, the Defendants submit that all the Court of Appeal did, in rejecting their arguments on their applications at that time, was to hold that the argument that s 67F did apply, in this particular action, to remove any exculpation or indemnity defences to claims made by the liquidators under s 106, was an argument with a real (rather than fanciful) prospect of success; the Court did <u>not</u> decide finally that the point succeeded. This was because (a) that was all that the Court of Appeal had to find in the circumstances pertinent to the application before them and (b) that was all that one would expect to be decided on an important and not necessarily simple point upon a procedural application with regard to whether service out of the jurisdiction should be permitted.

667. The Plaintiffs, however, maintain that when one examines the judgment of the Court of Appeal, it quite plainly <u>did</u> decide that the Plaintiffs' argument, which was a pure point of law on the construction of legislation and did not require the resolution of any factual dispute, was correct and did succeed. There having been no appeal from this point, they assert that that decision is binding.

668. I have found this a difficult point. On the one hand, there is much force in the Defendants' argument that at an interlocutory stage, all that one would expect the Court of Appeal to have decided was that the Plaintiffs' case on the point was seriously arguable, so as to justify trial and as a gateway to considering the further qualifying circumstances for permitting service out of the jurisdiction. It was not necessary for the Court of Appeal to make a final and binding decision on the point. Indeed, even a decision that it was seriously arguable that a s. 106 claim was capable of being mounted was probably not a vital plank for the court's ultimate decision, since there were many other points and grounds which were ample to support their eventual decision.

669. On the other hand, of course, the Court of Appeal <u>could</u> have made a final decision on such point at the time, as it was a pure point of law, not dependent on any disputed facts.

Furthermore, the terms of the Court of Appeal's judgment in this regard are strikingly forthright, in particular with regard to their emphasis on the public interest and the reasonableness of a policy that liquidation should be carried out by an independent officer, unimpeded by barriers created by pre-liquidation contractual limitations which operate against the interests of those in whose interests the liquidation is really being conducted. I gain the very strong impression that if the Court of Appeal did decide the point, then it decided it in the Plaintiffs' favour. I also note, ironically considering the argument which the Defendants now make, that in their eighth proposed grounds of appeal to the Privy Council from the decision of the Court of Appeal, the First to Fourth and Eighth to Tenth Defendants stated that the Court of Appeal did hold that s 67F applied to claims under s 106, and that it erred in doing so.

670. However, and having carefully studied the judgment, I am of the view that the Court of Appeal did not make a final decision on this point, for the following reasons. First, in a key paragraph at [57] the Court of Appeal chose the phraseology

> *"Unless a claim is manifestly without possible foundation, this court cannot exclude from contemplation the right of the liquidators to rely upon s 106."*

671. This circumlocution suggests to me that the Court of Appeal did regard its decision as being only whether the right to rely on s.106 was seriously arguable, and not that it was definitely and thenceforth unassailably, correct.

672. Second, if the Court of Appeal had intended to make a final decision on this point, it would in effect have been deciding it as a preliminary issue in the case. There had been no application for the determination of such a preliminary issue, and if a court is minded to take such a course of its own motion, it would be conventional and appropriate to make this clear to the parties so that they could argue their case on that basis, and in the knowledge that that would be the effect of the particular decision. That did not happen in this case.

673. I therefore conclude that the Defendants are correct, that the Court of Appeal did not decide this point of law finally. It is therefore open to the Defendants to seek to persuade me that s 67F of the Law does not apply to the liquidators' claims in this action, and I am free to decide the point.

674. The Plaintiffs advance the simple arguments which they have previously advanced, that the intention of 67F is to strike down the effects of exoneration or indemnity clauses which could be invoked by the company, when the relevant cause of action is instead pursued by a liquidator (or other person so empowered by s. 106.) Their argument, in essence, is that this is the obvious and simple - and I think they would probably say "ordinary" - meaning of s67F, as applied in the context of s 106.

675. They say that it is nothing to the point that this might mean that a liquidator can pursue a cause of action which the company itself would be barred from pursuing. They cite *Parkinson Engineering Services plc (in liq) v Swan* [2010] 1 BCLC 163, where a liquidator was held entitled to substitute himself as plaintiff instead of the company in order to pursue a claim for negligence under s 212 of the Insolvency Act 1986 against former administrators, notwithstanding the existence of a statutory release of liability of the administrators which would bar the company from making such claim. That case was, however, principally concerned with whether it was right to permit such substitution when it would have the effect of barring an outright limitation defence which had accrued since issue of the proceedings in

the company's name and before the application for substitution. The Defendants point out, correctly, that the statutory release contained in s 20(3) of the Insolvency Act 1986 at that time expressly excluded the release of the administrator from liability at the suit of a subsequent liquidator under s 212 of the Act. Consequently, the liquidator's right to pursue this claim was impeded only by limitation, and not, in any event, by the fact of the statutory release which bound the company. Thus, it seems to me, this case does not decide that a liquidator can pursue a claim under s 212 where a claim by the company would be subject to defeat by a contractual exclusion clause if brought by the company. It only decided that, as a matter of the court's discretion, where a liquidator had pursued a claim in the wrong form within the limitation period applicable to a s 212 application by him, he could be permitted to substitute himself for the incorrect plaintiff in respect of that claim, notwithstanding that limitation had expired against him in the meantime. I conclude that this case does not, therefore give any support to the Plaintiffs' proposition in this case.

676. The Defendants repeat their argument that the Plaintiffs' contention that s 67F will apply to any application brought under s 106 is not correct when one carries out a properly rigorous legal analysis. Section 67F applies in relation to a liability imposed by a provision of the 1994 Companies Law. Section 106 is of course, such a provision, and, it having been held that the operation of s. 106 is apt to impose a liability, the Plaintiffs then submit that this engages s. 67F.

677. However, the Defendants argue that this simply assumes that s.106 does, in fact, operate. Since it only operates to provide an alternative remedy for an extant cause of action, it is necessary for there to be an extant cause of action for it to operate. Whether it does operate therefore depends on making out that qualifying condition under the general law and circumstances, apart from s 106. The exoneration or indemnity clauses are part of those circumstance and as their effect in law is to extinguish the relevant cause of action, the conclusion has to be that there is no extant cause of action, nothing for s. 106 to operate on, and therefore, by extension, no scope or trigger for the operation of s. 67F; one just never gets there.

678. I would not have found this a difficult point to decide but for my impression of the strength of the underlying views of the Court of Appeal, mentioned above. This is because my own view is that the Defendants' analysis is correct. Indeed, it seems to me that, with respect, it is compelled by the logic of the Court of Appeal's own decision, but I say that with hesitation, because it does not seem to have been the view of the Court of Appeal itself.

679. The Court of Appeal's decision endorsed the analysis that, whilst s. 106 creates no new and independent cause of action, it creates an alternative remedy for an existing cause of action. It went on to hold, agreeing with the learned Deputy Bailiff, that the creation of that alternative remedy "imposed a liability" on the defendant party, such that s 106 was not "merely" procedural, but had other substantive effect. In applying this analysis, the Court of Appeal was therefore drawing, recognising and even relying upon, a distinction between a liability imposed through the vindication at law of a cause of action, and a liability imposed by a remedy created by statute, albeit granted in respect of that same cause of action.

680. The Court of Appeal's logic in holding that s 106 "imposes a liability" at all therefore focuses on the remedy only. It recognises a duality of liability, ie the liability naturally arising under common law from the cause of action (once demonstrated), and an alternative, separate

remedial liability, which is the imposition of statute. It seems to me that recognition of this duality inevitably involves recognising that s.67F, by its very terms, only operates in respect of the second, statutory, such liability. The logic actually uses a distinction between substantive and remedial "liability" as justification for holding that, even though s. 106 creates no new and independent cause of action, it still "imposes a liability". It is only this latter proposition which then justifies the engagement of s.67F, but this means that s.67F simply never touches on the question whether the original cause of action, the existence of which is a precondition for s.106 being capable of being invoked at all, does exist. If it does exist, the consequences that s. 106 operates and that s. 67F will apply in its operation clearly flow, but that says nothing about whether any previous cause of action does, or must, exist, and that question is logically anterior. It has to be decided first, in order to decide if the conditions for invoking s. 106, and consequently s. 67F, are present.

681. The indemnity and exoneration clauses are potentially material to the initial question, because of their effects in law. If an indemnity or exoneration clause has the legal effect of extinguishing the relevant cause of action, then the situation in which s. 67F applies because s. 106 applies does not arise because s. 106 never applies. Arguing from the effect of s. 67F that the exoneration/indemnity clause cannot extinguish the cause of action because that would prevent s. 67F from applying to s. 106 so as to provide an alternative remedy for that cause of action, is circular. Moreover, it is not using s. 67F to prevent the avoiding of any liability "imposed by" a provision of the 1994 Companies Law, ie by s. 106, but is giving s. 67F a different effect, which is outside the express statutory scope of its operation.

682. For those reasons, untrammelled by any relevant dicta from the Court of Appeal, I would decide this point in the Defendants' favour.

683. That, however, does not seem to me to be at all how the Court of Appeal saw the position. It appears implicit in what they did say, that they regarded the combination of s. 106 and s. 67F as removing the contractual protection afforded to the Defendants by the indemnity or exoneration provisions entirely, and making the s. 106 remedy available notwithstanding such clauses. As I have observed, the tenor of their discussion seems to be that the public policy considerations behind s. 67F showed the reasonableness of making its effect applicable to claims simply because they were being brought within the qualifying situation set out in s. 106 - although at the same time they do seem, to me, to suggest that the breadth of the statutory discretion conferred upon the Court under s. 106 would allow the Court to have regard to such provisions as factors which might affect its discretion, in appropriate circumstances (see the end of [55]).

684. Whilst the Court of Appeal has not, in my judgment, decided the point so as to bind my decision, its approach would obviously be highly persuasive, and it has given me cause for anxious consideration. In the end, though, and with respectful hesitation, I have concluded that the Court of Appeal's attention was not focused on the duality of the liabilities in question, which seem to me to become clearly apparent only when the logic of the position is examined as closely as has happened in the trial of the action. I therefore prefer the Defendants' analysis.

685. However, and very importantly, I do not think that, in the end, it would make any major difference if I were to come to the other conclusion, for three reasons.

686. First, for the avoidance of doubt, I make it clear that my decision at this point is only that if the effects of an exculpation or indemnity clause are found, as a matter of law and construction, to be that the material potential cause of action never arises, then the Defendants' argument is correct. If, on the other hand, the effects are only to provide a defence or cross-claim to the material potential cause of action, then the Plaintiffs' argument would probably succeed.

687. Second, I draw attention to my earlier holding that s. 106 is not apt to cover claims in negligence in any event, but only breaches of fiduciary duty (properly so called) and that misfeasance is an act or default which causes a misapplication of the company's property. This is not a point on which the Court of Appeal had to make any decision in their judgment considered above, and I have noted that they were very careful, throughout, to refer to claims which might be brought under s. 106, without any further dicta which might be argued to decide just what the array of such possible claims might be. The potential for the use of s. 106 to import the effects of s. 67F is therefore of limited availability on that score.

688. Third, even though there will, consequent on my decision, be no situation in which the Defendants have to face a s. 106 claim for negligence, this is the primary focus of exoneration and exculpation provisions, which, almost invariably, do not apply to any dishonesty, or wilful or deliberate default. Any misfeasance causing the misapplication of the company's property is most unlikely to be of a nature other than "wilful" conduct. It is therefore most unlikely that the exoneration or indemnity clause would actually apply in respect of such complaints; their potential effects would seem to be limited to innocent breaches of fiduciary duty (leaving aside "mere" negligence). Even if their contractual effect to remove liability in respect of such breaches were to apply, the situation would then seem very likely to be a reasonable case for invoking the court's discretion under (now) s 522 of the 2008 Companies Law to relieve from liability on the grounds that such a defendant acted "honestly and reasonably and …ought fairly to be excused."

689. Thus, the practical effect of my decision that s. 67F does not apply at the level of cause of action liability, but only at the level of remedy liability, is likely to be quite limited.

690. Lastly, an important point to note, from a general law perspective, is that the particular situation with which I have had to grapple in this case is fortunately now no longer of general application, because the Companies (Guernsey) Law 2008 took a policy decision which went further than s. 67F, and rendered void any attempt by a company to exonerate or indemnify a director for any breach of any duty, including simple negligence: see s 157. Thus, the effect of the interplay of s. 106 and s. 67F of the 1994 Companies Law and the common law duties of directors is now only of historic interest.

The 2008 Companies Law

691. The Plaintiffs second and more general line of attack on the indemnity and exculpation clauses actually turns to the above point, and is that they are avoided by s. 157 of the 2008 Companies Law. The relevant parts of this section provide that

> *"157(1) Any provision that purports to exempt a director of a company (to any extent) from any liability that would otherwise attach to him in connection with any negligence, default, breach of duty or breach of trust in relation to the company is void.*

"(2) An provision by which a company directly or indirectly provides an indemnity (to any extent) for a director of the company or an associated company, against any liability attaching to him in connection with any negligence default, breach of duty or breach of trust in relation to the company of which he is a director is void except as permitted by section 158 or 159"

"(3) This section applies to any provision, whether contained in a company's memorandum or articles or in any contract with the company or otherwise…."

(Sections 158 and 159 are not material.)

It will be seen that these provisions are, on the face of it, sufficient to avoid the effects of Articles 172 – 174 and the provisions of the IMA insofar as they relate to the Defendants as Directors of CCC. However, they did not come into effect until 1st July 2008.

692. Transitional provisions were enacted by Regulation 10 of *The Companies (Transitional Provisions) Regulations 2008.* This provided that

"10 (1) Section 157(1) and (2) of the new Law does not apply to an exemption from liability or indemnity provided before the date of commencement of the new Law until the 1st January 2010.

"(2) Accordingly,

(a) the validity and enforceability of any such exemption from liability or indemnity shall continue to be governed, until 31st December 2009, by the provisions of the 1994 Companies Law and the other relevant principles of law in force immediately prior to the date of commencement of the new Law; and

(b) any such exemption from liability or indemnity –

(i) shall after that date be deemed to be void only to the extent necessary to ensure compliance with section 157(1) or (2) as the case may be, and

(ii) subject to that may be read as if it were lawful to the fullest extent permitted by the new Law."

693. For the effects of this transitional, provision, the Plaintiffs referred to *Perpetual Media Capital Ltd v Enevoldsen* (2014) GLR 57. In that case, the indemnification provision had been present in the company's articles since October 2007. The directors took office in March 2009, the breaches of duty took place in July and August 2009 and proceedings were commenced in April 2011. The issue arose as to whether the indemnification provision was void under s 157, or whether it remained valid in favour of the directors by reason of Regulation 10. This depended on whether, in the circumstances, the indemnity was "provided" before 1st July 2008 or after. The Plaintiffs argued that "provided" referred to the date when the company gave the director the benefit of the provision, which therefore had to be when the directors took office; the Defendants argued that it was when the provision was put into the Articles. The Court of Appeal preferred the Plaintiffs' argument.

694. The Court of Appeal explained the effects of Regulation 10 as being that directors of companies appointed before 1st July 2008 obtained, by the Transitional Regulations, a period of grace up to 31st December 2009 during which any pre-existing indemnity provisions in the company's articles would continue to be valid for their benefit, but that they could not rely upon them thereafter; directors appointed after 1st July 2008 came immediately under the new regime, and the operation of s. 157 prevented their relying on any such indemnification provision from the outset of their appointment.

695. This decision is not, therefore directly applicable to this case, where the position is that the company's Articles were adopted in June 2006, and the directors were appointed then and shortly thereafter. The alleged breaches of duty took place in 2007 and before March 2008, and these proceedings were commenced on 7th July 2010. Thus, everything save the actual commencement of proceedings occurred before the coming into force of the 2008 Companies Law, and proceedings were commenced after the period of transition.

696. In *Savile AD4 Limited v Marlborough Trust Company Limited* ((2016) Guernsey Judgment 3/2016), McMahon DB – who had also been the judge at first instance in *Perpetual Media* and whose decision on the availability of the indemnification provisions had been reversed by the Court of Appeal - had to consider the case where the director defendants had been appointed in 2007, the alleged breaches took place in February and May 2008, and the proceedings were commenced in April 2013. He held that in such circumstances the directors were entitled to rely on the indemnification provision in the company's articles, because the termination of the "period of grace" in respect of directors appointed before 1st July 2008 only applied to avoid the indemnification provisions with respect to ***breaches*** committed after 31st December 2009; it did not prevent those provisions being invoked in respect of breaches of duty committed whilst the indemnification provisions were still permissible and therefore operative under the then law, even where proceedings were commenced after the end of the period of grace.

697. McMahon D-B said, at [32]

> *"I am satisfied therefore that the First and Second Defendants continued to enjoy the benefit of Article 153 under the terms of Regulation 10 until the end of 2009 and that it is not a benefit that can only be invoked up to that time. Section 157 of the Law makes such a provision void in its operation after that date, but does not also mean that invoking it after that date in respect of something which occurred when it was still operative is impermissible. Had the proceedings against a director been commenced, as here, later than 1 January 2010, on the Plaintiffs' argument the benefit of a provision like Article 153 would depend on timing. In my view that cannot be right. Accordingly I reject this further attempt by the Plaintiffs to defeat this application."*

698. The timings in the *Savile AD4* case relative to the coming into effect of s 157 under transition are materially identical to those in this case. The Plaintiffs submit, however, that the decision of McMahon D-B was wrong and ought not to be followed. I disagree.

699. In fact, it seems to me that the transitional provisions are a red herring, which muddies the real issue. In neither the *Savile AD4* case nor in this case did anything material actually occur during the transitional period (unlike *Perpetual Media*) so as to make this relevant to principle. If one simply ignores Regulation 10, then the real argument would be exactly the same. It is whether the avoiding effects of s 157 depend on the date when proceedings were commenced, or the date when the breaches in respect of which its protection is invoked took place. In other

words, it is whether s 157 has retrospective effect to remove a right of protection which the director enjoyed at the time and in respect of the alleged beaches, but which could no longer lawfully be operative at the time of commencement of proceedings.

700. There are two reasons why I respectfully endorse the view of McMahon D-B that s. 157 does not have such retrospective operation (regardless of the period of grace). The first is that as a matter of policy the law leans against retrospectively altering the accrued rights of citizens. The second is that of the uncertainty to which I think McMahon D-B was adverting, although I actually wonder whether his antepenultimate sentence in the quotation above was intended to read "*Had the proceedings against a director **not** been commenced, as here, later than 1st January 2010….*". The underlying point seems to me to be that it would be both uncertain and wrong for a defendant's ability to rely on an indemnity provision to depend on a matter entirely within the plaintiff's control, namely when the plaintiff commenced proceedings. For the director to be able to rely on such an indemnity if proceedings against him were commenced on, say, 30th December 2009, but not if they were instead commenced on 2nd January 2010, would be arbitrary and unprincipled.

701. In my judgment, therefore, the correct position is that a director who took up office before 1st July 2008 has a right to rely on an indemnity provision contained in the company's Articles at the time of his appointment (or if inserted therein prior to 1st July 2008) in respect of any breaches of duty which are alleged to have taken place before 1st July 2008, whenever proceedings in respect of those breaches are commenced. That is enough to decide the point in this case, although it also seems to me that the period of grace conferred by Regulation 10 continues that right, as regards directors so appointed, in respect of breaches alleged to have been committed until 31st December 2009, but not breaches thereafter, again, whenever proceedings in respect thereof are commenced. However, as that point is not material to my decisions on any basis, I express no concluded view on it.

Further points on exoneration/indemnity defences

(i) Incorporation from the Articles

702. The Plaintiffs argue that even if the exoneration/indemnity clauses of Articles 172-4 are not rendered void by statute, there are still two further reasons why they do not provide defences to the Defendants.

703. The first is that the terms of CCC's Articles of Association are not, in fact, incorporated into the respective service arrangements of the individual Defendants with CCC, such that they are not entitled to invoke these against CCC.

704. This point was considered and argued in *Perpetual Media* (above). The Court of Appeal there expressed a preference for the approach in Guernsey law to be that a director of a Guernsey company is presumed to take up office on the terms of the company's articles, but that that presumption would be rebuttable by evidence (see per Beloff JA at [35]).

705. The Plaintiffs submit that this approach is incorrect, and that the correct approach is that the matter of incorporation must be decided simply on the balance of any evidence actually presented, in the normal way, and they submit, for example, that a crucial question is whether there is evidence that the director actually read the company's articles, with the fact that he did or did not sign them being particularly significant. This was the competing (but rejected)

argument in *Perpetual Media*, but the Court of Appeal also went on to say that even if that rejected approach were accepted, it would be a low evidential threshold to establish incorporation.

706. In my judgment, the preferred approach of the Court of Appeal in *Perpetual Media*, even if not binding authority on the point, is highly persuasive as being the considered view of a superior court concerned precisely with the Guernsey jurisdiction, and I will follow it. I would add that it seems to me to be the eminently sensible, reasonable, practical and appropriate approach in any event. Any person becoming a director of a company is plainly well aware of the fact that it has "constitutional" documents. He could not later claim to be unaware of their contents where these governed or shaped his duty to ensure that the company is run correctly, according to its constitution. In those circumstances, it seems to me that the natural presumption must be that a director takes office on the basis of the whole package of provisions contained in the company's Memorandum and Articles of Association, including not just the burdens, but also the benefits which may be contained in them. This presumption will also have the merit of being clear and simple and, perhaps most importantly, to be what the ordinary man would expect. I therefore find that it is the correct approach in Guernsey law.

707. The issue of rebutting the presumption, if it ever arises, will, therefore, be a matter of evidence, and, of course, the evidence applicable individually to each of the seven individual Defendants. As that is therefore a fact-finding exercise of some proportion, I will embark upon it only if and where it becomes necessary to do so. I will simply record here that, just as the Court of Appeal opined that even if the competing approach were taken, and the matter considered on the basis only of the available evidence with no presumption in favour of incorporation, the threshold for establishing incorporation would be "low", it seems to me that the threshold for establishing that the articles of the company were not impliedly incorporated into any director's service arrangements will be high for the purposes of rebutting the presumption.

(ii) Construction of the clauses

708. The Plaintiffs' second argument is that Articles 172 – 174, do not, in any event, purport to provide exculpation or indemnity against certain kinds of conduct. For example, Article 172, the indemnification provision for directors, excludes liabilities incurred by or through their own "*wilful act neglect or default",* and the indemnification provision in respect of CIM and its affiliates, in Article 173, excludes liabilities resulting from their *"bad faith, fraud, gross negligence or wilful misconduct".* The director's exoneration provision in Article 174 (1) excludes conduct involving their *"bad faith, fraud, gross negligence or wilful misconduct".*

709. Similarly Clause 2 (b) of the IMA (exclusion of CIM's liability) does not extend to a loss resulting from "*wilful misconduct or gross negligence* [in Delaware law]", and Clauses 6(a) (b) (indemnification and exoneration of CIM and affiliates) does not extend to *"wilful misfeasance, gross negligence* [in Delaware law], *bad faith or reckless disregard".* The Plaintiffs submit that the Defendants' breaches of duty fall within the excluded standards of conduct.

710. This submission is one of quite fine detail and will only require consideration if and when I conclude that the application of these clauses does arise as an issue which I need to determine. It will also then require consideration, not only of the meaning of the terms used, but also my detailed findings of relevant fact. I will therefore again leave this until such time as it may be necessary to consider it further.

711. The Plaintiffs have further and more detailed arguments with regard to the precise or possible application of the terms of the various exoneration and indemnity clauses, upon their true construction, and they have also raised arguments as to the extent to which Article 174(2) of CCC's Articles might be void for being contrary to public policy. Again, these arguments were not gone into in oral submissions at the trial in the interests of time. If they require consideration, then that will be better and more effectively done in the light of relevant findings of detailed fact, rather than at the level of legal principles. I will again, therefore, revert to these points only if and when necessary, and will invite further argument if I think appropriate.

(iii) Statutory discretion

712. Lastly, for the sake of completeness, I record that the Defendants would, if ultimately necessary, seek to invoke the court's statutory discretion under s 522 of the 2008 Companies Law, to excuse a director from liability on the grounds that he "*acted honestly and reasonably and .... ought fairly to be excused*". (There appears to have been no equivalent provision in the 1994 Companies Law, but the court's powers here depend on the law in force when it comes to make its decision.) This is again, obviously, a provision which would require to be applied in the context of detailed findings of fact, and I will accordingly defer any consideration of it until it may be appropriate.

(7) The Entity Defendants as Directors

713. The first seven Defendants are individuals who were formally appointed directors of CCC, as its first directors, in accordance with its Articles of Association. The Plaintiffs' claims are made against them as such. The Entity Defendants were not appointed directors of CCC. The Plaintiffs nonetheless claim that, on the facts of this case, they each can and should be held liable as if they had been validly appointed directors of CCC, on the basis that they were, in Guernsey law, either *de facto* directors of CCC or "shadow" directors of CCC, and that they therefore owed to CCC the same duties as if they had been duly appointed directors. There is little or no Guernsey law on this topic, but there is a large body at least of English law on the requirements for making out either qualification.

(a) *De facto* directors

714. The term "*de facto* director" does not appear in Guernsey company legislation. The material Law in this case is the 1994 Companies Law, as amended in 1996. This was the Law in force at the time of the events complained of; the 2008 Companies Law did not come into effect until 1st July 2008.

Section 117 of the 1994 Companies Law provides that

> *"In this Law unless the context otherwise requires,*
>
> *.... 'director' means a person occupying the position of director, by whatever name called".*

715. This is slightly different from s.131 of the 2008 Companies Law, and indeed from all the recent English Acts at the time – the Companies Act 1948 s 455(1), Companies Act 1985 s

741(1) and Companies Act 2006, s 250. In all of these the definition is inclusive, rather than exhaustive, as exemplified by s. 131 of the 2008 Companies Law, which reads:

> "*In this Law "director" includes an alternate director and any person occupying the position of director, by whatever name called."* (emphasis added).

716. On a straightforward reading, s. 117 therefore deals only with nomenclature, making it clear that a company officer is to be treated as a "director" if he functions as such, even if he has a different official title. It does not refer to persons acting with no official position or title at all. However, since the thrust of s. 117 is that liability in the eyes of the law arises from *"occupying the position of 'director' "* (ie carrying out the functions of a director) an appropriately purposive construction suggests that the definition covers persons acting as a director but with no title at all, ie no formal appointment to any office. I would so read it, and I therefore conclude that the minor difference in wording between s. 117 of the 1994 Companies Law and s 131 of the 2008 Companies Law is not of significance for this case, and neither, here, is the fact that the 1994 Companies Law, though modelled on the English statute, used this slightly different wording. In particular, I am satisfied that English authority provides useful assistance as to the scope of de facto directorship under the 1994 Companies Law.

717. The concept of a *de facto* director in English law was first recognised, in the 19th century, in the case of a person who had acted as a company director, but whose appointment was defective. Such a person could not escape responsibility as a director of the company by relying on the invalidity of his appointment. He had acted as a director *de facto.*

718. The first English case to extend the concept beyond this, to a person who had never even purportedly been appointed as a director of the company, appears to have been *Re Lo-Line Electric Motors Ltd* [1988] Ch 477. The defendant there had never been formally appointed, but was found to have been held out by the *de iure* directors of the company as being a director, and he had behaved as such. He was held to be a *de facto* director. This led Millett J (as he then was) in *Re Hydrodan (Corby) Limited* [1994] 2 BCLC 180, to explain the concept in the following terms:

> *"…a de facto director is a person who assumes to act as a director. He is held out as a director by the company, and claims and purports to be a director although never actually or validly appointed as such. To establish that a person was a de facto director of a company it is necessary to plead and prove that he undertook functions in relation to the company which could properly be discharged only by a director. It is not sufficient to show that he was concerned in the management of the company's affairs or undertook tasks in relation to its business which can properly be performed by a manager below board level."* (emphasis added).

719. The concept was later extended yet again to include persons who were not even held out by the company as directors but who purported to act as directors of the company with no authority at all. It thus extends to those who "interfere" in the company's affairs.

720. All this shows, though, that the focus is on the defendant's acts. The reason for imposing liability is that those who in fact act as company directors should be held responsible as such. However, the extension simply to those who meddle brings a need to define and delimit the factual basis which does import liability. Thus, in the passage of Millett J's judgment cited

above, the passage emphasised is of central importance. The principle is that liability as a director is incurred by a defendant for doing acts, in relation to the company, which could be properly done only by a director. It is therefore necessary to decide if that condition is made out by identifying what acts can only be done by a director in the particular company. This requires investigating and identifying the corporate governance structure of the company, so as to see whether the relevant acts of the defendant are "directorial" (as I shall now refer to them) in that context.

721. Jumping slightly ahead, the most recent English case in which the authorities with regard to *de facto* directorship have been reviewed is *Smithton Ltd v Naggar* [2014] EWCA Civ 939, relied on by the Plaintiffs. Arden LJ there synthesised the cases, concluding that

> *"where a person had never been even invalidly appointed a director, it was necessary to examine the governance system of the company in order to assess whether he acted as a director"*.

At [35] – [42] she set out a series of practical points material to determining whether a person was a *de facto* director. I distil those which are material to this case, as follows;

(i) A party may be a *de facto* director even if there is no invalid appointment; the question is whether he carried out the function, and thus assumed responsibility to act as, a director;

(ii) To answer that question, the court may have to determine in what capacity the alleged director was acting;

(iii) The court will in general also have to determine the corporate governance structure of the company, (which can and will vary from company to company), so as to decide whether, in relation to the company's business the defendant's acts were "directorial" in nature; it is important that a first instance judge make findings in this regard;

(iv) The court is required to look at what the party actually did and not any job title he had;

(v) The test is objective; neither the party's intention, nor his belief that he was or was not acting as a director, is of any relevance;

(vi) The test is fact and circumstance dependent. It may be appropriate to look at the party's actions "in the round" but equally, in an exceptional case even a single act may be taken to constitute a person a *de facto* director; and

(vii) Whether the company held the party out as being a director would be a relevant factor; whether third parties regarded him as being a director may be material evidence.

722. I will adopt and apply these principles. I also add my own comments and emphasis to them, being points which I derive from looking at the authorities generally.

723. First, and as to (iii) above, in *Holland v HMRC* [2010] UKSC 51, Lord Collins observed at [91] that

> *"it is just as difficult to define "corporate governance" as it is to identify those activities which are essentially the sole responsibility of a director or board of directors"* .

724. It seems to me that these are two ways of stating what is really the same test. Once one finds "directorial" acts, then whether one describes these as rendering the actor part of the corporate governance structure of the company, or whether one simply says that he must be taken to have assumed the functions of a director by so acting, is simply a matter of language.

725. Also as to (iii), the qualification noted by Millett J in *Hydrodan* remains; the test requires the finding of actual "directorial" acts on the part of the defendant and merely being involved in the management of the company, or exercising a degree of influence over its decision making, is not in itself enough, although in the former case it may become enough if there is no other person involved in the management of the company in practice. That, however, is not this case.

726. Next, because liability as a *de facto* director is brought upon a defendant as the legal consequence of his own acts and their being found to be "directorial acts", it is imposed only in respect of such directorial acts; a "*de facto* director" does not automatically become responsible for the totality of the company's acts or activities.

727. Identifying what are or are not "directorial" acts in any particular case may not be easy. At the company's inception, all its powers to act are vested in its directors (by whatever name called) as a result of company legislation and the particular company's articles of association. Subsequently, such powers can be delegated, to a greater or lesser degree. In the case of a small and simple company, authority to act for the company and deal with its assets may well remain with its directors, both at the high level of strategic decision-making and the low level of everyday decisions and acts of implementation. In the case of companies with large enterprises, employees, advisers and agents will be engaged to carry out the more everyday work, and where the nature of the business is complex or requires expertise, others may be involved in high level decision-making or activities. The structure will vary with the particular needs of the company and the particular skills of the directors. Insofar as the directors delegate active functions, their involvement will then, quite properly, become more supervisory than operational, although a residue of supervisory function will always remain at the core and be non-delegable. Therefore, whilst decisions within the retained area(s) of control remaining with the directors will certainly be "directorial" in nature, how far, within the spectrum of possible structures, actual delegation of power to act may have gone can differ from company to company, and will be fact-specific. Whilst the authorities acknowledge the difficulty of generally identifying what are or are not "directorial" acts in respect of a company, it seems to me that, in practice and like the proverbial elephant, one is likely to be able to recognise such an act in context, even if one cannot easily define it.

728. Thus far, however, the cases have been concerned only with holding a natural person to be a *de facto* director of a company. What is here alleged is that another corporate entity should be held to have been a *de facto* director of a company, and this adds yet another dimension to the concept of a *de facto* director.

729. The important case of *Holland v HMRC* [2010] UKSC 51 illustrates the analytical issues which have to be grappled with when the factual situation extends to corporate entities. In simple terms, in *Holland,* the subject company (S) was owned by another company (H) which

was in turn owned by Mr Holland with his wife, and Mr Holland was the sole director of company H. The sole director of company S was company H. The issue was whether, through being the sole director of Company H which was the corporate director of Company S, and carrying out acts on behalf of Company S, Mr Holland had been a *de facto* director of Company S, so as to incur personal liability for an undoubted misapplication of Company S's funds. It was held by the majority of the Supreme Court (led by Lord Collins) that Mr Holland was not a *de facto* director of Company S, even though every decision of Company S was actually taken by him and implemented by him. This was because he was to be taken to have done those acts as the appropriate organ of, or agent for, Company H, the *de iure* corporate director. His acts were therefore the acts of Company H.

730. This decision was driven by respect for the distinction between the legal personality of a company and its owners, and a reluctance to pierce the corporate veil, (see [25]), influenced by the fact that company legislation permitted one company to be a director of another company. The dissenting minority, (led by Lord Hope) agreed that merely being a director of a corporate director (H) of a company (S) did not *ipso facto* render that person a *de facto* director of company S, and that something "more" (compare *Hydrodan* (above) at p 184B) was required. However, they considered that the extensive nature of the acts actually performed by Mr Holland in regard to Company S did amount to that something "more", and they would have found him to be a *de facto* director.

731. On any basis, though, the entire Supreme Court plainly felt it right to reject, as an acceptable basis for the imposition of liability, an impressionistic "broad brush" argument that Mr Holland was "really" a director of the subject company, in the sense that he was its directing mind in a generalised way. All members tested the position by a principled legal analysis of the corporate structures which had been set up, and the position, authority and pertinent acts of the defendant which were claimed to have made him a *de facto* director. (It is to be borne in mind that no argument as to Mr Holland's being a ***shadow*** director of Company S arose in this case.)

732. I do not overlook that the reasoning in the *Holland* case may well have been influenced by the particular development of English law as regards the use of corporate directors. English company law had expressly provided that a corporation could be the director of a company in the Companies Act 1985, but it had intervened again in the Companies Act 2006 (s.155(1)) to decree that a company must have at least one natural person as a director. This was to avoid the unacceptable consequence that a company might have no natural person who could be held accountable for misapplication of its assets.

733. No such developments have featured in Guernsey law, at any rate at the time with which I am concerned. Corporate directors were (and still are) permitted, by the combined effects of s 117 of the 1994 Companies Law quoted above and the Interpretation (Guernsey) Law 1948, which enacts that unless the context otherwise requires, a reference in any enactment to a "person" means either a natural or a legal person. It follows that the actual decision in *Holland*, which would not be binding on this court, might be inappropriate in a Guernsey law context. I can see that it also might be thought that there was some force in the minority approach in that case.

734. However, this is not a point which arises for decision here. The actual decision in *Holland* is not directly material to this case, because there the claim was to hold an individual liable as a

de facto director because of his own personal acts, whereas here the claim is the reverse; it is to hold another company liable as a *de facto* director because of the acts of individuals associated with that company.

735. What is to be derived from *Holland*, and other cases such as *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187 (which decides that a party with the power to appoint a director to a company does not thereby become liable for the acts of such director, whether vicariously as his employer, or at all), is the importance of the capacity in which a natural person is acting, for the purpose of the correct legal analysis of the overall situation.

736. It is material in at least two different ways. The first is the requirement already noted that the relevant act within the subject company must be an act required to be done by someone with the capacity of a director. If the defendant could have carried out the acts in question in some other capacity, either because they were not acts which only a director could carry out *(Hydrodan)* or because the defendant enjoyed some other capacity in which he could properly do them *(Holland)*, then the defendant is not a *de facto* director.

737. The second is that, since a corporate entity can only act through a natural person, where it is sought to make a corporate entity liable as a *de facto* director, one must find not only directorial acts done by the relevant natural person on behalf of the subject company, but also that that natural person was carrying out those acts as agent of the corporate entity sought to be made liable as its *de facto* director. Not only that, but it seems to me that, analysing the authorities, he must be found to be doing so only in such capacity.

738. It follows, in my judgment, that it will be well-nigh impossible to fix a corporate entity with liability as a *de facto* director of another company through the acts of any individual who was a *de iure* director of that other company at the time. That individual will obviously be carrying out "directorial acts" in his capacity as a director of the company, and not as agent for the targeted defendant.

(b) Shadow directors

739. The term "shadow director" is found in the 1994 Companies Law only through having been introduced by amendment in 1996. It was introduced, though, only for the purpose of the new section 67C, which relates to wrongful trading:-

> *"*67C ….(7) *In this section "director" includes a shadow director, which means a person in accordance with whose directions or instructions the directors of the company are accustomed to act"* (emphasis added).

740. It follows that the Plaintiffs can certainly invoke the doctrine of shadow directorship against the Entity Defendants with regard to their wrongful trading claims. The question whether they can do so with regard to their claims based on the general fiduciary duties or duties of skill and care owed by a director to his company is not so clear.

741. The concept of the "shadow director" was enacted into Guernsey law more broadly in the 2008 Companies Law (see s. 132), but that was, of course, only as from 1st July 2008, and even then the enactment did not extend the term "director" as used in the Companies Law generally to include a "shadow director" as there defined. Rather, it enacted that where the term "shadow director" was itself used in the 2008 Companies Law, this meant a "*person in accordance with*

whose directions or instructions the directors of the company are accustomed to act", and in s 132(3) it specifically extended the meaning of the word "director" in particular sections of the Law (ss 160 and 162-4, which have no relevance here) to include a "shadow director", as so defined.

742. Thus, in both the 1994 Law and the 2008 Law, the operation of the defined concept of a "shadow director" is confined to the two situations, first where that term is actually used in the Law itself, and second where it is specifically directed to be treated as if it had been used. These situations do not include the operation of the company director's fiduciary duties or duties of skill and care, neither of which is actually laid down in the Companies Laws at all. Neither Law enacted that wherever the term "director" was being used or applied in the Law, it included a shadow director.

743. The significance of this is that liability as a *de facto* director of a company applies because the office of a "director" in company law has been held, by judicial interpretation of that term (in English law but with Guernsey law reasonably following suit), to extend to a person who acts as a director of a company in actual fact, even though not as of right. However, liability as a shadow director is not the result of judicial interpretation, but of legislative enactment. It is therefore confined to the cases stipulated by the enactment.

744. It consequently seems to me, that it is only if the concept of *de facto* directorship itself could be extended to include the shadow directorship situation that this would enable a finding of liability for breach of fiduciary duty or of duty of skill and care to be made against a shadow director. This would be a perfectly reasonable interpretation. The basis for imposing liability on persons as *de facto* directors of companies is that of imposing duties and responsibilities to the company on those who are in practice taking the operative decisions on its behalf. This principle can be applied just as readily to the shadow director situation as it does to the conventional *de facto* director situation.

745. If it were open to me to do so, I would readily construe the Guernsey Companies Laws to the effect that a person could "occupy the position of director" of a company by issuing directions or instructions to its *de iure* directors which those directors were accustomed to act upon, and thus that person would be a director of the company, in any material respect according to the facts.

746. However, albeit with reluctance and on balance, I do not think that doing so is open to me. It seems to me that the terms of the Companies Laws - and it is even more clear in the 2008 Law - treat the concept of shadow directorship and the situation giving rise to it as being a separate and distinct concept in its own right. The legislature has then prescribed the situations in which the situation of a person falling within that concept is to be taken to impose director's liabilities or duties, initially on a very limited basis in 1996, and subsequently in a wider range of situations in 2008. That being the case, it seems to me that the legislature has to be taken to have intended those situations to be exhaustive with regard to shadow directorship, and that in enacting those express provisions it was implicitly ruling that the term "director" did not, itself, extend to them. The consequence is that the legislation seems to me to have ruled out any permissible judicial extension of the principles of *de facto* directorship to include shadow directorship.

747. It would follow that liability as a shadow director in Guernsey law applies only where the applicable Companies Law directly stipulates. I would hold, therefore, that the allegation of

shadow directorship against the Entity Defendants is available only in respect of the Plaintiffs' claim for wrongful trading. However, I have to consider the legal principles regarding a shadow director for the purpose of the wrongful trading claim in any event. I therefore do so generally and what I say below are my findings on the scope of the concept of shadow directorship in Guernsey law, whether its application is limited as just discussed or not.

748. First, a minor point of construction. Under the 2008 Companies Law, the definition of a shadow director was extended by adding the further qualification that a person was

> *"not to be regarded as a shadow director by reason only that the directors act on advice given by him in a professional capacity"* (s. 132(2)).

749. I do not think this makes any substantive difference to the meaning of the concept under s 67 of the 1994 Companies Law as amended. In my judgment, this qualification is really implicit in the original wording, not least because "advice" and "directions or instructions" are different things. I accept that "advice" could conceivably be rendered in such a way that it could fairly be characterised as either "directions" or "instructions". However, that would be a matter of fact to be proved, and does not mean that advice generally is to be taken as falling naturally within such a description.

750. I do not think that I was urged by Advocate Wessels to infer, from the introduction of this qualification on 1st July 2008, that prior to that time a professional adviser in Guernsey on whose advice directors of a company would generally act was to be taken to be a shadow director of the company, but I would in any event decline to do so. To do so would, in my judgment, be attributing far too much inferential weight to amendments to companies legislation which were probably inserted for the avoidance of doubt, and would in fact be contrary to what I have indicated I would regard as the natural meaning of the words in context, according to their obvious policy intention.

751. I approach the matter, therefore, on the basis that the court is looking for "directions" or "instructions", even though it would not be precluded from finding, on appropriate facts, that communications which were termed "advice" nonetheless fell into those categories in substance.

752. Once again, the English case of *Re Hydrodan (Corby) Ltd* (above) provides a useful starting point for formulating the appropriate test. Millett J, at p 183 c-e, and having emphasised the contrast with a *de facto* director, (in that the former openly acts as a director, whereas the latter claims not to be a director at all), determined that the statutory definition required proof of

> *"(1) who are the directors of the company, whether de facto or de jure; (2), that the defendant directed those directors how to act in relation to the company or that he was one of the persons who did so; (3) that those directors acted in accordance with such directions; and (4) that they were accustomed so to act. What is needed is first, a board of directors claiming and purporting to act as such; and secondly, a pattern of behaviour in which the board did not exercise any discretion or judgment of its own, but acted in accordance with the directions of others."*

753. Later English authority has established that it is not necessary for all the directors to act in accordance with the relevant directions or instructions; a governing majority will suffice: see *Ultraframe (UK) Ltd v Fielding* [2005] EWHC 1638 at [1272]. It is also not necessary that

an alleged shadow director should control all the decisions of the directors, or all the company's field of activities: *Secretary of State for Industry v Deverell* [2001] Ch 340 per Morritt LJ. There must, though, be actual "acts" by the Board which are being controlled in the manner described, because this is what is stated in the statutory definition. There must also be a pre-existing pattern of such allegedly controlled acting. This is necessary in order to satisfy the requirement of "being accustomed": see *Ultraframe* (above) at [1277-8].

754. The essence of this concept is that the alleged shadow director is, in reality, the actual director or the "directing mind" of the company in the relevant respects, (ie the offending acts of the *de jure* – or it could even be: *de facto* - directors), because those who are actually carrying out the particular offending acts are merely the conduits of his wishes and decisions.

755. Lewison J in *Ultraframe* expressed some reservations as to the extent of fiduciary duties properly imposed on shadow directors, since they would usually be incurring liability precisely because they would be operating with a conflict of interest as regards another person or entity (at [1290]). I would decline to follow that dictum on any basis, though, for being what I would regard as an unguarded comment, since the whole point of imposing liability for shadow directorship is precisely to hold liable the persons who are in fact directing a company's affairs contrary to what would otherwise be its directors' duties. Fortunately, in *Vivendi SA v Richards*, [2013]EWHC 3006, Newey J clarified the position sensibly, concluding that shadow directors did owe fiduciary duties to the company, and that

> *"A shadow director can, I think reasonably be expected to act in the company's interests rather than his own separate interests when giving such* [sc. such as the directors will be accustomed to act upon] *directions and instructions." [143].*

756. Once again, though, discussion of this topic shows the need for careful analysis of what is actually going on in substance, especially as regards defendants with a potential conflict of interest. This is highlighted by some of the examples considered in *Ultraframe*, which discuss (see [1266-9]) the position of funders, lenders, suppliers, etc, who may be able to dictate the actions of the company to its board because of the strength of their commercial negotiating position. Lewison J accepted and endorsed the view that doing so would not make that counterparty a shadow director of the company. He also accepted that a creditor of the company is entitled to protect his own interests as creditor without necessarily becoming a shadow director of the company. This is a realistic approach and, on a more general plane, it underlines that the courts will be careful, in making judgments in the context of commercial matters, to give appropriate recognition to the realities of the business world. Such recognition, together with the exception of trusted professional advisers from liability, emphasises both the focus of the policy that imposes liabilities on shadow directors, and that any finding is dependent on facts.

757. Advocate Wessels took me to *Secretary of State for Industry v Deverell* (above) as his principal authority and as epitomising the test for shadow directorship. Morritt LJ summarised his conclusions at [35] in five propositions:

> *"...(1) The definition of a shadow director is to be construed in the normal way…....it should not be strictly construed……*
>
> *"(2) The purpose of the legislation is to identify those, other than professional advisers, with real influence in the corporate affairs of the company. But it is not necessary*

that such influence should be exercised over the whole field of its corporate activities……

"(3) Whether any particular communication from the alleged shadow director, whether by words or conduct, is to be classified as a direction or instruction must be objectively ascertained by the court in the light of all the evidence. In that connection I do not accept that it is necessary to prove the understanding or expectation of either giver or receiver. In many, if not most, cases it will suffice to prove the communication and its consequence. Evidence of such understanding or expectation may be relevant but it cannot be conclusive. Certainly the label attached by either or both parties then or thereafter cannot be more than a factor in considering whether the communication came within the statutory description of direction or instruction.

"(4) Non-professional advice may come within that statutory description. The proviso excepting advice given in a professional capacity appears to assume that advice generally is or may be included. Moreover the concepts of "direction" and "instruction" do not exclude the concept of "advice" for all three share the common feature of "guidance".

"(5) It will, no doubt, be sufficient to show that in the face of "directions or instructions" from the alleged shadow director the properly appointed directors or some of them cast themselves in a subservient role or surrendered their respective discretions. But I do not consider that it is necessary to do so in all cases. Such a requirement would be to put a gloss on the statutory requirement that the board are "accustomed to act" "in accordance with" such directions or instructions…..a qualification beyond that justified by the statutory language."

758. I would broadly accept these propositions but with the following qualification.

759. First, I do not think that Mr Wessels sought to argue that the "real influence" referred to in proposition (2) can be viewed as either an accurate paraphrase for, or an alternative expression of, the qualifying test for being a shadow director contained in the statutory definition itself. i.e. the requirement of there being "directions or instructions." If he did, so, then I reject that argument. In my judgment, it is not available, certainly not insofar as it is inconsistent with the actual words of the statute. A test of "real influence" is not only not the statutory requirement, but is both so vague as to be unworkable, and departs too far from the essence of the concept, which is that a "shadow" director is a person who is, in reality, running the company in the relevant respect, albeit doing so through the actions of others who compliantly do his will. It may be possible that a person who has serious influence on the affairs of the company because his views or advice are habitually sought and acted on out of deference could fall within the definition of shadow director, but that would depend on whether the circumstances justified the relevant findings of fact as to the communications amounting to "directions or instructions".

760. Second, I do not understand Morritt LJ to be saying, in proposition (3), that "directions or instructions" can arise without the intention and objective of, at least, the alleged giver of the instructions being that the Board should act in accordance with his expressed wishes. If he is so saying, then I respectfully disagree. There is a difference of quality between advice, even if forcefully expressed, and a direction or instruction, and that difference is that the maker of the communication is doing so with the intention of procuring a result for his own ends. Of

course, that state of mind may be capable of being inferred from indirect evidence in the usual way, but it does not seem to me that the statute authorises dispensing with such a finding. The statute requires a finding that the *de iure* directors were accustomed to act in accordance with the "directions or instructions" of the alleged shadow director and not merely in accordance with his presumed wishes or interests.

761. Third, I note, and Mr Wessels accepted, that the requirement to find "directions or instructions" requires the finding of actual communications, from the alleged shadow director to the Board Members, which constitute "directions or instructions". This is plain from Morritt LJ's proposition No (3). Such a finding is, of course, a matter of evidence and subject to the usual processes of pleading and proof. Again, though, it cannot simply be glossed over or assumed as part of some postulated bigger picture. Any inference that there were "directions or instructions" must be made as a finding of actual fact, justified, on balance of probability by evidence.

762. Fourth, it is clear from the cases such as *Kuwait Asia Bank*, (above) that the element of influence or even control over a company's affairs which arises from either holding its shares, or having control over the employment position of its directors, is not sufficient on its own to constitute a party – generally there a company, - a shadow director. This underlines, again, the need for proof of the factual situation which constitutes shadow directorship, and that mere allegation of a relationship of influence, or similar, is not enough.

763. Fifth, and at the risk of stating the obvious, if it is sought to make a corporate entity liable as a shadow director, then it is necessary to find directions or instructions in the form of communications issued by that entity. Since a corporate entity can only act by human agency, then even if actual communications by a human being can be pointed to, issues of the capacity in which those communications were made will still need to be examined, to decide whether the communication was actually that of the corporate entity. In other words, any "directions or instructions" will have to be established to be *those of the corporate entity*, and this also requires affirmative proof on the evidence. This is not surprising, as the actual director of the company will already be liable, and fixing a shadow director with liability is an extension of liabilities arising out of the corporate structure.

764. Finally I make some general observations. There has been dispute in the English cases as to whether the concepts of *de facto* and shadow directorships are or are not mutually exclusive. In my judgment, and for the reasons given by Millet J in *Re Hydrodan* (above), logic dictates that they have to be, certainly now that statute has intervened to delimit the concept and application of the liability of shadow directors as discussed at the beginning of this section. In this situation, it may be possible to be a shadow director and a de facto director at the same time, but not in respect of the same acts, because the test for each basis of liability is materially different. A *de facto* director is fixed with liability because of what he does. A shadow director is fixed with liability because of what he procures. Fortunately this seems more of an academic dispute than one of real consequence. I have indicated above the extent to which I am concerned with it here.

765. Again, and although not bearing directly on the facts of *de facto* or shadow directorships, it is helpful context, in my judgment, to keep in mind that a party which is entitled to appoint a director to the board of another company does not *ipso facto* become either a shadow, or a *de facto*, director of the company. Whether he (or it) does so has to be judged on the basis of the

actual facts; for example, he is plainly more likely to do so if he is in fact able to appoint a majority of the Board. However, the position in law is that by appointing another person as a director of a company, the appointor is taken to authorise the appointee to perform conscientiously the duties of such a director, and therefore to exercise his own judgement and to act in what he perceives to be the best interests of the company, rather than those of his appointor. The appointee becomes agent of the company and not of his appointor.

766. As mentioned in relation to *de facto* directors, if a company which is entitled to appoint a director to the Board of another company appoints one of its own employees, then even though the employee carries out his directorial functions as part of his employment duties, the employer is not vicariously liable *ipso facto* for the acts of the employee as such director: see. *Kuwait Asia Bank EC v National Mutual Life Nominees Ltd* [1991] 1 AC 187 (PC) – an instructive and useful case on the position of nominee directors and the proper scope of duties thereby owed. Once again, this principle recognises that the office of director imposes freestanding personal and independent liabilities on the party holding that office, regardless of the origins of his appointment. Of course, if the actual facts demonstrated that the employee director had been following instructions issued to him by his employer, then the situation would be different.

767. Insofar as the foregoing points are not of direct relevance to this case, I find them to provide helpful guidance as to the proper approach to the concept of shadow directorship as it does come to be applied in this case. To distil the essential points for the present case:-

(i) To fix any of the Entity Defendants with liability as a shadow director of CCC the Plaintiffs need to prove that the actual directors (*de iure* or possibly *de facto* if already found) were accustomed to act in accordance with "directions or instructions" given by that corporate entity. This requires proof, on the evidence in the usual way, of actual directions or instructions.

(ii) "The directors" would include a relevant voting majority of the board of directors.

(iii) It is insufficient to establish one instance only of obedience to such direction or instruction; there has to be a series of such acts so as to prove the requirement of being "accustomed" so to act. However, that does not necessarily have to be on the same subject matter, and in an appropriate case, relatively minimal evidence of previous biddability might well suffice.

6. <u>The issues to be determined</u>

768. Having now determined the law which I will be applying, it is convenient to marshal the issues which, in consequence, arise for determination, before turning to the evidence and the witnesses.

769. Turning to the allegations in the case, the Defendants say that they have identified 187 separate allegations of breach of duty pleaded against them in the Cause, although I confess that I have not counted them. They appear (from the Defendants' comments on the unagreed "Concise List of Issues" referred to below) to be the total number of sub-paragraph allegations contained in Paragraphs 263C-263H, 308D-308J, 339B-339G, 367D-367I, 369T-369Y, 390B-390G, and finally 417, 418B-E, 418I-418L, 419, 422 and 424B-424E of the Amended Cause.

770. There are ten defendants. The Plaintiffs' claims are purportedly made against them jointly and severally, but since the obligations (apart perhaps from wrongful trading) are individual, the liability of each Defendant has to be considered separately as already mentioned. The 187 breaches of duty are not, I think, all alleged against all ten defendants, but neither are they the sum of allegations against individual Defendants, because there is a pattern of pleading breaches in the Cause against groups of Defendants, comprising either the four "Carlyle Directors", the three "Independent Directors" or the three Entity Defendants. The total number of individual breaches pleaded, with which I could theoretically be concerned, is therefore well into the 100s.

771. If all the pleaded breaches of duty had identifiable pleaded consequences which might afford the Plaintiffs a remedy at law, then I might have felt obliged to deal with them individually, but as already mentioned, they do not. The relief sought by the Plaintiffs is simply financial relief, being either for compensatory damages claimed for breach of fiduciary duty or for negligence, or for "contribution" on the grounds of wrongful trading (the measure of which is compensatory in nature), or for the "restitution" of unjustifiable fees and expenditure. The last claim is discrete and is straightforward in nature. All the other claims depend on proving wrongful acts or omissions by a relevant Defendant which can be shown to have caused a loss to CCC. In essence, what has been ultimately claimed (the Cause is still somewhat vague in this regard) is the difference between CCC's net asset value taken at an appropriate date (depending on the findings of fact constituting liability) some time between 26th July 2007 and 27th February 2008, adjusted insofar as necessary to take account of assumed sales which should have been made on the one side, and what was actually realised upon CCC's liquidation in March 2008 on the other.

772. To try to identify the issues which did require decision within the essential scope of the action, and to provide a working framework for covering these, I directed the parties to try to agree a "Concise List of Issues". Unfortunately, they were not even able to agree on that. Their attempts appear to have foundered (from the footnotes by each side to a travelling draft which has been shown to me) because any attempt by the Defendants to identify the common thread of the Plaintiffs' allegations and express the issues in such focused terms has been rebuffed by the Plaintiffs as a "partial and incomplete summary" of their case, as to which they insist on incorporating reference to the minutiae of individual allegations in their pleaded Cause.

773. In the end, therefore, I had to formulate my own list of issues. I have based this on the partially agreed "Concise List" document, but I have used the structure suggested by the Defendants, which I find to be reasonably dispassionate and, above all, realistic. My list does not give an entirely sequential course for decisions, but it covers all the issues which I think arise and might require determination in order to resolve the case. It is as follows, though it should be noted that I have already partially decided some of these issues in stating my holdings on the law above, and in particular answered issue 10(ii)(b) in the negative.

List of potential issues for decision

As to the First to Seventh Defendants:

1. Whether at any time between 26th July 2007, and 27th February 2008, and specifically

   (i) on or after 26th July 2007 and in particular at CCC's Board Meeting of 26th July 2007;

(ii) during August 2007 and in particular at CCC's Board Meeting of 23rd August 2007;

(iii) during September 2007 and including 1st October 2007;

(iv) during October/November 2007 and in particular at CCC's Board Meeting of 13th November 2007;

(v) during December 2007; and

(vi) during January and up to 27th February 2008

any of the First to Seventh Defendants (and if so which) acted

(a) in breach of his fiduciary duty to CCC or

(b) in breach of his duty of skill and care to CCC

in failing to advise, insist or secure that CCC take urgent steps to

(1) sell down CCC's RMBS assets;

(2) raise additional equity capital;

and/or

(3) conduct an orderly winding down of CCC.

2. In regard to 1 above,

(i) whether CCC was at any such material time insolvent or on the brink of insolvency so as to extend the duty owed by each of the First to Seventh Defendants to act in the best interests of CCC to include a duty to have proper regard for the interests of CCC's creditors, and if so

(ii) whether any of the First to Seventh Defendants (and if so which) acted in breach of such extended duty.

3. In regard to any decision of any of the First to Seventh Defendants found to be in breach of duty under 1 above, whether such decision was a decision to which no reasonable director, acting properly and being in the position and with the skill, knowledge or expertise of that director, could have reasonably come in all the circumstances.

4. Whether CCC suffered any and if so what loss and damage in consequence of any breach of duty found under Paragraph 1 above for which such Defendant is consequently liable.

5. Whether in acting as above, any such Defendant (and if so which) committed misfeasance towards CCC within the meaning of s 106 of the Companies (Guernsey) Law 1994.

6. What contribution (if any) any such Defendant found guilty of misfeasance should be ordered to make to the assets of CCC in its liquidation.

7. Whether any of the First to Seventh Defendants (and if so which) knew or ought to have concluded at any time between about 17th August 2007 and 31st December 2007 that, absent the prompt taking of such steps as mentioned in Paragraph 1 (1)-(3) above, CCC stood no reasonable prospect of avoiding insolvent liquidation within the meaning of s 67C of the Companies (Guernsey) Law 1994.

8. If so, whether such Defendant thereafter took every step that he ought to have taken with a view to minimising the potential loss to the company's creditors.

9. What contribution (if any) any such Defendant found guilty of wrongful trading should be ordered to make to the assets of CCC in its liquidation.

10. Whether

    (i) any such Defendant found guilty as aforesaid is *prima facie* entitled to rely on the effects of Articles 172 – 174 of CCC's Articles of Association (as amended on 8th May 2007) so as to claim either exoneration from or indemnification from CCC against, any liability which would otherwise fall upon him as above, but if so

    (ii) whether the effects of such provisions are avoided by the operation of either

        (a) s 67F of the Companies (Guernsey) Law 1994 or

        (b) s. 157 of the Companies (Guernsey) Law 2008.

As to the Eighth Defendant:

11. Whether the Eighth Defendant, during the time stated in Paragraph 1 above and in the same respects as there mentioned, was thereby in breach of its contractual duties to CCC contained in the Investment Management Agreement dated 20th September 2006 made between CCC and the Eighth Defendant, or alternatively in breach of a co-extensive tortious duty of care to CCC.

12. If so, whether CCC suffered any, and if so what, loss and damage in consequence of such breach for which the Eighth Defendant is consequently liable.

13. Insofar as the Eighth Defendant is found to be in breach of a contractual or tortious duty as mentioned in Paragraph 11 above, whether it is entitled to rely on the exoneration and indemnification provisions contained in paragraphs 2 and 6 of the said Agreement.

14. Whether, CCC is, alternatively to any claim for damages to which it may be entitled against the Eight Defendant, entitled to restitution of fees or other sums paid by it to the Eighth Defendant pursuant to the said Agreement of 20th September 2006 and if so in what sum.

As to the Eighth to Tenth Defendants:

15. Whether any of the Eighth to Tenth Defendants (and if so which) was either

(a) a *de facto* director of CCC or

(b) a "shadow" director of CCC

and acted in such capacity so as to incur liability for breach of fiduciary duty and/or breach of duty of care and/or misfeasance and/or wrongful trading as a director of CCC as mentioned in Paragraphs 1- 10 above, *mutatis mutandis.*

As to all Defendants:

16. Whether any of the Defendants found liable under the foregoing paragraphs should be relieved from liability (in whole or in part) pursuant to s 522 of the Companies (Guernsey) Law 2008?

17. What interest, if any, should be paid by any Defendant found liable under the foregoing paragraphs?

I have used the above template for my determination of the disputes in this trial. With the above comments as to the scope of the action and the issues arising, I now turn to the evidence and witnesses.

7. The Evidence and the Witnesses

Documentary and witness evidence

774. As one of his first submissions in closing, Advocate Wessels submitted that this is a case in which the court should – he seemed to come close to saying "must" – treat the contemporaneous written evidence as having "primacy" over the Defendants' written or oral evidence, for being the most reliable evidence. He did so principally on the basis of the passage of time – some nine years – and its effects on a witness's natural fading of recollection, leading to a consequent tendency to "reconstruct" rather than recollect. However, from his other submissions I have no doubt that he was also urging that what has been politely described as "*the natural influence of self-interest*" (*Roach v Page (No 37)* 2004 NSWSC 1048 at [76]) will have played a significant part in the contents of witness statements and oral testimony, undermining and reducing its weight.

775. He relied on dicta of Leggatt J in *Gestmin SGPS SA v Credit Suisse (UK) Ltd* [2013] EWHC 3560 Comm at [22]. There, having set out sceptical comments, based on research findings, on the fallibility of memory particularly as regards a former state of mind, and having alluded to the exacerbating effects upon such unreliability of the process of preparation for a court case (see [16] – [21]), Leggatt J states the following proposition:-

> *"In the light of these considerations, the best approach for a judge to adopt in the trial of a commercial case is, in my view, to place little if any reliance at all on witnesses' recollections of what was said in meetings and conversations, and to base factual findings on inferences drawn from the documentary evidence and known or probable facts. This does not mean that oral testimony serves no useful purpose - though its utility is often disproportionate to its length. But its value lies largely, as I see it, in the opportunity which cross-examination affords to subject the documentary record to*

critical scrutiny and to gauge the personality, motivations and working practices of a witness, rather than in testimony of what the witness recalls of particular conversations and events. Above all, it is important to avoid the fallacy of supposing that, because a witness has confidence in his or her recollection and is honest, evidence based on that recollection provides any reliable guide to the truth."

776. A similar approach was adopted in *Daniel v Tee* [2016] 4 WLR 1538 at [19]-[20], a claim for breach of trust by negligent investment made many years earlier, with the added factor that the plaintiffs were then aged between 9 and 13. The judge, Mr Richard Spearman QC, cited *Gestmin* above and said at [19]:

> *"…At the end of the day, the best guide to the truth is often to be found not so much in the demeanour of the protagonists, or even concessions made in cross-examination, but in the contemporary documents and in an objective appraisal of the probabilities overall."*

777. Rose J took a similar approach in *Libyan Investment Authority v Goldman Sachs International* [2016] EWHC 1538 (Ch) at [37]-[42] with regard to a claim launched in 2014 with regard to alleged undue influence in early 2008.

778. Advocate Wessels, also referred to the ever-useful Australian case of *Bell Group Limited (In liqn.) v Westpac Banking Corporation (No 9)* [2008] WASC 239 at [1052-4] where Owen J had expressed similar sentiments to those of Leggatt J, having remarked that his *"primary port of call in assessing reliability was the contemporaneous documents".*

779. Advocate Wessels' submission was that the contemporaneous records were so much more likely to reflect the facts accurately than the statements, written or oral, prepared or made for the purposes of this litigation, that they should be preferred to the witness statements or oral evidence. Indeed he went as far as to submit that much of the oral evidence of the Defendants' witnesses should not be accepted unless corroborated by a contemporaneous record.

780. Insofar as this submission verged on suggesting that I should ignore the written statements and the oral evidence of, in particular, the Defendants and their witnesses, I reject it. It is a somewhat selective submission in any event, as the Plaintiffs accept and indeed rely on those parts of the Defendants' oral evidence which they can characterise as admissions.

781. Even in a case based on matters happening some years previously, the evidence must be considered in its totality. It is a matter for the court itself to assess the reliability or probative weight of any element. It is stating the obvious that a contemporaneous document carries the weight of being the product of the author's thinking at the time, whilst later statements do not, but the weight to be attached to this is a matter for the judge. I take on board all the points about the fallibility of memory, the further dangers of reconstruction as compared even to recollection, the distorting effects of preparing witness statements and continually chewing over what happened, and the natural effects of self-interest even on a conscientious and honest witness. It is, though, my function as a judge to discern and allow for any of these where it seems right to do so, but to do so as a part of the total exercise of examining all relevant evidence, weighing the conclusions which it appears to support, doing so in context and with any appropriate injection of common sense, and then coming to the necessary finding of fact, on balance of probability.

Documents

782. Given the reliance placed by the Plaintiffs on the documentary evidence, I make some further comments on documents. The weight to be attached to statements in any document must itself be considered in context. Emails, for example, are undisciplined communications, and whilst they often replace formal letters and memoranda, they are much more casual in ethos and style. This gives them an unguarded quality which may, of course, be very valuable in giving an authentic and uncrafted insight into the mind of the author, but on the other hand, they may also generate a written record of a throw-away statement which the writer would never have put in a formal memorandum as a considered view, but which is happily dashed off on a Blackberry. The court must assess the significance of such statements with these two considerations in mind. They apply also at the other end of the spectrum. Where a contemporaneous document has been produced in circumstances where it has been carefully composed, the reasons for this will affect any assessment of how far its terms express the writer's fully candid views, or have been formulated for effect.

783. Advocate Wessels moved on to a further submission, that the *absence* of documentary evidence can be "equally significant", by which I take him to mean of similar evidential importance to the claimed "primacy" of contemporaneous written documents. He cites what I regard as an uncontroversial dictum, namely

> *" .... if the judge is satisfied that certain contemporaneous documentation is likely to have existed were the oral evidence correct, and that the party adducing oral evidence is responsible for its non-production, then the documentation may be conspicuous by its absence and the judge may be able to draw inferences from its absence."*

per Arden LJ in *Re Mumtaz Properties Limited: Wetton v Ahmed* [2011] EWCA Civ 610 at [14]. This is again just part of the process of weighing up all the evidence available, and drawing the inferences which appear, in all the circumstances, to be justified: see [16]. It is also an example of the permissibility of drawing adverse inferences in appropriate circumstances, but the key feature of *Mumtaz,* in that regard was that the defendant was found to be responsible for the non-production of documents which did exist, which would have shed clear light on the veracity of his evidence, and which the court found had been in his possession. The inference was drawn, not from the non-existence of documents, but from their non-production.

784. I know that there have been major disputes in the past about the production of documents in this case, which I have not had to investigate. That, though, is beside the present point. As I understand the Plaintiffs' proposition about absent documents, it is not that material documents which do exist have not, ultimately, been produced, but that if the Defendants' assertions (such as that proper consideration was given to steps to be taken with regard to managing CCC's business) are to be believed, then one would have expected documentary records of this to exist, but as such documents have not been produced, those assertions should not be believed. That point is simply an evidential argument and not an adverse inference.

785. Moving to another point, I required the parties, during the trial, to agree a listed bundle of the documents which I was to treat as being the actual evidence in the case. This is because documents do not become evidence to be taken into account in a case simply by being copied into a trial bundle. That merely makes it potential evidence, and there are further rules of procedure and evidence which need to be observed.

786. First, even though in modern practice, the rule against the reception of hearsay evidence has been largely done away with by the *Evidence in Civil Proceedings (Guernsey and Alderney) Law* 2009 ("**the Evidence Law 2009**), such evidence still, technically, requires the service of the necessary notices to be admissible see ss 1-4 of that Law. The Evidence Law 2009 ought not to be a reason for any party simply to expect to rely on hearsay evidence, regardless. It has yet to be authoritatively decided whether, in Guernsey law the mere inclusion of a document in a proposed trial bundle should be deemed to be a good hearsay notice by the proposing party under rule 2 of the *Evidence in Civil Proceedings (Guernsey and Alderney) Rules 2011* (**"the Evidence Rules 2011"**), as has apparently been decided in England in relation to similar provisions.

787. Next, and the centrally important point, a defendant is entitled to know the case which he has to meet, including the evidence being relied on against him, and to know this before he makes his defence. This requires, therefore, that the plaintiff, at the formal closing of his case, should be able to identify all the documentary evidence which he is actually relying on, so that the defendant can deal with it in the course of presenting his defence. Although no doubt most such documents will have been referred to either in opening speeches or by witnesses, it is always possible that there are documents which are being relied on simply for their own sake, and a defendant is entitled to be clear about what these are. Likewise, at the close of the defence, the defendant must similarly be able to add to the plaintiff's list any further documents which the defendant relies on as part of his own case, in the same way. This has the result, first, that any objections to the admissibility of any documents which either side wants to rely on can be flagged up and determined, second that implications from any purely documentary evidence can be addressed by the opposite party in argument, and third, that the judge, when writing a reserved judgment, knows exactly what it is permissible to look at as evidence, and exactly what can, and indeed must, be ignored, out of trial bundles which all too often are many times larger than the material actually deployed in the trial.

788. In this case, and after the inevitable sparring between the parties, the exercise has produced a list of 4,872 items of documentary evidence. Two classes of documents within this list require special mention.

789. First, the Plaintiffs, in particular, had often, in the course of the trial, referred to emails between persons who were not called as witnesses, within organisations, such as other banks, which were not parties to the proceedings, as evidence of the truth of what those emails said. In the end, though, both parties wanted to refer to such materials, and therefore by mutual agreement, all such documents which either side wanted to refer to have been included within the admitted evidence. These emails are hearsay, and I will give their contents such weight as supposed evidence of the truth of that which is asserted in them as I think appropriate.

790. Second and similarly, there had been reference in the trial to matters such as press releases of third parties, newspaper and journal articles and so forth. With the parties similarly each wishing to refer to some such material, even if they would no doubt have liked to exclude other such material referred to by the opposition, the final compromise position is, once again, that it is agreed that I can have such regard as I think appropriate to all such material as has been included in the admitted evidence list. Again, of course, the weight to be attached to such matters depends on my judgment, and this in turn depends at least partly on the purpose for which it is sought to use it.

Assessment of oral testimony

791. Given the accusations of lack of integrity which the Plaintiffs level at the Defendants, I think it is important to say something about my approach to the assessment of oral evidence.

792. Two main factors affect this. The first is whether the witness is being honest, the second is whether he has a reliable recollection. Perfectly honest evidence can still be mistaken. But there are also more subtle considerations, such as whether the witness is really conveying what he wants to say accurately and clearly. This is not just a matter of intelligence or education. The ordinary man is not accustomed to having to express himself with the precision of a chancery lawyer, and due allowance must be made for this.

793. Also, being involved in such a momentous matter as a court action, particularly as a party, means that any witness will undoubtedly have rehearsed, many times, his recollection of relevant occurrences, not just in the formal context of instructing lawyers, but also informally, to himself, when lying in bed at night trying to make sense of what has happened. In the course of this rehearsal, the thought process can easily move from "I actually have no clear recollection of what happened" through "I think it is likely that that is what happened" to "that *must be* what happened" (which may be dispassionate rationalisation, but will often be wishful or consoling thought), and then further on again to, "that *is* what happened." This is not necessarily, or even probably, dishonesty. The witness may well be perfectly sincere in his belief that what he is stating in a witness statement or in oral evidence is true, having thoroughly convinced himself that this is the case. Of course, it can verge on dishonesty, if the witness has some insight, and is aware of an uncomfortable feeling that what he is saying might not be right, but it can equally be totally subconscious.

794. Also, a witness, and in particular an actual party, is entitled to give as good an account of himself in his evidence as he honestly can. In doing so he will inevitably exercise subjective judgement on the propriety of taking the benefit of any doubt. Some individuals are naturally more self-critical, and less self-confident than others, and people's responses may therefore vary, especially in answer to questions which they feel are illegitimate for being either unfair, or peripheral, or impertinent. Being asked to express an opinion about a colleague, for example, may well come under more than one such head.

795. Second, a witness in an important case will undoubtedly have prepared himself to give evidence. There is nothing wrong with that; any intelligent person, especially a businessman, will prepare himself for any event on which important consequences ride. It is no part of any witness's duty to avoid thinking about material events so as to be able to answer questions with innocent spontaneity. Of course there is a difference between legitimate preparation and illegitimate coaching (see the discussion by Lewison J in *Ultraframe Ltd v Fielding* at [22] – [33]) but, I state with some relief, there has been no suggestion of the latter in this case. Still, though, the court needs to be astute to sense where answers may have been prepared through rehearsal so as to present the most favourable case consistent with the witness's own conscience, and where answers have been prepared simply in the sense of refreshing recollection so as to be ready to deal with matters at the important time, rather than only in forlorn retrospect.

796. Third, even absent any considerations of self-interest or desire which may affect a witness's evidence, there is a natural wish, in most ordinary people, to try to be helpful, and this will often lead a witness to try to give an answer if possible. This can easily lead a witness to state

as fact matters which are really nothing but "helpful" speculation on his part. Ordinary people do not formulate their everyday speech with close regard to the niceties of hearsay and the forensic rules of what constitutes permissible direct oral evidence. They do not punctuate their sentences with accurate qualifications such as "I understand", "apparently" or "is supposed to" but rather they make the assertions of belief as if they are known fact. (As an irrelevant aside, the Turkish language has a verb tense to convey exactly this degree of uncertainty, and is used for reporting a fact, the truth of which the speaker believes but cannot personally warrant. From this point of view, English might be seen as deficient.)

797. All the above considerations can feed into an assessment of a witness's oral evidence and, to some degree, the contents of witness statements, and I have had regard to all of them in my assessment of the witnesses in this case.

798. However, even if a court concludes that a witness has not been totally dispassionate, or even totally candid, that does not mean that his evidence on the topic is to be entirely disregarded. Importantly, even if a witness may appear to have lied as to one matter, that does not mean that he must be assumed to have been lying on every, or indeed any, other matter, or to be guilty of whatever misconduct is alleged against him, or that the evidence of the opposing party is therefore true. This is the essence of the well-known *Lucas* direction in English law.

799. With regard to my assessment of the oral evidence in this case, I need to mention two further matters arising out of the passage of time. The material events in this case occurred between 2006 and 2008 – around nine years before the trial and seven or eight years prior to the eventual formulation of witness statements. As I have said, I accept Advocate Wessels' point that this means that witness recollections are likely to have faded and have become more likely to have been affected by reconstruction, and I will weigh the evidence with this in mind. I observe, though, from the history of the matter, that the Defendants and other material witnesses, will have been questioned about their recollections of events from quite early on in the aftermath. Whilst the possible effects of this for reconstruction have been noted, it also makes it more likely that their recollections became retained from a point much nearer the relevant time than now.

800. A further point, though, is that all witnesses are now eight or nine years older than they were at the material times, and I must take this into account with regard to the impressions I have gained of them from their oral evidence. For most of the witnesses I have concluded that this factor does not make any significant difference, and the impression I have gained of them at the moment is likely to be much the same as the one I would have gained of them at the material time, but for two, I think it may do so. Ms Cosiol, by far the youngest witness, was only 31 at the material time, and was a relatively recent and junior employee within the Carlyle organisation, for which she still works. She is likely to have grown in maturity and confidence in the intervening years. Mr Loveridge is the other. He has retired and, although I understand that he is now only 73, I gained the clear impression that it is more likely than not that he has slowed down in his responses and reactions and suchlike since the time with which I am concerned. These are probably not major points, but I bear them in mind.

801. The second point which I bear in mind is that, as in very many court cases, the matters on which I am focusing were not the be-all and end-all of the protagonists' lives at the time. They were acts and actions being conducted in the wider context of their general life, and other aspects of their business activities. It always needs to be remembered, particularly where a

person's judgment is being retrospectively challenged, that the concentration on the "material" matters which happens in a court case creates the appearance of a context of attention and concentration which is false. There were matters other than CCC occupying the lives and the attention of all the Defendants (though perhaps Mr Stomber less than most, as he was employed precisely to have such focus), and it was not any breach of duty that this should be the case. Of course, at times of crisis crucial matters properly deserve more attention, and it would be expected that the affairs of CCC would occupy a larger part of the Defendants' waking life than at other times, but a party's actions or inactions must be judged against the reasonable background of what was known to him and expected of him at the time, rather than on the assumption that the relevant matters were, or necessarily should have been, the centre of his waking attention, in the way that they in fact will be during a court case.

802. A simplistic, but quite important, example of the tendency to forget this is the fact that the Plaintiffs have continually dropped into the habit of referring to the business of CCC as if it were only ever comprised of investments in RMBS, thereby side-lining the fact that the original business model was materially diversified and deliberately constructed with a combination of leveraged finance assets and RMBS. This case is focused only on the RMBS portfolio and the Defendants' actions with regard to that because that balance was changed, in August 2007, in response to the first financial crisis, but this was not always the case. The capacity for distorting impression arising from a courtroom investigation must not be overlooked.

Missing witnesses – adverse inferences

803. Referring to authority as far back as 1774 for the proposition that all evidence is to be weighed according to the proof which it was in the power of one side to have produced and in the power of the other to have contradicted (*Blatch v Archer* (1744) 1 Cowp 63), the Plaintiffs submit that the Defendants have failed to call at least five "important" witnesses of material fact, whose absence therefore weakens the evidence actually called by them and enables the evidence adduced by the Plaintiffs to be readily accepted, even to the point of the court's drawing inferences adverse to the Defendants upon material points.

804. The five witnesses are Mr Greenwood (CCC's Chief Dealer), who, it is suggested, could have contradicted the Plaintiffs' case with regard to opportunities for CCC to sell RMBS, Mr Trozzo, who could have supported CCC's risk management practices, Mr Green, CCC's former Chief Financial Officer, who would obviously have had knowledge of CCC's financial position, and Mr Rubenstein (a Carlyle co-Founder) and Mr Jeff Ferguson (Carlyle's general counsel) the latter two both, at times, having been involved in matters to do with CCC.

805. The Plaintiffs argue that all these witnesses were available to the Defendants for being "in their camp" as either current officers or employees, or ex-employees who are contractually obliged to cooperate with Carlyle as regards any litigation and suchlike about CCC. They were, it is said, highly material witnesses on essential matters such as CCC's ability to sell RMBS, or at least its perceptions of this, its risk management controls, its appreciation of the potential imminence of insolvency, and, in the case of Mr Rubenstein and Mr Ferguson, the control exercised by Carlyle over CCC, which the Plaintiffs allege and found their case upon, and which the Defendants deny. The Plaintiffs argue, therefore, that once they have adduced evidence sufficient to raise a case on such points (as they submit they do) then CCC's failure to call those witnesses, and the absence of any reasonable explanation for not doing so (which

they submit there is not) bolsters the weight of the Plaintiffs' evidence and indeed justifies the court in drawing inferences adverse to the Defendants on such matters and accepting the Plaintiffs' case.

806. The Defendants first stress that any such principle is a matter of logical inference from the absence of a witness, and it therefore depends both on a *prima facie* case having been established which that witness's evidence could displace, and also, therefore that the witness must be able to give material evidence, with regard to an issue in the case. They rely on Cockburn CJ in *McQueen v Great Western Railway Company* (1875) LR 10 QB 569 at 574, as cited and interpreted in *Wisniewski v Central Manchester Health Authority* [1998] PIQR 324 at 337.

807. They also submit that any such approach has to be applied realistically. In a large and complex case it is important to identify and distinguish (a) issues which are not central in the sense of requiring to be resolved in order fairly to determine the proceedings, and also (b) evidence which would simply be duplicative of evidence given by other witnesses. A party is not obliged to call every single witness who might give evidence about, even, a central issue, but is entitled to make sensible judgments. They cite Rose J in *Libyan Investment Authority v Goldman Sachs International* [2016] EWHC 1538 (Ch) at [51], declining to draw adverse inferences from the absence of certain employees of the Defendants as witnesses "*even though the contemporaneous evidence shows that they were closely involved in the events giving rise to the claim"* and stressing the importance of not causing parties to complex litigation to feel that they may be criticised *"if they do not provide evidence from everyone who is named in the contemporaneous documents. That would lead to litigation becoming completely unmanageable."*

808. The Defendants submit that, applying these principles, such considerations provide a reasonable explanation for not calling the relevant witnesses. In the case of multiple witnesses, only a failure to call the witness whose evidence would obviously be the most cogent or superior might give rise to any such adverse inference. They also point out that a party cannot be criticised for non-selection of witnesses in respect of any issue which only arose clearly for the first time at the trial itself.

809. The Defendants therefore dispute the Plaintiffs' arguments as to the drawing of any adverse inference against them at all. They submit that the evidence of Messrs Rubinstein and Ferguson went, at best to peripheral issues only: Mr Rubinstein could add nothing of value to the evidence of the documents and the other Carlyle witnesses, particularly Mr Conway, and it was Ms Cosiol who did give evidence, rather than her superior, Mr Ferguson, because she was directly involved with CCC. Insofar as the evidence of Messrs Trozzo and Greenwood (in particular, but similar arguments would I think apply to Mr Green also) could have gone further than peripheral issues, there was no issue upon which only they could give evidence rather than Mr Stomber, with whom they worked closely and to whom they reported, or other Board Members. The Defendants dispute, in any event, that the Plaintiffs have in practice called sufficient evidence to make out a *prima facie* case, which therefore requires rebuttal, in respect of the points as to which they now claim that these witnesses should have been called.

810. Finally, they object that, in the case of Messrs Greenwood and Trozzo, the Plaintiffs could have obtained their evidence, but elected not to do so. This is a reference to another series of skirmishes between the two sides, regarding the Plaintiffs' methods of collecting evidence in

the United States. In short and simple terms, the Plaintiffs have sought to obtain evidence from these two witnesses privately, using the power of court orders in the United States, on the basis that their evidence was required for the purpose of the liquidation. The Defendants intervened to object that this was disingenuous and the powers were really being used to gain evidence for the purpose of this litigation, and thereby gain illegitimate litigation advantage. The US courts agreed with the Defendants. However, the Defendants offered to the Plaintiffs that they would procure Messrs Trozzo and Greenwood to co-operate in giving evidence by deposition, on the basis that the depositions were taken, in the usual way, with both sides in attendance. The Plaintiffs declined to depose Messrs Trozzo and Greenwood on that basis, and therefore their evidence was not taken at all.

811. Advocate Wessels' response to this is that the Plaintiffs reasonably objected to the evidence of Messrs Trozzo and Greenwood being taken and introduced into this case by way of the deposition process, because it was not a level playing field. That is because, the Plaintiffs say, the Defendants would be able to talk to Messrs Trozzo and Greenwood beforehand and outside the deposition process; it was not so much that they would therefore know what the evidence of Messrs Trozzo and Greenwood would be in advance and the Plaintiffs would not, but, and not to mince words, that this would enable the Defendants to "prepare" (ie coach) the evidence of Messrs Trozzo and Greenwood to suit their case, an advantage which the Plaintiffs would not have. He also argued that the opportunity to take a written deposition in a one or two hour appointment was not the same, or as good as, the opportunity to cross examine these witnesses orally and at greater length at the trial.

812. However, Advocate Wessels' primary point was that the potential availability of the evidence of Messrs Trozzo and Greenwood to the Plaintiffs as well as the Defendants was beside the point; the real question was: who would you expect to call them? It would (he argues) be the Defendants. And why did the Defendants not call them? He returns to the point that the obvious explanation must be the fear that their evidence would undermine the Defendants' own case as it was being presented, from which the court should therefore infer that that case was known to be flawed.

813. I decline to draw any general adverse inferences from the calling or not calling of witnesses by the Defendants in the circumstances of this case. I thoroughly support the comments of Rose J, in *Libyan Investments Authority* about the undesirability of any decision of the court which could cause parties to proliferate witnesses in a complex case out of a fear that something would be held against them if they did not.

814. I largely accept the Defendants' propositions that the matters as to which the evidence of these witnesses might be expected to go, either at all or as a matter of being the best available evidence, were either peripheral to the real issues, or criticisms raised only as assertion and not with sufficient evidential support to raise a prima facie case. This certainly applies to the cases of Messrs Green, Rubenstein and Ferguson. I also consider that it applies, albeit more on balance, in relation to Mr Trozzo. The Plaintiffs' material case is that CCC's Board failed to authorise or instruct the sale of RMBS when it should have done and CCC's Management failed to advise this. The application of risk management considerations, or the Investment Guidelines as risk management tools, speak for themselves from the documents and the Defendants' actual recorded decisions in this respect, but they are only the context or the consequence of the key impugned decision, which is the decision not to sell. Adding more material to the debate on these subsidiary aspects takes the key issue little further, if anywhere.

In any event, I think I can satisfactorily infer Mr Trozzo's likely attitude, so far as it may be relevant, from the emails and documents in the case. These could be expected to have captured and recorded – and even betrayed - any significant point that he would have made.

815. The witness about whom I have had most misgivings was Mr Greenwood, bearing in mind that, along with Mr Ng, he was directly involved in the implementation of CCC's trading transactions, and therefore actual or potential selling. My concern arises out of the Plaintiffs' allegation that CCC had a wrong-headed or grossly negligent rigid intention not to sell RMBS at all, after about 20th August 2007. This assertion would require not only that Mr Stomber formed, advised or put into effect such an intention, but that he gave instructions to Mr Greenwood (and presumably Mr Ng) not to effect any such sales. The Defendants' evidence about their attitude to selling has been firstly that of their witnesses, especially Mr Stomber, and secondly reliance on the contemporaneous documents.

816. The Plaintiffs criticise, in particular, the way in which CCC dealt with an apparent purchase enquiry from UBS for about $1Bn of RMBS at the end of August 2007, because, they say, CCC did not "show" bonds which met UBS's desired criteria even though it had them, but instead offered bonds with different attributes. They rely on this as evidence that CCC had no genuine intention of trying to sell RMBS. However, the only issue *on the pleadings* has been whether the communications between CCC and UBS at the time – there being no dispute about the facts of these - justified the description "negotiations" as used in the Combined Defences, at paragraph 528: see the traverse in the Amended Réplique (para 222). This was in October 2015. I cannot locate any notification of the expansion of the dispute from being whether there really were any "negotiations", to being that there were negotiations which were intentionally obfuscated because there was no genuine intention to sell RMBS, before the Plaintiffs put this proposition to Mr Stomber in cross-examination.

817. It is only at this point, though, that Mr Greenwood's evidence seems to me to begin to become independently material. This is because Mr Greenwood's evidence as to the instructions he received from Mr Stomber, and presumably followed, would tend to remove speculation on this topic However, it is not the only way of refuting this allegation, which was only highlighted very late in the day.

818. I conclude, therefore, that there are sufficient explanations in (i) the late raising of the point, (ii) its place in a very complex and extensive case, and (iii) reasonable judgments as to the extent of necessary evidence, to justify Mr Greenwood's not having been called as a witness by the Defendants, at least to the extent that there is no justification for drawing any adverse inference from this.

819. However, my decision in this regard is fortified in respect of both Mr Trozzo and Mr Greenwood by history, and by the Plaintiffs' attitude to being afforded the opportunity to take their evidence on deposition (but not in private), and declining this opportunity. I regard their stated reasons for this as inadequate to entitle them, later, to invite adverse inferences to be drawn from the fact that the Defendants did not then, themselves, elicit such evidence. I have recited what happened above. I am not impressed with the Plaintiffs' claimed justification for not joining in the deposition of Messrs Trozzo and Greenwood if the Defendants were also able to participate, namely that this would allegedly not be an even-handed process because the Defendants could discuss their evidence beforehand with Messrs Trozzo and Greenwood, but the Plaintiffs could not. I find that an absurd and colourable

excuse. What the Plaintiffs were really trying to do, and they appear to have tried in other contexts, was to obtain evidence privately, no doubt taking whatever advantage was available from an opportunity to be in sole control of the questions, and then assess whether or not it would suit their case to deploy the evidence at all. This shows just as much lack of confidence in the prospect that the evidence of Messrs Trozzo and Greenwood would be likely to support the Plaintiffs' case as could be inferred in the opposite direction from any failure of the Defendants to call those witnesses as additional support for the Defendants' case. No adverse inferences are therefore justified.

820. The Plaintiffs also add a criticism of the absence of Mr Black of JP Morgan, to give evidence about the "significant" meeting between himself and Mr Conway and Mr Stomber on 20th August 2007, as to which these latter both gave evidence. This is somewhat ironic, as it was the Plaintiffs who were keen to elicit Mr Black's evidence, but whose efforts - notably late in the day - to obtain this through the Letters of Request procedure from the Royal Court to the English High Court were aborted, and withdrawn by them when lawyers for Mr Black intervened and objected that he had only ever spoken (to the Plaintiffs) on the basis of a categoric assurance that he would not be called to give evidence. The Plaintiffs' criticism was then made on the more subtle – although so oblique as now to be irrelevant – grounds that the Defendants had raised objections to their attempts to use the Letters of Request procedure at all. I find nothing to which I should give any weight in any of this.

821. The Plaintiffs have added a further criticism of the allegedly "remarkable" absence of any representative from any of the repo lenders with whom CCC had done business, suggesting that, with Carlyle's extensive business influence, their absence must suggest that they could give no evidence to assist CCC. This suggestion strikes me as fanciful. CCC's repo lenders are mainly creditors with claimed debts in CCC's liquidation. They also no doubt have their own embarrassments about what occurred in the financial markets of 2007-8. Mr Black's obvious aversion to giving evidence suggests that very strongly. There are many and varied reasons why, in a business world in which information, relationships, both business and personal, the doing of favours and the trading of advantages plainly plays a large part, it may be either difficult or unwise to try to seek out witnesses from others in that business world. I can draw absolutely no fair inferences from the fact that the Defendants chose not to proliferate witnesses further in this action, in that direction.

822. For the sake of balance I should add that these arguments and submission were not all one-sided. The Defendants also made a submission that I should draw adverse inferences against the Plaintiffs from the fact that they had failed to call a Mr Reijtenbagh, who was present at the Carlyle Investor Conference in Washington in September 2007, to substantiate the disputed allegation that investors there were misled by CCC's senior directors to the effect that CCC was going to, or indeed had already, deleveraged significantly. Mr Reijtenbagh is a wealthy former investor in CCC, who appears to be the funder of this litigation for the liquidators. The application was not, however, seriously pursued, and it seemed to me to be made more out of irritation than conviction. As I would have rejected it anyway, I say no more about it.

823. Lastly, I must add, as regards the impact of the decisions above, that my declining to draw adverse inferences does not, of course, mean that I draw any artificial inferences at all in the opposite direction. It just means that the evidence is what it is, and I weigh up the actual evidence on the topic which is before me in order to make any material finding of fact on the consequently apparent balance of probabilities.

Missing questions – adverse inferences

824. The Defendants have objected, at times, to matters not being put to witnesses, and referred to evidence being "unchallenged", with the implied or express consequent submission that the evidence of the particular witness must therefore be taken to be accepted and thus believed at face value. The Plaintiffs retort that in a case of this length and complexity the court must apply a measured and proportionate approach to the rule in *Browne v Dunn* (1893) 6 R 67 that

> *"where a party intends to challenge the evidence of a witness, the challenging party is obliged to direct the attention of the witness to that fact."*

825. They submit that the rule must be more relaxed where the case is complex such that challenging every disputed factual pronouncement by every witness would disproportionately increase the length of the trial, or where cross-examination is subject to time limits, or where there are other more central witnesses who deal with the point, or where it is perfectly plain from other sources, such as the pleadings, that the witness's evidence is in dispute. The Plaintiffs say that all these features apply in this case, such that the rule in *Browne v Dunn* cannot or should not be applied, certainly in its full rigour.

826. I accept the Plaintiffs' submission, but in my judgment this is not an all or nothing point. It is simply a point of fairness and a matter of degree. The rule is based on the principle that a person should not have adverse conclusions drawn against him without knowing that he is at risk of this, and having a fair opportunity to deal with the challenge or criticism. The court is not, in fact, bound to accept the evidence of a witness simply because it is stated and is not directly disputed. Whether the court will do so is a matter of impression, weight, and balancing all factors relevant to doing so – in other words, whether it is reasonable to do so. Absence of cross-examination will simply be a factor feeding into this balancing exercise. Failure to cross-examine on a centrally relevant point of evidence, especially in a relatively simple case, will carry more weight than failure to cross-examine or challenge on a more peripheral one. It will also carry more weight where there was cross-examination on other peripheral points, especially if limits on time are then prayed in aid to mitigate the effects of absence of cross-examination. The decision whether or not to cross-examine on any particular matter is a decision for the cross-examiner.

827. I draw attention, however, to the fact that the rule does not require that a cross-examiner "put his case" to the witness, as it is often inaccurately paraphrased, but requires that he must direct the witness's attention to the fact that his evidence in a particular respect will be challenged. It follows that the excruciating cross-examination question "Do you agree Mr X that when you did Y you were guilty of gross negligence" is as unnecessary as it is forensically absurd.

The witnesses of fact

828. I give below my impressions of the witnesses of fact as they gave evidence to me, as this will assist in understanding my decisions but I preface these comments with some further general observations.

Defendants' factual witnesses

829. The main witnesses of fact in this case were, unsurprisingly, all on the Defendants' side. The Plaintiffs make sustained and aggressive attacks on the evidence of all these witnesses, as to

both the witness's integrity and his/her reliability apart from integrity. Whilst I will not ignore the points made, I have found them to be generally excessive, often unfair and usually tediously overemphatic in their language. The Plaintiffs' characterisation of any partial recollection by a Defendant or their witness was routinely "selective memory" or "reconstruction" where it was adverse to the Plaintiffs' submissions, and "candid" where it was not.

830. All the witnesses who gave factual evidence for the Defendants were obviously intelligent, highly-qualified, successful and generally articulate. Their very positions attest to their capabilities. I therefore do not repeat such comments in relation to each of them individually. Having said that, however, differences of personality were apparent and I state my impressions where these have informed my assessment of their evidence.

831. I will also again say generally, at this point, that I formed the view that all of the Defendants' witnesses of fact were basically truthful and conscientious, although there were some points of concern, which I will mention. It will be apparent from my initial remarks about the factors in assessing oral evidence that the fact that I find a witness truthful does not necessarily mean that I accept their evidence as fully accurate and reliable.

Mr Conway

832. Mr Conway had made a 157 page witness statement and gave oral evidence for six days. As one of the original founding partners of the Carlyle group, within whose general area of investment responsibility CCC's activities fell, he was both a voting director of CCC and, I find, the pivotal oversight link between the Carlyle commercial organisation and CCC. An important issue, of course, is whether his position and influence was more than that.

833. The Defendants stress Mr Conway's impressive financial background and achievements in a global context. Whilst I accept the breadth of experience and expertise which this has no doubt given him, I am here concerned, nonetheless, to examine his conduct as regard the particular facts and circumstances of CCC.

834. The Plaintiffs assert that the evidence showed Mr Conway to be a "*strong, determined and dominant character*". I would not dissent from the former two, but Mr Conway certainly did not strike me as being the last, although I might have accepted "forceful". I saw no sign of an overbearing personality underlying his oral evidence, even over six days, and I did not see within the papers, either, any signs of overbearingness, as contrasted with firmness where appropriate (for example in dealing with a quarrel between Mr Stomber and Mr Zupon), and a forthright expression of opinion in discussion.

835. The Plaintiffs criticise Mr Conway as a witness giving oral evidence, for having a highly selective memory, tending to be evasive, and being allegedly inconsistent with his witness statement. They therefore submit that his evidence is unreliable, at any rate in respects which supported his own position.

836. I find little to justify these attacks. As to selective memory, this was asserted especially with regard to meetings with CCC's repo lenders of 20th August 2007, and in particular as regards what was said by Mr Black of JP Morgan. In fact, I found Mr Conway's account of what he remembered and the reasons why he remembered particular aspects of such meetings but only those aspects, to be not only plausible but actually quite likely, and to have the ring of truth.

The example of "evasiveness" concerned Mr Conway's declining to attempt to give, in the witness box, details of when other business models for CCC which he said had been prepared "periodically" had actually been prepared. Such a criticism is unfair. A witness is perfectly entitled to make a statement of his recollection as to what happened in general terms, even if he is unable to give chapter and verse detail and does not want to do so because it would not be honest or potentially accurate, to do so. This is frequently the state of a perfectly honest witness's mind. The lack of detail then simply becomes a factor material to assessing what weight can be given to the general assertion, assessed in the context of all other relevant evidence. It is not a necessary conclusion from a witness's failure or refusal to give a categoric answer to a question that he is "evasive". It may well be that he just cannot honestly do so.

837. As to being inconsistent with his witness statement, I will of course judge whether any such suggested inconsistency reflects on the quality or reliability of a witness's evidence, and if so how far. Given the quantum of written evidence and the length of cross-examination, it is not at all surprising to find that there may be points in different parts of Mr Conway's evidence which can be contrasted and suggested to be inconsistent. I will evaluate the significance of any apparent inconsistency in its full context.

838. In fact, though, to help myself gauge the strength of these inconsistency criticisms, I considered the two examples suggested by the Plaintiffs. The first concerns Mr Conway's allegedly inconsistent views of the "significance" of moving CCC's investment guideline on minimum borrowing capacity from an intended 150% of actual requirement to 125%. On examination, however it seems to me that the "inconsistency" is reasonably explained by the fact that in his witness statement Mr Conway was focusing on CCC's "investment strategy" (in regard to which the "alterations" were not "significant",) whereas in his oral evidence, the question which he was addressing was focused solely on the quantum of change in the investment guideline itself, as to which he accepted the word "significant", put to him by the cross-examiner, as being appropriate. I also observe that the Plaintiffs failed to include the following words of Mr Conway "*I think it was significant, but it was also a recognition of reality as opposed to a significant change that was being made*" which seems to me not only to be a qualification to the tenor of what he had just said, but also to tie his meaning back very much to what he had said in his witness statement.

839. The second example concerned discussion about the use of the word "high" in the context of the "price" paid by Carlyle to gain assistance for CCC's position from Citibank in August 2007. On reading the passages in the evidence and contemporaneous documents, and considering the different circumstances and purposes for which those statements were made, this criticism seems to me to be greatly overstated if, indeed, there is really anything in it at all.

840. Mr Conway gave evidence with assurance, dignity and unfailing courtesy throughout. Just occasionally, the odd spark of what I have no doubt is an underlying steel in his personality showed through – for example, when faced persistently with pressure to agree with propositions which he felt he had already dealt with several times, or when asked a question with an embedded assumption with which he had already said he did not agree. He had plainly prepared thoroughly for the task of giving evidence, both so as to master the material in the case and also as to how to best to present what he said, but, as I have said, preparation is not the same as contrivance and I am quite satisfied that this was part of his natural approach to doing any job as thoroughly as possible. His answers were occasionally laconic, but I did not

find them evasive. The fact that he at one stage reminded himself audibly that he should give "*the shortest complete correct answer*" to my mind showed transparency rather than deviousness. Mr Conway was plainly determined to give the best account of himself possible, but, I judged, with due regard to propriety and the "rules" of a court case. This was perfectly reasonable.

841. I formed the clear view that Mr Conway is a pragmatist, but an honourable one. I assess that he seeks to conduct his business relationships fairly, as he sees it, but also firmly and without sentimentality. There were signs within the correspondence that others with whom he dealt saw him this way. I have no doubt that he will be generous and accommodating where he can afford to be - he has found business relationships to work out for the best in that way – although he could probably be firm to the point of ruthlessness where necessary, but it is a matter of honour that he will keep his word and perform his obligations. He expects others to do likewise. Mr Conway is astute, and I think has an instinctive perceptiveness about human nature, but he is also a realist. Such qualities, together with a natural charm, mean that he is quite plainly a man who inspires loyalty. I accept that they also make it important for me to be careful to look behind any veneer to his evidence, and I have done so.

842. Mr Conway was obviously very quick thinking and I was particularly impressed with his ability to retain in his mind the general picture of events, so that even when he was being asked questions focused on one particular aspect, he could remember the bigger picture and refer back to other points where these suggested qualifications to either the questions or what would be literal answers. His responses were open and fluent, and although there was the odd moment when he appeared slightly uncomfortable or embarrassed (it would have been surprising if there had not been, during 5 ½ days of cross-examination), I am quite satisfied that he gave me honest and sincere evidence, albeit no more expansive than his oath required. He plainly possessed the self-discipline not to volunteer more than necessary to provide the shortest complete correct answer.

843. That is not to say that I have had no reservations about his evidence. I was unconvinced by his profession not to have found Mr Stomber's relentless production of emails at all irritating, and I felt that his expressions of unqualified support for Mr Stomber were somewhat mechanical. The fact that I found his evidence difficult to accept unreservedly on some minor matters does not, though, detract from my overall acceptance of his evidence on central matters as being honest, having the ring of truth, and likely to be a reasonably reliable recollection.

844. I have in this instance recorded my consideration of the Plaintiffs' criticisms of Mr Conway as a witness in some detail. This is to give a sample of such criticisms, and an illustration of how I have approached them, especially in regard to one of the two most significant Defendants. I will not do the same in respect of every individual criticism made against other witnesses, because it would be disproportionate to do so. I will be stating my conclusions in more general terms, and give any detail only in respect of points which I have found of real significance.

Mr Stomber

845. Mr Stomber had made two witness statements totalling 230 pages, and he too gave oral evidence for six days. Although not a voting member of the Board, he is probably the focal Defendant in the case even more than Mr Conway, through having been the CEO and CIO of

CCC, and also in overall charge of its investment decisions and day to day management through his position with CIM.

846. It was apparent from the outset of his evidence that Mr Stomber felt the weight of this central responsibility. It also emerged in the evidence that he had been maintaining his position at CCC in the context of some friction with the other non-voting director, Mr Zupon, clashing with him both as to authority and personality.

847. The Defendants stress Mr Stomber's extensive Wall Street experience, in particular in fixed income bonds, and including at Merrill Lynch, as I have already mentioned. The Plaintiffs point out that Merrill Lynch was nearly brought down at the same time as CCC.

848. In their closing submissions, the Plaintiffs appeared to mount a sustained attack on Mr Stomber's competence generally, as well as upon his reliability as a witness in the case. As to the former, they suggested that Mr Stomber did not really understand the markets in which CCC was operating, had far less relevant experience than he had led his fellow directors (and the court) to believe, and specifically had no experience in managing a highly leveraged portfolio of Agency RMBS bonds using 30 day repo finance. They suggested that Mr Stomber had operated under a misapprehension as to the "standard" rate of haircuts for such securities in such repo transactions, failing to distinguish between rates for leveraged and unleveraged portfolios and between "customer" rates for bank to client transactions and "dealer" rates for interbank transactions, because he had been involved only with the latter in each case. The Plaintiffs expressly asserted in written submissions that "*[his] previous experience was not apposite for his role as CEO, CIO and President of CCC*".

849. The ramifications of this suite of criticisms went far further than anything either pleaded in the Cause, or even put to witnesses. Only one point directly pertinent to these submissions had been put to Mr Stomber, that being as to whether he had inverted the pre-2007 recognised standard rates of repo haircut for floating and fixed rate securities (at 2% and 3%) in one paragraph of his witness statement. He had disagreed. However, the implications of this suggestion, if he had indeed done so, would have undermined CCC's entire business model from the outset, going far further than any pleaded claim. The suggestions regarding his previous experience also implied either that he had obtained his post by misrepresentations, or that it had been negligent of those promoting CCC in its early days to hire him at all.

850. In his oral closing submissions, and in answer to direct questions from the bench, Advocate Wessels drew back from these extreme and unheralded assertions made in his written closing submissions. He confirmed expressly that the Plaintiffs were not alleging either that CCC's original business model had always been flawed or that Mr Stomber had been insufficiently expert to have been the appropriate hiree for his position. Whilst, as I understand it, they maintained their criticisms of some of Mr Stomber's evidence about technical aspects of the repo and financial markets, and suggested that the court could have no confidence, therefore, in the value of Mr Stomber's evidence or judgment in technical matters when otherwise unsupported, they relied on events and matters prior to July/August 2007 only as knowledge and information which the Board had before them when they came to take the decisions of which the Plaintiffs do complain. They confirmed that 26th July 2007 was and is the starting point of those complaints.

851. I have therefore proceeded on that basis. I observe that the force of many if not most of the points of criticism of Mr Stomber's technical evidence is much reduced by the fact that they

were raised only by reference to supplemental expert evidence, produced many days after Mr Stomber's cross-examination had concluded and he had been released and gone home.

852. As regards Mr Stomber's credibility as a witness of fact, the Plaintiffs again submitted that he had been highly evasive, confused and confusing, suffered variously from selective memory and selective amnesia, and that he had to spend most of his evidence trying to explain away what he had written in contemporaneous emails. I can see some reason for these points being raised, as I will explain below, but in the end, I find this criticism to be overblown.

853. Mr Stomber struck me as studious, energetic and hardworking, but also highly strung (a description in fact volunteered by Mr Hance), somewhat awkward, and not strong on tact and diplomacy. I also think he was rather aware of this last. Mr Stomber is, metaphorically, a street-fighter, (Mr Sarles, an experienced banker, saw him having the character of "a trader"); he is dogged and tenacious. In the right place this will produce results, but his natural business style is blunt and confrontational, rather than emollient or persuasive. At the same time he seemed to me to be a self-critical person, and a natural worrier, who therefore constantly needed to reassure himself by achieving objectively demonstrable good results, and receiving the approval of others, especially those of higher rank in the workplace.

854. As a result, he is absolutely driven in his work. I accept the Defendants' submission that he "gave his all", although that point is not particularly material in the case.

855. Mr Stomber's desire for approval and confirmation of his views and actions, express or implicit, leads him to be remarkably open and informative about what he is doing, both to his peers and to his superiors, to a degree which I suspect others find excessive but are largely too polite to say. His wish to impress others, but also to appear to be confidently relaxed, also seems to me to have led him into a style of communication which is frequently either extravagant, or colloquial, or both. He does not use direct description where a metaphor will do. He is knowledgeable, but is also not adept, when recounting a matter, at sensing the degree of detail which is comfortable for his audience. Mr Loveridge said that he "spoke in riddles". Having seen both of them give evidence, I can well understand this comment.

856. Mr Stomber certainly did not always express himself clearly in cross-examination, and his evidence did tend to be discursive. This was partly because, it seemed to me, he would quickly think of many fairly refined aspects of an answer to the question, and his mind was jumping more quickly through these than he was able to express with clarity. It was also, I am sure, because of an unsurprising nervousness, a tense concern to be accurate, an awareness of the weight of responsibility which he felt hung on him, and the pressure of being a Defendant in this action, but fundamentally because his natural manner is discursive in any event. At first, and again unsurprisingly in the circumstances, he was defensive even to the point of truculence. However this initial bristliness eventually gave way to weary resignation, and Mr Stomber grew ever more obviously (and I am quite certain, genuinely) extremely tired towards the end of each day of his cross-examination. I have no doubt that he found giving evidence very, very stressful, not just as an exercise in itself but also because of having, as a result, to re-live a period which has probably been the most embarrassing in his professional career.

857. I equally have no doubt, though, that he was an honest witness, and I formed the view that his capacity for self-doubt was greater than his capacity for self-serving reconstruction. Although there might have been hints of the latter, I do not think it was conscious. However, with the way things have turned out for Mr Stomber, I am sure that he will have gone over his evidence

again and again, seeking to reassure himself that he did nothing wrong and that his judgments were right at the time. I shall therefore have to bear this in mind and ask myself whether, sincere though I think he was, he has actually rationalised his answers to uncomfortable questions to any material degree.

858. I will note here one matter which the Plaintiffs emphasised as a "*stark*" and particularly telling point against Mr Stomber. They submitted that he had admitted that he had been caught out in an assertion that he had never produced a new proposed business model for CCC which acknowledged that it required a liquidity cushion calculated at 40%, when he was then shown an email of his of 7th September 2007 to Mr Conway which appeared to say exactly this, and had responded "trapped in my own language". I have re-read the several pages of relevant transcript with regard to that, and I do not endow it with the significance which the Plaintiffs suggest it bears. The appropriate place to explain that, though, is later on, in its context at the time.

Mr Hance

859. Mr Hance had made two witness statements totalling 132 pages, and he gave oral evidence for four days. He is an accountant by training with 17 years' initial experience at PwC, followed by a short spell taking over, improving and selling on, a food services company. Thereafter, in 1985, he joined North Carolina National Bank which subsequently became Bank of America. There, ultimately as CFO and a Board Member, Mr Hance oversaw the management of the Bank's own portfolio of about $400Bn of fixed income investments, consisting mainly of Agency RMBS, and itself leveraged (though only in the teen ratio). He had retired from Bank of America in 2005. In 2007 he held directorships of five other publicly listed companies apart from CCC, two being REITS and the others being respectively in energy, telecommunications and manufacturing This gave him significant broadly-based Board experience; it was never specifically suggested that his other directorships interfered with his devoting a proper amount of time to CCC's affairs.

860. Mr Hance has an affable manner. He gave evidence calmly, clearly and courteously. Indeed it seemed to me that at times his natural courtesy even led him to "accept" things out of politeness to the cross-examiner, rather as one would in a social context. Mr Hance seemed to me to be very willing to be direct, and also very anxious to make himself clear. He was plainly trying to make his evidence as comprehensible as possible to those outside his sphere of familiarity and expertise. He called on his experience both in banking and also as an auditor, from his work for PwC.

861. Mr Hance struck me as a practical man, and I judged that whilst he would certainly do a job properly, he was not disposed to over-complicate matters. He would do what was necessary to achieve the proper or intended result, but would not extend this. By this I am not intending to suggest that he shirked anything, or was disposed to take a narrow view of what matters it might be necessary to consider when making any decision, but simply that he believed in efficiency and had a good judgment (and the confidence to apply it) as to what effort and work was needed, and in what direction, in order to move a project forward and guide it to success.

862. He seemed to me to value and to be proud of his independent status, and I noted that he had chosen to be a consultant adviser with Carlyle rather than becoming a direct employee. From the evidence, I gained the impression that he was both seen and made use of as something of a man-manager and elder statesman. I also find that he saw that as an important

part of his role as Chairman of CCC, especially to help manage the very differing, and sometimes clashing, personalities of Mr Stomber and Mr Zupon.

863. The Plaintiffs' criticisms of Mr Hance's credibility were few and, I find, insubstantial. I find Mr Hance to have been an honest and measured witness in whose evidence I can have confidence.

Mr Zupon

864. Mr Zupon was the last of the Defendants to give evidence. He had made a witness statement of 67 pages, and gave evidence over 2 ½ days, although originally scheduled for four. Mr Zupon had left Carlyle a year after the events with which I am concerned to form his own business.

865. Whilst he had been involved with CCC's investments at the outset – through CIM he was supervising that part of CCCs' investments which comprised leveraged finance assets – once it was decided to sell these in order to raise liquidity he no longer had such a function and he had already been rather distanced from the overall management of CCC by his personality clash with Mr Stomber. However, he remained an advisory member of CCC's Board, even after his own particular area of expertise had disappeared.

866. Mr Zupon struck me as a naturally serious man (I do not think his seriousness was caused entirely by giving evidence) with a quick and incisive brain. I can see also that he was a very talented technician in his chosen business speciality. His explanations of concepts, when requested, were very clear. He appeared, and again I think this was his nature rather than simply a reaction to giving evidence, to be very logical and methodical.

867. Whilst I did not find him evasive or unwilling to co-operate, his demeanour was guarded. He gave evidence extremely carefully; of all the witnesses he was the one who took most care to inform himself thoroughly - as he was perfectly entitled to do - about the context of any question put to him, by reading the document or the relevant exchange of emails quite widely before giving answers. I have no doubt, both from observing his manner of approaching giving evidence and from the contemporaneous records of his questions and interventions within the documents, that the taking of such care was also applied to his work.

868. Mr Zupon had, he admitted, very little actual recollection of the meetings and events on which he was questioned, but he would still express a view as to what happened - although when this was pointed out to him, he did co-operate in trying to identify where he was providing his belief rather than memory, and this seemed to me to apply to much of his evidence. Where he could really add nothing to the documentary records, though, he would say so, and this was in fact the pattern of his answers, rather than a statement simply of having "no recollection", which was what other witnesses tended to say. Where Mr Zupon did say that he had actual recall, his evidence seemed to me to carry conviction, and whilst I am conscious of the dire warning from the *Gestmin* case about the fallibility of memory expressed with conviction, I nonetheless found his answers to be generally persuasive, in context.

869. Mr Zupon gave evidence with self-possession and dignity. I am quite satisfied that he did so with his focus on giving a proper and accurate account of what he could remember (where he could do so) or what he genuinely thought to be the case, rather than with any second-guessing of the effects of his evidence. He clearly found the process of giving evidence somewhat

bewildering and frustrating. I gained the impression that he viewed his witness statement as being like a report for presentation, and had therefore imagined that cross-examination would be a question and answer session simply checking out or elaborating its contents. Not, perhaps, having realised how far the point of cross-examination is to challenge and tease out flaws in written evidence, he was bewildered by the randomness and (he felt) repetition of some of the questioning.

870. After two days, this frustration overflowed into a protest that he was feeling that most of the questions were designed to trap him into making admissions or being inconsistent with evidence which he had already given. In the particular incident he protested that the answer to a question which he had not been able to answer when it was put to him was clearly apparent from a document to which he was referred, shortly afterwards but in quite a different context, and that this was not fair.

871. It did not seem to me that his cross-examination had been unfair, given the testing nature of cross-examination, although it did seem to me that it had at times been opaque, and that in the particular instance, a misunderstanding about the basis of the various questions put had some justification. Advocate Wessels agreed, therefore, that he would indicate, as he went along, the topics of questioning to which he was moving so as to enable Mr Zupon fairly to turn his mind to that topic, and that he would put the point of his case sufficiently directly to Mr Zupon to make sure that he had the opportunity to comment. After that, cross-examination proceeded more quickly and efficiently. I mention this incident for what it told me about Mr Zupon's readiness to stand up for himself when necessary.

872. I found the Plaintiffs' general criticisms of Mr Zupon to be minor; and I regard Mr Zupon as a reliable witness, whilst making due allowance for his admitted lack of direct recollection.

Mr Allardice

873. Mr Allardice was the first of the independent directors to give evidence. He had made a witness statement of 87 pages and gave evidence over four days. His background experience and qualifications have already been mentioned.

874. Mr Allardice is forthright and this was certainly his style in emails. He was initially somewhat stiff and defensive in his oral evidence, but when he later relaxed, he showed a dry sense of humour. His evidence was politely precise once he got into his stride. He was well able to give a good account of himself, especially once he was reassured that giving evidence was just a process of recounting what he recalled, rather than being a memory test. He gave evidence as a man who had mentally rolled up his sleeves and prepared for battle, and I certainly gained the impression that "battle" was very much how he saw this case. He was the only one of the Defendants who I felt was consciously attempting, in his evidence, to paint a particular picture of himself. The picture he wanted to portray was that of the common-sense, practical evaluator of CCC's situation, both in his own thinking and when contributing to discussions with fellow board members. I find this picture to have been a fair one.

875. Mr Allardice is, I am satisfied, a man of energy, who prides himself on focusing on practicalities rather than on the theoretical. He emphasised that his approach to his role was always to try to see what was really going on behind the "distractions" of what people might be saying. He also explained that his approach to being an "independent director", and in particular Chairman of an Audit Committee, was to try to see everything - problems,

transactions and projections - in terms of their actual effects in cash terms, this being what he saw as the key function of any business. He portrayed himself (and I accept this) as a "figures" man, who likes to try to work out the cash implications of matters being discussed, as a frame of reference. He in fact illustrated this in the witness box and when he did so, I felt that it did carry the ring of naturalness. He said that he was generally cautious. He was ready and able to see the worst case, and think about its implications; he was not a man to "count chickens".

876. Mr Allardice clearly regarded himself as the most senior of the independent directors, no doubt because of his role as Chairman of the Audit Committee, and he translated his position as an "independent" director into the dual functions of injecting an outside pragmatic overview into the discussion of situations presented by Management, and of maintaining a detached presence in and around CCC, available to act as a sounding board where day to day issues might benefit from outside assistance to resolve. He had a close relationship with Mr Stomber through being a previous colleague, and he said (and I accept) that they would visit or speak with each other weekly, as well as communicating generally in emails. It is also plain from the evidence that Mr Allardice – very creditably - took an active and energetic part in CCC's affairs. He was certainly the most active of the independent directors.

877. I am not confident that Mr Allardice's actual memory is that good; he did frequently admit to lack of recollection, but I am prepared to accept that this was genuine and not convenient. I accept broadly that his evidence was a conscientious attempt to do his best to say what he remembered, but I do have some reservations about the confidence with which I can view parts of his evidence.

878. The Plaintiffs' criticisms of Mr Allardice's evidence (except in the respects which they regarded as supporting their case) were their usual ones of having selective memory and being evasive, and also moving into advocacy for the Defendants' cause rather than giving evidence. These broad complaints do not cause me seriously to doubt Mr Allardice's evidence or his reliability. It is only natural that some witnesses start giving longer and more assertive answers when they have gained confidence in dealing with cross-examination.

879. There is, however, one matter which has caused me real concern, and this is Mr Allardice's evidence with regard to PwC's positive assessment of CCC as a "going concern" in November 2007, which the Defendants naturally rely on as support for their own views and case that CCC was not seen as being terminally vulnerable by its own auditors. There was a long standing and rather prominent issue in the case as to the fact that PwC had given an "independent" revaluation of CCC's RMBS assets for the purpose of their review of CCC at the end of September 2007, and had reached the rather remarkable conclusion that this check valuation of a $22Bn portfolio of bonds was within $72 of the valuation placed on the portfolio by CCC itself. The Plaintiffs argued that this was so extraordinary as to be incredible, and that this was so obvious that the Defendants could not reasonably have placed any reliance on it as a properly "independent" confirmation of that value. The obvious conclusion was that PwC must have, at best, gone to the same source of valuation as CCC had and simply recomputed it, or, at worst, had simply accepted unquestioningly, and recomputed, CCC's own valuation.

880. Mr Allardice gave oral evidence immediately after Mr Reville of PwC, who had explained something of PwC's methodology and practices for making a "going concern" assessment otherwise than at a company's full year end audit, but who (the Plaintiffs had suggested) had

not been able to give a convincing explanation for the remarkable small discrepancy, except to deny that it was extraordinary, and to assume that it was the result of difference in the rounding of figures on a spreadsheet. Mr Allardice denied that he had been following Mr Reville's evidence through the transcript service. Nonetheless, on the third day of cross-examination, Mr Allardice was questioned about his own reaction to the supposedly independent revaluation.

881. In response, he gave an elaborate description of his thought processes of noting and reacting to the remarkable fact of this very small discrepancy, and how it might have come about. He said that he had requested sight of the underlying spreadsheet data from PwC, but to make his own assessment of it rather than ask them to explain what they had done. He had, he said, concluded that the facts of both a difference and its remarkably small size would be the result of an exercise of gathering information independently from dealers, because actual prices of the individual bonds, in $1,000 units, might run out to six or more decimal places but be very close to each other (because, he had reasoned, differences between dealers' prices would be very "tight") but they were only given to four decimal places on the relevant spreadsheets, thus producing apparent identicality in places but otherwise with rounding differences which were a plausible explanation for a $72 aggregate difference; there would have been quite a number of instances of rounding, operating in different directions, in the valuation of 165 separate parcels of bonds, such that an overall net effect of a mere $72 was not so remarkable as at first sight it might seem.

882. Not only, though, did Mr Allardice explain the several stages of the thinking which he said he actually carried out at the time, but he also testified to having a definite recollection of having spoken to Mr Reville about the PwC valuation, in order to try to understand the reasons for both the fact of the difference at all, and its remarkably small size.

883. The Plaintiffs point out, correctly, that none of this account of his thoughts appeared in Mr Allardice's witness statement, nor did he make any second witness statement when (they suggest) its materiality must have become obvious, nor did he seek to add it when invited to make any amendments to his evidence prior to confirming his evidence in chief in the witness box. Neither was there any mention of his conversation and query to Mr Reville in his witness statement. Mr Reville also had not mentioned it, and had, moreover, been absent on his honeymoon around the time of the 13th November Board Meeting, to which Mr Allardice had connected it. The Plaintiffs therefore invite me to disbelieve this account as untruthful, and consequently to view all of Mr Allardice's evidence with scepticism insofar as it is self-serving.

884. I have to say that I find this evidence, as given, implausible. I accept that in the course of sharpening up minds in preparation for giving evidence, people do remember things which they may not have thought about before, or may have dismissed as unimportant. However, I also accept the Plaintiffs' point that it is remarkable in the extreme that this process of elaborate thinking and appraisal took place and yet Mr Allardice did not recollect any of it before preparation for giving oral evidence, and did not, even then attribute sufficient importance to it to make sure that it was introduced as part of his evidence in chief. I cannot therefore accept that Mr Allardice did give the degree of critical thought which he now says he gave to satisfying himself that there was a good explanation for the remarkably close "independent revaluation" of CCC's portfolio by PwC. I find that no more than general cursory thought was given to it at the time, and I also find that the "recollection" of having

spoken to Mr Reville about it to try to understand how the remarkably minor discrepancy came about, is no more than wishful reconstruction in reaction to pressure.

885. I accept Mr Allardice's evidence that he noted the $72 discrepancy. I have therefore asked myself whether the implausibility of his evidence as to what he then thought about it is simply the result of his own analytical approach, ie that in trying to articulate what was, in reality an automatic and semi-intuitive reactionary thought process at the actual time, he has over-elaborated on the detail of what such a process "must have" involved. However, having heard, and later read and re-read very carefully his oral evidence on this topic, which lasted about 45 minutes, I am regretfully unable to reach this conclusion. The thinking which he describes is a far too structured "due diligence" exercise simply to be explicable as the verbalisation of a general mental appraisal.

886. I am quite sure that Mr Allardice considers that reliance on PwC's audit conclusions was reasonable. I think it most likely that, having become aware of the criticisms made of his (and others') doing so, he has subsequently looked again at the detail on the spreadsheet, and constructed a thought process which could reasonably have taken place and would, if it had taken place, have provided a reasoned justification for a reliance on it, - even though in fact it did not take place because at the time he gave the matter rather less attentive thought than this. His later thinking therefore became a progression of thoughts as to what could have happened, becoming what "must have" happened and metamorphosing again into what did happen.

887. I regret to say, though, that I also think that Mr Allardice did have some insight into this being what he was doing. I did not feel that Mr Allardice was entirely at ease when giving his explanations, and I noted that his words seemed quite oddly chosen in places, eg

> "*when I prepared the witness statement and then subsequently to all this preparation thought more about everything to prepare myself here, and it was clear that the $72 led me to have a discussion with John Reville and to want to look at the underlying materials….*" (emphasis added).

888. This is not an expression of later recollection, but of rationalisation. I find that the combination of his underlying views that (i) reliance on PwC had been reasonable, (ii) the approach which he described could in fact have happened and would certainly have justified it, (iii) the Plaintiffs' liberal criticisms of the directors of CCC in this case are unfair, and (iv) the action is a battleground, led him to feel a kind of justification for levelling the playing field by putting forward the more favourable reasoned picture which he painted. However, whilst, having had it explained to me, I can accept the logical reasoning behind this picture, I just do not believe that it is what actually happened.

889. This point must undoubtedly have an effect on my views of Mr Allardice's credibility generally. It has caused me to look very carefully and critically at his answers to consider whether or not they may be affected by *ex post facto* rationalisation. The incident itself is not, however, of direct impact on any of the points which are crucial to the case.

Mr Loveridge

890. Mr Loveridge was the second of the independent directors. His witness statement was a mere 52 pages and he gave evidence over two days.

891. Mr Loveridge is now almost entirely retired, having sold his business and retired formally in 2002, but being wooed by former clients to remain on their various boards for a time. He struck me as one of the "old school" of trust professionals, with the conservative, low key and traditional approach of that background. He was plainly not of the same school of "cut and thrust" business executive as were the other individual Defendants.

892. Mr Loveridge was extremely nervous at the beginning of his evidence, and was very anxious to explain to me that he is 73 years old, has a bad memory and that the events about which he was being asked to give evidence took place more than eight years ago. His evidence certainly lacked the incisive quality of his co-defendants' evidence. He was inclined to be vague in his answers, and at times lacked consistency. Frequently, and after a while almost routinely, he resorted to responding "I do not recall" to any question about anything of any detail.

893. Whilst I do not suggest that Mr Loveridge's evidence was not conscientious, at times his resort to the "I do not recall" rubric seemed to me to arise from relief that this was an acceptable answer, to which he could safely retreat, as a slogan. This was particularly obvious in answering a form of question frequently put by Mr Wessels, along the lines of "when you saw this email didn't you [take some action]?" His "I do not recall" response failed to recognise the distinction that he might "not recall" because the matter had not happened at all, or because it had happened and he had simply (and quite possibly not unreasonably) forgotten it.

894. I do not suggest that Mr Loveridge's lack of recollection was untruthful, although I do not think he was really trying very hard. I gained the impression that nerves, the pressure of being a Defendant and of giving evidence, and the fact that he knew in his heart that the intricacies of CCC's business were matters rather outside his understanding, all combined to help give him a mental block.

895. It will be gleaned that I have no confidence that Mr Loveridge, at any rate by the time of giving evidence, had any real understanding of CCC's business and the financial markets in which it operated, at least beyond an utterly basic level. However, it is also the case that Mr Loveridge was not on CCC's Board for the purpose of this; his function was to represent and oversee CCC's position in Guernsey, its good standing and relations with the regulatory authorities, and to exercise the general business oversight position of an independent non-executive director. The implications of this though, are moving on to issues of competence rather than evidential reliability, and I will deal with them at the appropriate point.

896. The Plaintiffs criticise Mr Loveridge's lack of recollection as so extraordinary as to be disingenuous. I have dealt with that. They also criticise his vagueness and readiness to say, when it was put to him that certain things ought to have happened, that he was "sure" that they had, even whilst at the same time saying that he had not been there, or that he could not recall. Whilst this may have been vague, it seems to me, though, that it is not entirely fair to criticise this as evidence which could not honestly be given. I interpreted it as an expression of confidence in his co-directors. I accept, of course, that its value as probative evidence is an entirely different matter.

897. Mr Loveridge was probably in the most difficult position of all the individual defendants in this case. First, he is the only non-American, which must in itself feel somewhat isolating. Second, and more important, he is the only Defendant with no background or expertise in some form of investment or commercial banking, and with no experience of the kind of financial products and market in which CCCs' business was operating. His own experience

and expertise was that of Guernsey trust administration, corporate governance and compliance, and it was that skill that he brought to the party. He made this point in the course of his evidence; I bear it in mind.

Mr Sarles

898. Mr Sarles had given a 65 page witness statement and gave evidence over two days. His background and credentials have already been mentioned.

899. Again unsurprisingly, Mr Sarles was somewhat brusque at the outset of his evidence, and defensiveness led him once or twice to resist propositions which, on reflection, he came to agree were correct. But as he settled down, he became more expansive and articulate, and he provided comprehensive explanations of his thinking and his reasoning. He struck me as highly capable and above all, organised and methodical. He likes to marshal his thoughts on a topic into lists of points and summaries, and then to prioritise these for action or in order of importance. Examples of his note-taking and preparation occur in the papers, and this methodicalness was apparent in the way he answered questions in his evidence.

900. The Plaintiffs' substantive argument - levelled at all the independent directors - is that they were almost entirely passive in their involvement in CCC's affairs, doing no more than comply with the suggestions or requests of, in particular, Mr Conway, Mr Hance and Mr Stomber as to the exercise of their powers under the Articles, as well as their consideration of board decisions. Mr Sarles disputes this.

901. As with most of the other Defendants, the Plaintiffs suggest his evidence is unworthy of reliance because of some matter which is mentioned only late in the day, which they argue shows that it has been contrived and false. In this case, it is Mr Sarles' evidence, given in cross-examination, of having had a telephone discussion with Mr Stomber on about 17th August 2007 with regard to CCC's financial position and the proposed suspension of the investment guideline as to the minimum liquidity cushion. The Plaintiffs submit that this must be contrived and false, because of not being mentioned in Mr Sarles' witness statement, or in supplementation of his evidence in chief, and it had not been mentioned by Mr Stomber.

902. I am not persuaded by this criticism, and certainly not so far as to have any serious doubts about the general reliability of Mr Sarles' evidence in other respects. Whilst the Plaintiffs' criticisms of lack of "discussion, deliberation or question" by the Independent Directors were of course plain to be seen on the pleadings, this was one individual matter in the context of many more such allegations. I do not think that the occurrence of such a conversation was implausible in itself (as the Plaintiffs assert), and I do not, in this instance, find the absence of previous, or corroborating mention of it to be so extraordinary as to undermine my general favourable impression of Mr Sarles' evidence. I accept him as a thoughtful and candid witness, doing his best to produce his best recollections of events.

Mr Reville

903. Mr Reville of PwC (CCC's auditors) and the partner in PwC with overall responsibility for CCC's affairs, provided a witness statement of 30 pages regarding PwC's involvement with CCC and its financial situation during the relevant period, and he gave evidence for one day, although scheduled for two.

904. The Plaintiffs suggest that Mr Reville's evidence was evasive, tendentious and of little assistance to the court, largely because they submit that he was defensive with regard to PwC's work, disappointingly partisan in his obvious support of CCC (and, of course, Carlyle), on examination was unable to give any detailed evidence about important matters (such as the real source of the data or process which had been used to arrive at the revaluation of CCC's portfolio or RMBS within the remarkable difference of only $72 already referred to), and had declined to answer questions on the purported grounds that their premises were too hypothetical, but in reality only because they had been too awkward.

905. I do not accept any of these criticisms. Mr Reville was a thoroughly composed witness, although he was no doubt assisted in this by the fact that neither he nor PwC is a defendant. Like Mr Hance he was direct in his answers to questions, which probably contributed to Advocate Wessels' making good time and terminating his cross-examination one day early. Mr Reville was concise and businesslike. His explanations as to how the reviews of CCC had been conducted were lucid and helpful. He was very clear as to what he saw his role as auditor of CCC to be.

906. It is unsurprising that he should have supported CCC's actions; it would have been far more surprising and significant if he had not. It was also plain that he wished me to know that his view as an auditor had been that the Directors and Management at CCC had always behaved responsibly and commendably in regard to their conduct of CCC's business and that the standards which they imposed upon themselves were high, and he felt that they had achieved them. The Plaintiffs dismiss and deprecate this as a superfluous and partisan piece of evidence. That is a matter for me to review objectively for myself. Overall I found Mr Reville to be a good witness, on whose evidence I feel I can safely rely.

Miss Cosiol

907. Miss Cosiol is a specialist corporate lawyer who remains employed by Carlyle currently, as a principal in its legal department. Miss Cosiol had made two witness statements relevant to this trial, one (in fact her second in the action) a general one of 44 pages, and a further one in relation to two particular matters which arose later. Whilst scheduled to give evidence for three days, her cross-examination was concluded by Advocate Wessels in one day only.

908. Miss Cosiol is a quietly spoken lady, and whilst self-assured, she was, at the same time, almost self-effacing in her evidence. Her involvement with CCC occurred in the early stages of her career in legal practice, when she was aged about 31 and was both new and very junior in the organisation. The assurance and incisiveness of her emails at the time, however, is notable; the contrast with her manner was striking.

909. She has clearly gained in experience, and no doubt also in confidence, since her involvement with CCC. At that time, having just joined Carlyle, she worked under the overall supervision of Mr Jeff Ferguson, Carlyle's Chief in-house legal counsel who, she told me, was a tax lawyer, of a cautious nature. Her title of "General Secretary" in relation to CCC meant that she provided assistance in administration, governance and compliance and liaison as regards CCC's affairs, with oversight from her legal expertise. She took the notes at board meetings and some other committee meetings, which she later converted into minutes. She agreed that, in this, she "took direction" (rather than "instructions") from Mr Conway and Mr Stomber and also at times from Mr Nachtwey, Mr Buser and Mr Mayrhofer of Carlyle, because they were senior to her, as well, obviously, as Mr Ferguson as her immediate boss.

910. The Plaintiffs make their customary criticisms of Ms Cosiol: - that she was partisan, had a selective memory (or was giving evidence of things she could not in fact remember) and that she was generally an unsatisfactory witness. I do not agree. Miss Cosiol struck me as competent, conscientious, and efficient, and I felt that she was being candid in her oral evidence. Her evidence was open, clear (if quiet) and thorough and I have no doubt, from the papers, that she brought those qualities to her work at the time as well.

911. The Plaintiffs criticise Ms Cosiol roundly for being willing to give evidence that she believed that certain events had occurred even though she had no recollection. I have already said that I do not regard that as a real criticism of a witness, as it may well be the actual truth. Ms Cosiol seemed to me to make it tolerably clear where her evidence consisted of such belief rather than actual observation or recollection, and I have no difficulty with the credit of a witness who says that she believes something must have happened either as a matter of logical reasoning or because it was her impression. Of course, the probative value of such evidence is a different matter from its integrity.

912. Several of the Plaintiffs' attacks on Ms Cosiol are founded on her stated belief at the time that CCC was not "in the zone of insolvency" at around 20th-23rd August 2007, on the grounds that this judgment is so plainly wrong, and inconsistent with the notes she took at the meeting, that it is "simply incredible". In context, however, it seems to me quite plain that what Ms Cosiol was really saying, both in her witness statement and oral evidence, was that this judgement was not one that she made. Having raised the point, she left it to the management of CCC who were better qualified to make it. In fact, what she actually said was that she did not recall thinking that the company was in the zone of insolvency, not that she had positively thought that it was not. I do not find this, more nuanced, statement to be implausible or incredible, bearing in mind Ms Cosiol's position as a new and junior legal adviser at that time.

913. Being well aware, Ms Cosiol said, of her lack of knowledge and in-depth understanding of CCC's business, she took copious notes at meetings, and it is obvious from the documents that she certainly did. Her actual recollection was generally, she also said, no better than her notes, and in explaining her lack of actual memory, she pointed out that CCC had been far from the only project on which she had been employed, although during the relevant period it had taken up the best part of her time, in particular at around the crisis of March 2008. I regard her evidence as being expressed in terms consistent with this and I did not see her as indulging in reconstruction to support the Defendants, or as having to "explain away" matters.

914. I am quite satisfied that Ms Cosiol gave honest and candid evidence. I find her to be a reliable witness, insofar as her evidence goes, although this is really not very far. In the end the main value of her evidence lies in the contemporaneous meeting notes which she took.

915. I must add here that the Plaintiffs went so far as to submit that it was apparent that Ms Cosiol was "unwilling to assist the Court and gave evidence in what she perceived to best serve the interests of her employer". This submission was based particularly on Ms Cosiol's evidence about whether she had, or must have, received legal advice from Linklaters at the end of August 2007 that a proposed guarantee by TCG of CCC's repo obligations to Citigroup in return for holding a 2% haircut would not require to be publicly disclosed. This submission impugns Ms Cosiol's integrity and I make it clear that I entirely reject it, as without foundation. It is regrettable that the Plaintiffs should ever have thought fit to make it.

916. The Defendants also provided witness statements from Mr Curtis Buser, currently Chief Financial Officer of the Carlyle Group, but at the relevant time its Chief Accounting Officer, and also from Mr Peter Nachtwey, the Chief Financial Officer of the Carlyle Group from July 2007 until 2010. The Plaintiffs elected not to require them for cross-examination. Their written evidence as to their own involvement with Carlyle and in the affairs of CCC at the material times, and certain points raised by the Plaintiffs was therefore taken as read, and is unchallenged.

Plaintiffs' factual witnesses

Ms Alexander

917. The Plaintiffs relied on only two factual witnesses for the purpose of this trial. The evidence of Ms Annette Alexander, a corporate and investment lawyer with Carey Olsen, went only to issues about enquiries being made by Ms Cosiol in August 2007 with regard, first, to obtaining urgent GFSC approval to Carlyle's giving CCC a $100Mn loan, and, second, as to what duties might be placed on directors of the company if it was in the "*zone of insolvency"* (a concept known to her from Delaware law) and her notes and recollections of a telephone conference call with US lawyers and (apparently) a lawyer from Linklaters which took place on 20th August 2007 with regard to this. Ms Alexander had "very little" independent recollection of such events, seven years after them, and her evidence was accepted by the Defendants without cross-examination.

Mr Shah

918. The Plaintiffs' only oral witness of fact was Mr Kunjal Shah. He gave evidence out of turn, after the conclusion of the evidence of the Defendants' factual witnesses and the Plaintiffs' own experts. Mr Shah's evidence was brief, and it is convenient to deal with it all at this stage.

919. He was described by the Plaintiffs as a "senior investment professional experienced in managing credit risk associated with leveraged investment funds." At the material time, Mr Shah worked for Deutsche Bank in New York as a counterparty risk manager for "hedge funds", amongst which he counted CCC. I understood from the general tenor of the evidence and the definition in Barron's Dictionary of Financial Terms with which I was supplied, that it is very doubtful that CCC was fairly described as a "hedge fund", which term generally connotes "a lightly regulated investment pool which will typically not only use a high degree of leverage to increase returns (and thus risk) but will also engage in using long and short trading positions, derivatives and other speculative market practices and engage in many different markets". I had thought that Mr Shah's description of CCC as a "hedge fund" arose out of a Deutsche Bank internal classification, rather than being an indication that Mr Shah himself did not focus clearly on the nature of CCC's actual business, but Mr Shah later produced a stunned silence in the court when he announced that he had understood CCC to be a company which traded in securities and in particular RMBS, and not a "buy and hold" vehicle.

920. The purpose of Mr Shah's evidence was apparently, twofold. It was first to present an account of at least one repo lender's reaction to CCC's difficulties in and shortly after August 2007, with which Mr Shah had had some involvement at the time. Second and seemingly more important, it was to support the Plaintiffs' assertions that CCC made misrepresentations to its counterparties about either being in the process of deleveraging substantially, or indeed having

in fact already done so, at the end of August and during September 2007, when in fact it had not done so and had no intention of doing so. This goes only to credit. The subtext was, of course, that this showed that CCC's Directors and officers were willing to behave discreditably.

921. Mr Shah had subscribed to a witness statement in which he expressly alleged that he had himself been so misled at a meeting between Deutsche Bank representatives and CCC representatives (I think Mr Stomber) on 31st August 2007. This culminated in the statement that in October 2007, when he had, on behalf of Deutsche Bank, agreed to waive an event of default constituted by a breach of covenant by CCC as to maintenance of its net asset value ("**NAV**"), he had not known certain negative facts about CCC's position, because he had been misled in this way.

922. The Plaintiffs ambitiously suggested, after his cross-examination, that Mr Shah was "an honest and reliable witness with a good recollection of events". He was nothing of the sort. The Defendants say that he was not a satisfactory witness and I agree with them.

923. Mr Shah was a singularly unimpressive witness. His evidence was inconsistent, confusing, and sloppy, and ultimately more concerned to defend a position which he had carelessly and mistakenly adopted than to accept the truth.

924. Mr Shah had written an internal Deutsche Bank email, in about October 2007, in order to brief a senior director about CCC for a meeting which the director was about to have, and he had there recorded that CCC had deleveraged substantially. It appeared that the Liquidators had obtained a copy of his email, and, knowing that this had not been the case, had questioned Mr Shah about it. When Mr Shah had learned that CCC had not, in fact de-levered, he asserted that he had therefore been misled by them, as described above, and he gave a witness statement to that effect.

925. In cross-examination, he was obliged to accept that he could not plausibly have believed that CCC had actually deleveraged to the extent he now alleged that he was told within the timescale that was available, because this would have been impossible. He also had to accept that his assertions as to alleged misrepresentations made at his 31st August meeting were in fact derived from the contents of slides for a <u>later</u> CCC investor conference (on 11th September 2007) which had not been in existence at the time of the August meeting, but which had been later sent to Deutsche Bank and filed. He also accepted that he had misread the information contained on those slides. It was further pointed out to him that there was no record, in his contemporaneous email summary of the 31st August meeting, of the supposedly important and allegedly untrue statements which he claimed had been made.

926. I am satisfied, and I find, that what in fact happened was that Mr Shah, with no real knowledge or recollection of the facts even in October 2007, was called upon at that time to provide a briefing note about CCC to his senior management for the purposes of a high level meeting or review. He compiled his email note from a superficial review of the papers in his file, including the slides mentioned, which he interpreted hurriedly and incorrectly. He did not look any further, or in any more depth, at the position he was reporting. Then, when asked about this note six or seven years later, he has defended his position by leaping to assert that the obvious error contained in it as to CCC's having deleveraged shows that he was misled by CCC, rather than considering the alternative possibility, that his own memorandum about the position had been wrong, superficial and, in fact, sloppy.

927. At best, therefore, Mr Shah's evidence in this action was careless, and lacked any rigorous appraisal of what he was saying, despite its very serious nature. Although I do not think Mr Shah was consciously dishonest, I am satisfied that he was well aware of the thrust of evidence which the liquidators were looking for, that his self-importance was greatly flattered by being asked to be a witness, and that this allowed him to be drawn into making inappropriate and unjustified accusations. In fact, (and ironically in all the circumstances) the evidence of Mr Shah is a striking example of just the kind of unreliable "reconstruction" which the Plaintiffs urge me to be wary of when examining the oral evidence of the Defendants.

928. I do not, therefore, regard Mr Shah's evidence on this topic as any evidence of CCC putting out false and misleading publicity or statements as to their financial situation. In any event, that would not go directly to any cause of action relied upon in this case. As to the remainder of Mr Shah's general evidence, I do not discount it entirely, as it is not in fact (and I so find) inconsistent with other evidence as regards CCC and the general circumstances of its relationships with its repo lenders. However, it is only that corroboration which leads me to accept anything Mr Shah says.

The expert evidence

General

929. The function of expert evidence is to assist the court to draw sound conclusions about matters of which the court does not have knowledge or experience. The forensic emphasis with expert evidence tends to be on "opinion evidence", because of the well-known rule that the opinion of a witness is not admissible evidence except where he is an expert on the topic. The basis of this rule of evidence is simply that of probative value; the opinion of an expert is more likely to be reliable and hence have probative value, than the opinion of a non-expert.

930. However, much expert evidence is still evidence of primary fact, because the expert will often give evidence of factual matters, such as the customs or practices of a trade or profession, or simply facts accepted as general knowledge in the profession at the time, from his own observations. Indeed, at time this may be the whole purpose of his evidence. It is often useful in itself for the court where it is factual evidence of which the court has no knowledge, but when the expert gives such evidence, (often to provide the basis for conclusions he subsequently expresses), he is giving evidence of primary fact, just like any other witness.

931. Beyond primary observable fact comes secondary fact, in other words, inferences of fact drawn from the primary facts. Whilst ordinary witnesses can, and frequently do, give some evidence of such secondary fact, that is on the basis that the judgement or analysis applied in drawing such inferences is no more than what is applied by ordinary people in everyday life, and requires no specific expertise. Where drawing the correct inference is not that simple and does require some specialist knowledge or skill, expert evidence will assist the court to draw correct inferences, sometimes because it simply prevents the court from falling into error through not appreciating factors which might make an apparently logical conclusion incorrect, but also, as inferences become more complex or refined, by providing a positive opinion about the correct inference which should be drawn from particular facts. In the end, though, however much the expert's opinion may be useful in such circumstances, it is trite law that the function of the expert is to assist the court to decide the case soundly; it is not to decide the case himself.

932. The qualities required of the best expert witness are therefore, first, a wide and deep knowledge of his expert field; second, a mind of high intellectual ability, applied in interpreting relevant facts and matters within that field; third, the ability to be dispassionate about that exercise; and fourth, the ability to explain his expert field and his conclusions clearly enough to enable the ordinary reasonably intelligent layman (otherwise, the judge) to understand his reasoning. The expert demonstrates not only his own expertise, but also his appreciation of his duty as a witness, by not straying into expressing opinions outside the scope of his expert function. An expert witness's duty in giving evidence is first and foremost to assist the court by giving honest and dispassionate evidence both as to fact and as to his opinions, regardless of who has engaged him. Probably the greatest compliment to an expert witness is that one can express confidence that his evidence would have been just the same if he had been called by the opposing party.

933. Since expert evidence is expensive to obtain and can extend the length of trials, it is the duty both of the court and the parties to limit expert evidence to that which is necessary for resolving the proceedings ie the action: see Rule 8 of the Evidence Rules 2011.

934. There has been a large amount of expert evidence in this case. I permitted this at times with some reluctance but for three reasons. First, the Plaintiffs, as liquidators, have virtually no ability to call direct evidence of the events which they rely on as grounds for their complaints. They therefore have to make their case on the basis of inferences from the available documents and other evidence with the support of expert evidence. In a matter as significant as this, it would be unreasonable to hinder their ability to do so to any great extent.

935. Second, there is often no very clear delimitation of separate fields of expertise. A party who conscientiously seeks to keep down the number of expert witnesses to be called runs the risk of it being argued that a particular expert whom he calls is not sufficiently expert in some aspects of his evidence, and that these should be rejected, or the evidence of an opposing expert witness preferred, on those grounds. Whilst there are limits as to how far it is reasonable to allow proliferation of experts to avoid this charge, once again, in a matter of this significance, I judged that it was appropriate to allow the Plaintiffs some indulgence where they insisted that they needed to call separate experts in different disciplines in order to support their case.

936. Third, and of particular importance in a case of apparent complexity at the case management stage, there is force in the argument that the court itself, inevitably less familiar with the substance of the issues than are the parties and their advisors, is not in a good position to make sensitive judgments about what expert evidence is (or is not) going to be of real importance at a future trial, and that therefore the safer course, if in doubt, is to allow the expert evidence in, rather than to exclude it.

937. Ultimately, therefore, I was presented with evidence from no less than 16 expert witnesses, mostly in financial fields of varying degrees of relevance. These were: Financial economics (in effect, the bond market), repo financing, RMBS, investment banking, financial risk management, insolvency, and accounting and audit. There were also experts on Delaware law, arising from the fact that CIM's management contract with CCC was governed by Delaware law, and Dutch financial regulatory law, arising from the fact that CCC had been listed on the Euronext Exchange and the Plaintiffs wished to rely on certain points regarding the Defendants' conduct as directors of such a listed company, but which required aspects of Dutch law to be established.

938. In the end, I find that my misgivings with regard to permitting some of the expert evidence, particularly that sought late in the day by the Plaintiffs, have been justified. The two accountancy/audit experts were not called and I am not sure that their evidence was even referred to in the trial, although it is considered in appendices/annexures to the parties' main closing submissions.

939. The experts in Dutch regulatory law were not called and their evidence was scarcely referred to either. This is probably because it became more and more obvious in the course of the trial that their evidence not only did not go to any matter which it was alleged caused any damage to CCC (a point which it was disproportionate to investigate closely at the case management stage), but scarcely had any material effect as regards even the reliability or credibility of any witness. In any event the adducing of expert evidence solely to found an attack on a witness's credit could never be justified, on principle.

940. The experts in Delaware law were not called either. However, since Delaware law is a matter of fact in this court, and since Delaware law was plainly material to the assessment of any potential liability of CIM under a contract governed by Delaware law, the inclusion of that evidence was justified, even though one would have hoped it might be agreed. These two experts appeared to be in little material disagreement, apart, I think, from some fairly refined questions of whether the imposition of a contractual duty of care or fiduciary duty in the Management Agreement would replace or exist in parallel with equivalent Delaware common law duties of care and good faith, and the technicalities of the application of exoneration clauses in Delaware law. Their evidence has to be dealt with from their written reports, as and when necessary. Whilst the presence of two expert witnesses might have been excessive in the event, this is not the kind of case where the imposition of a single joint expert was ever likely to be appropriate or save worthwhile costs.

941. I record one further point about the scope of the expert evidence. The Defendants have made some critical comment about the Plaintiffs' insistence on seeking the introduction of numerous experts, where, they say, this was unnecessary and duplication. They point particularly to the fact that Dr Carron appears to be well qualified to give evidence about investment risk management, having done so before, but that the Plaintiffs insisted that he was <u>not</u> doing so in this case, and that they therefore required a separate expert in this field, in the shape of Professor Das. Yet, say the Defendants, when Dr Carron's evidence emerged, he has expressed opinions in the field of risk management as well as financial economics.

942. Expert opinion evidence in the form of commissioned reports (as contrasted with expert opinion evidence which an existing witness of fact happens to be qualified to give by virtue of his experience) is admissible under the Royal Court Rules only pursuant to a direction of the court in that regard, to enable such evidence to be suitably controlled. It may therefore well be the case that such evidence of Dr Carron is strictly not admissible. However, it does not seem to me that the Defendants have suffered any sensible disadvantage as a result of any such duplication.

943. Given the overlap and difficulty of always distinguishing areas of expertise, I have not sought to dissect Dr Carron's evidence so as to exclude any evidence which might be in this category. That exercise would be unrealistic, and actually disproportionate in all the circumstances. I have therefore not sought to exclude from my thinking any statements of experts where they

seem to me to possess expertise, as contrasted with gratuitous opinions in areas where they do not. I have taken this approach as regards all the expert evidence.

944. The expert evidence was initiated sequentially, with the Defendants' experts being responsive to the Plaintiffs'. This was principally because it was a convenient way of ensuring that the Defendants really did know what case they had to meet. Expert conferral then took place, with the experts in matching disciplines compiling a joint report of matters of agreement and disagreement. The fields of expertise of the experts called by each side did not precisely cross-match, which complicated the logistics and timings for the process of conferral and joint statements.

945. In the interests of a convenient course for the trial itself, and having regard to the importance of the voluminous expert evidence in the case and that this ought to follow the factual evidence rather than partially precede it, it was agreed that the Defendants' factual witnesses should give evidence in the first part of the trial, with the expert witnesses following on; first the Plaintiffs' and then the Defendants'. Unfortunately, this sensible and very convenient course of evidence caused certain procedural problems when the Plaintiffs then sought positively to supplement their own experts' reports (four of these) with further written report evidence, immediately before their own experts gave evidence, but after the Defendants' witnesses of fact had concluded their evidence, been released, and mostly flown back across the Atlantic. Not surprisingly this provoked a degree of objection from the Defendants. However, whilst vociferously recording their complaints they elected not to pursue objections to two of these supplementary reports, (those of Mr Eric Welles and Dr Harpal Singh Maini) on the basis that they felt able to deal with the additional evidence through their own experts. They did, however, object to the other two further reports, (those of Mr Philip Wallace (insolvency) and Dr Andrew Carron (financial economics) and the admission of these therefore became the subject of an application.

946. My approach to whether these supplementary reports should be admitted will have been apparent from the short judgment which I delivered at the time but, broadly, I held that where the supplementary report was correcting a witness's earlier report, it was obviously to be permitted. The witness would not be able to take the oath unless it was. However, (i) insofar as a further report simply repeated evidence previously given it was inappropriate, (ii) insofar as it contained matters which were in the nature of submission and could be advanced as such it was intrinsically inadmissible, and (iii) insofar as it raised new arguments which had not been raised previously nor been the subject of expert conferral and which had not been raised with the Defendants' factual witnesses in their cross-examination evidence, it was by then too late, and I was not prepared to permit its introduction.

947. I therefore disallowed the further reports of Dr Carron and Mr Wallace, although I made it clear that, insofar as any of the material contained in them naturally became referred to in the course of the relevant expert's oral evidence, (as to which I would be astute to detect any artificial attempt to achieve this) then such material, which the Defendants had by then of course seen, could become admissible in accordance with the normal rules and procedure governing the admissibility of relevant evidence arising in the course of trial.

948. It is convenient at this point to set out my impressions as to the nine expert witnesses who gave oral evidence at the trial, and to give some indication as to my general views of the helpfulness of their evidence and where I might broadly prefer one to another. I will of course have to deal

with more of the detail of their opinions later where specifically material. It is also convenient to deal with this by taking the pairs of witnesses on opposite sides, but owing to the lack of matching of experts previously mentioned, I will deal with the witnesses on aspects of financial economics in a convenient group.

949. Naturally, each side was critical of the other side's experts and commended its own. I will not be referring to every criticism made, but only to those which I think have either sufficient justification or significance to require me to do so.

(1) The Financial Economics experts:

- **Dr Carron, Dr Maini and Mr Welles for the Plaintiffs;**

- **Professor Hubbard, Dr Niculescu (and Mr Bezant and Dr Webster) for the Defendants.**

(a) Dr Andrew Carron - Financial economics – financial markets, CCC's business and damages.

950. Dr Carron has a BA in economics from Harvard University and an MA, MPhil and DPhil in economics from Yale University. He is principally a researcher. After some years conducting research with the Brookings Institution, he spent from 1984 -1996 in the financial investment world, working first at Lehman Brothers and then at Credit Suisse, researching into the mortgage and bond markets, and also in a risk management role. In 1996 he became a consultant with National Economic Research Associates Inc, ("NERA") an international organisation which provides economic analysis for major clients (regulators, risk managers and parties to litigation). He became its President from 2006 – 2012; he is currently its Chairman.

951. The Defendants describe him, and I think not unfairly, as a professional expert witness; his CV testifies to 129 other cases in which he has provided expert evidence. On any basis though, he plainly has vast experience and expertise.

952. Dr Carron appeared, in the early stages of the action, to be the Plaintiffs' principal expert witness. In the event, the emphasis of the Plaintiffs' case has very much shifted away from Dr Carron to Dr Maini's evidence, as appears below.

953. Dr Carron produced two reports, conferred and gave joint statements with his three counterparts among the Defendants' experts (Professor Hubbard, Dr Niculescu and Mr Bezant) and gave oral evidence for two days. Dr Carron's perspective was more of a macro-economic overview of the issues in this case than the Plaintiffs' other two financial economics witnesses.

954. I have already indicated the scope of his second report near the beginning of this judgment; it was a general description of the operation of bond markets. Its contents were factual, were not challenged, and were extremely helpful to me as an education in this area and as a reference tool. Dr Carron had also compiled, and produced, a reference list of each of the 150 RMBS bonds (165 tranches) purchased by CCC with all their details, balances, cash flows and financings. Again this was not challenged. It was hardly necessary to refer to it at the trial, but it did have the useful function of helping me not to lose sight of the nature of the assets which are central to this case, and which have inevitably been referred to as "RMBS" as if they

could be regarded as fungibles. They are not; they are individual bonds or tranches of bonds, with individually different, even if often similar, characteristics.

955. Dr Carron also produced a useful document in the shape of a table and bar chart of CCC's repo funding at repo roll dates, from 15th June 2007 to 25th February 2008, broken down by counterparty bank and showing the use of repo finance from that counterparty before and after every roll date, with its attached haircut level. This was eventually refined into a neutral factually agreed form. It is a very useful document, and along with certain other such trial aid documents as I will specify, should be treated as appended to this judgment.

956. Dr Carron's main evidence, very briefly summarised (from a report of 343 pages even excluding its appendices and exhibits), covered the workings of the financial bond markets with particular reference to the RMBS market, a review of CCC's business model and the risks inherent in it, an analysis of CCC's financial circumstances over the period from its IPO until its collapse in March 2008, and elaborate financial modelling (using Monte Carlo simulation techniques) of the risks for CCC's cash flow solvency implied by prospective changes of circumstance, the two of particular materiality being the potential for change in (i) the value/price of CCC's RMBS assets (evidenced by price volatility data) and (ii) the rates of haircut applied to its repo financing. Having concluded that (simply stated) CCC needed to deleverage and increase its liquidity, raise more equity, or conduct an orderly winding down of its operations, Dr Carron then referred to an "Asset Sale Model", which he used to calculate what asset sales by CCC, at particular times and within a period (of around two months) would have increased CCC's liquidity back to an appropriate target level. He used this further, to calculate the amount of the losses actually sustained by CCC on its insolvent liquidation in March 2008 which could thus apparently have been avoided if CCC had taken what he labelled as the "appropriate action", by which he meant selling such assets on the bases and assumptions which he had postulated. His stated view was that

> *"sales need not have been "urgent" or immediate. CCC's directors and managers could have conducted an orderly sale over the course of several months, thereby avoiding the "distressed prices" that may accompany a block sale".*

957. Dr Carron gave a number of examples of his calculations, depending on the quantities of RMBS sold, when and over what period, and whether these were sold at IDP prices or at recorded secondary market prices or at an estimation of these, where information was not available.

958. To give a flavour of his conclusions, his broad suggestion was that CCC should have sold $10Bn of its RMBS over 1-3 months after August 2007, and would then have sustained, between $553Mn and $624Mn less in losses than it ultimately did. The highest of his calculations, though, suggested a reduction in losses of $1.4Bn, including interest, and was on the basis of a total sale of the whole portfolio at that time. Dr Carron very fairly made it clear, however, that these many examples of damages calculations were just that, and could be recalculated appropriately to any findings of fact which the court might make as to what sales ought to have been made, and when.

959. Dr Carron's expertise in the techniques of financial modelling and statistical analysis is undoubted. There are challenges to his work – or perhaps more accurately the work of his team, which he has endorsed – with regard to matters which have been taken as input assumptions into his modelling and whether those assumptions are reliably based. That point

goes to my considering how far I find Dr Carron's evidence convincing in the scientific field and are more appropriately mentioned later.

960. I do have other concerns though, as to how far I can rely upon the general objectivity of Dr Carron's evidence. The Defendants point out that Dr Carron's instructions were to advise upon the assumption that facts stated in the Plaintiffs' Cause were true, and also that he was asked questions about CCC's financial position relating only to 2007, which therefore caused him to ignore or fail to mention (said the Defendants) improvements in CCC's position in early 2008. Those two matters, they suggest, would tend to slant Dr Carron's evidence against the Defendants at the outset, even if this bias did not emanate from Dr Carron himself.

961. More importantly, perhaps, the Defendants questioned the impartiality of Dr Carron's report, conscious or unconscious. They pointed out subtle ways in which his report was worded, apparently rather carefully, so as to create criticism by innuendo. The Plaintiffs dismissed Advocate Swan's cross-examination on such matters as trivial and arid.

962. I am afraid that I do not agree. From an initial reading of Dr Carron's report I had already formed the view that it/he was very conscious of the objective of his evidence for those instructing him. This impression was reinforced by some aspects of his cross-examination. My attention was drawn to features, such as that sentences were juxtaposed so as to create an impression without actually stating it, eg: "*In my opinion the strategy was designed primarily to avoid selling RMBS assets. To have done so would have realised losses…*" putting into the mind of the reader, without actually opining, that the latter was the motivation for the former. In other instances, commentary was tendentious, with attention drawn to material with negative connotations, without any express comment but with material which might have been thought counterbalancing not being mentioned. I find force in these criticisms because this kind of occurrence just seemed rather too great in number to be entirely chance. In addition, Dr Carron strayed outside the proper scope of his own expertise in matters such as giving his opinion (helpfully to the Plaintiffs) as to the validity of PwC's reporting that CCC was a "going concern" in late 2007, and whether it was appropriate for CCC to rely on this. In fact, this did not seem to me even to feature in the scope of the instructions which Dr Carron recorded.

963. I am aware, - because I enquired - that Dr Carron had not drafted his report, or done the initial work for it, himself, but had delegated this function to persons who worked for him. It may be that such matters as a tendentious style and gratuitous negative comments resulted from an excess of enthusiasm on the part of his subordinates who did the research and prepared the report for him, but who were less conscious of the duties of expert witnesses than Dr Carron himself might be. He said, and I accept, that he reviewed their work and in fact edited it extensively, but even if this is the case, Dr Carron endorsed these matters and the impression they created in signing off his report. An expert witness who delegates work to an underling needs to be particularly careful and critical to ensure that the overall flavour, and not just the literal accuracy, of what may be said is still that which he would have conveyed himself if he had originated the work.

964. Unfortunately the impression which I have formed of Dr Carron's report means that I do not feel entirely confident in placing reliance on Dr Carron's propositions or opinions, express or apparent, where these are adverse to CCC's Directors, without very critical evaluation of their objectivity. Having confidence in the neutrality of an expert is particularly important in the

case of evidence such as Dr Carron's, which is in the highly technical field of statistics and suchlike, where it is particularly difficult for the non-expert to judge whether propositions are valid or "feel" soundly based. It is all too easy for an ordinary person to gain - or to be given - an impression from the superficial appearance of a graph, or a table of statistical probabilities, or a tendentious comment, without fully and accurately appreciating the significance, or effects, of assumptions which have been made, or the methodology which has been used, until this is carefully explained.

965. A particular further reason for my concerns in this regard, and one which I regard as rather important, arises from suggested flaws in the conclusions presented by Dr Carron about how to make an appropriate calculation of the increased losses which CCC is supposed to have suffered through not taking the "required actions" with regard to selling RMBS. These matters were raised by Mr Bezant, in his report, and they were gone through with Dr Carron towards the end of his cross-examination, and without contest. Mr Bezant was then not called by the Plaintiffs for cross-examination. I refer in more detail to the substance of this later, but the important point for present purposes is that the points made by Mr Bezant and acknowledged by Dr Carron, which seem to me to be significant, were either not appreciated by Dr Carron in presenting his original report, or were ignored by him. The implications of either explanation cause me real concern about the reliance I can place on Dr Carron's other opinions.

966. In summary, with regard to Dr Carron's evidence, I feel uncomfortably as though I have to have my wits about me in considering what weight to attach to what he says, rather than being confident that I can simply rely on his expertise as neutral assistance in interpreting facts. In fact, if I ask myself the question, do I feel confident that Dr Carron's evidence would have been essentially the same if he had been called by the Defendants, the answer is that I actually do not.

(b) Dr Harpal Maini – Financial economics - RMBS trading

967. Dr Maini has a PhD in Computer Science from Syracuse University, and is a Master of Mathematics and Engineering from the Birla Institute of Technology and Science in India. He has over 20 years' experience in the "structuring, trading and sales" of Agency Mortgage Backed Securities, during which he developed expertise in the areas of bond and portfolio analytics, risk and trading systems, market research and portfolio management.

968. Dr Maini has thus been in the market. He has operated as both a direct investor and a market maker. He worked for Deutsche Bank from 1996 – 2000 as a Director of Mortgage Trading (being Vice President of Mortgage Swaps and Mortgage Derivatives) and similarly for GMAC-RFC from 2002-4. From 2004-14, he was Managing Director, Head of Mortgage Trading (Market Making and Proprietary Trading) and Co-Head of Mortgage Sales and Trading at BNP Paribas in New York, where he managed a very large portfolio of RMBS products. He is now an independent consultant in these financial areas, with Investors Consulting Group LLC.

969. Dr Maini gave evidence about RMBS trading, his analysis of CCC's portfolio, the market for such assets, and methods of selling such assets. His initial report of 1st September 2015 was short – a mere 26 pages. His conclusions were more subtle than those of Dr Carron. He recognised that a bulk sale of CCC's RMBS carried risks (examined elsewhere) but was ultimately of the view that, using a combination of recognised sales techniques and appropriate

volatility hedges, CCC could have incrementally disposed of about $500Mn worth of RMBS floaters per week (ie about $2Bn -$3Bn per month) beginning in July 2007 through to at least the end of the year. At what price, though, remained opaque.

970. Upon conferral with his opposite number, Dr Niculescu, Dr Maini felt it necessary to explain his points of difference with Dr Niculescu in far more detail by producing, in May 2016, an addendum report which was longer than his primary report and raised new matters. As has been already mentioned, he produced yet a further Supplementary Report dated 1st September 2016, part way through the trial after reviewing the evidence of the Defendants' factual witnesses during the trial. This reactive approach in his evidence has produced a disjointed assemblage of expert evidence which was not in accordance with directions which had been given, and has not made it easy to trace and compare the relevant evidence. The Defendants made some exasperated objections, but in the end, decided that they could deal with Dr Maini's evidence as it had emerged. Dr Maini gave oral evidence for two and a half days.

971. Dr Maini is obviously a very intelligent man and I have no doubt that he is an excellent mathematician. He is rightly proud of his skills, and this leads him to be confident of his opinions. He has an energetic "hands on" type of personality and he exuded enthusiasm for his work and calling. I formed the view that this was because he sees it as an intellectual and mathematical challenge, almost in the nature of a game, which he relishes.

972. His evidence, though, was frustrating. His manner seemed to be naturally quite ponderous, and from the outset he was wary and suspicious. The combination of extreme wariness and a quick mind led him, all too often, to answer, not the question he was being asked, but the question he had surmised would be the following question. It also made him almost incapable of answering "yes" to any question, to the extent that he would answer "no" even when asked to confirm propositions quoted directly from his own expert report. This slowed cross-examination enormously. When he was eventually able to accept that "yes but" would probably convey any reservations he had, the progress of cross-examination improved, but this became something of a mantra. He was very concerned not to appear to agree with propositions without being precise as to what he was agreeing to, and had a compulsion to repeat the same reservations with each answer. It was only when a formula on the basis that I would assume (unless told) that his answers were qualified with the phrase "all other things being equal" that cross-examination proceeded faster. As a result of all this, though, it was often extremely difficult to elicit his views on single aspects of the RMBS landscape at all clearly.

973. Dr Maini was keen to explain and demonstrate the complexities of RMBS products. This was not just, he emphasised, with regard to their structuring, which became complex enough, but also as to the effects on their attractiveness in the markets of subtle implications from their underlying collateral, even matters such as the geographical groupings of the individual mortgages from which a particular bond was derived. He readily told me that his own particular expertise lay in trading – spotting arbitrage opportunities – in the more abstruse areas of the RMBS market, ie in trading in the elements of RMBS securities which were not the relatively mundane ones of Agency debentures, or even CMO ("Collateralised Mortgage Obligation") floaters, but were the less well understood elements, often being what was left behind when a particular RMBS product had been created. He described these as having "*whippiness*" and being "*the more risky bits*". They were, in particular, Inverse Floaters, which were his particular speciality, but also extended to such exotic derivatives as IIOs

(Inverse Interest Only), and the support collateral generated when a dealer created a PAC (Protected Amortisation Class) security. Dr Maini had apparently built his success and reputation on a skill at spotting where such derivatives were over- or undervalued, and carrying out profitable trades accordingly.

974. I fully accept Dr Maini's expertise and I was impressed by it. I am also quite satisfied that, despite his combative manner, he was giving me totally sincere and honest evidence according to his own views; he just saw cross-examination as an impediment to this. However, aspects of his evidence are troubling for my purposes. First, his style and reactions in the witness box suggested to me that his recollection of his experiences might well tend to be coloured, albeit not deliberately, by the urge to justify a theoretical view already expressed. Second, Dr Maini is, on his own admission, not a "wordsmith", but even short of this, he did not strike me as a man with any patience for detail, - except in the technical areas of his work which are his consuming interest. I found a lack of clarity and accuracy in what he said about matters which I could follow and evaluate relatively easily. This therefore gives me concern as to how confidently I can rely on the apparent accuracy of what he says in areas where I am entirely dependent on his expertise.

975. The Plaintiffs suggest that any lack of clarity was caused by unfairly aggressive or pedantic cross-examination of Dr Maini, but I do not agree. For example, Dr Maini described himself as "*a CCC at the time*" of his work with BNP Paribas. There is no doubt some parallel, in that what I think he meant was that he was transacting with the bank's own money, as CCC was. However, he was quite plainly not transacting with the same business objectives as CCC, and whilst Dr Maini's comment was proffered as a helpful and courteous explanation to a judge of the position and experience which qualified him to give expert evidence on the subject, it was scarcely accurate. Whilst Dr Maini is undoubtedly an expert, he is an expert MBS trader, on an all day and every day basis. CCC was not in that business; CCC was a "buy and hold" shop, ie an investor rather than a trader. The transactions which CCC entered into were in furtherance of its strategy as an investing operation seeking to maximise income, rather than for making money out of trades, which is what Dr Maini was doing - and I am prepared to assume doing expertly - for BNP Paribas at the relevant time. Indeed, it was also very apparent that not only is Dr Maini's expertise that of a career trader, it is also that of a trader in an esoteric section of even the relatively esoteric RMBS bond market itself.

976. What I felt I certainly did gain very much from Dr Maini, though, was an insight into the ways and ethos of the market in some respects, which I elaborate on later, such as the importance of information and how it is prized and guarded, that no-one tells you anything they do not want you to hear, and that trading negotiations may often be indirect and oblique all with a view to gaining best advantage.

977. Whilst, therefore, I found Dr Maini's evidence extremely useful at opening my eyes to the sophistication, complexity and even psychology of the financial markets with which I am concerned, I bear in mind that his opinions are those of an enthusiastic trading participant in that market, and in a specialist area of it. I need to consider carefully, where his background may have coloured the views he expresses in ways which are therefore not a fair parallel with the circumstances of CCC and its personnel.

(c) Mr Eric Welles – Financial economics - repo financing

978. Mr Eric Welles was the Plaintiffs' expert in commercial banking and particularly the repo finance aspect, and thus the financing available to CCC.

979. Mr Welles gave evidence from the background of 18 years' experience in repo lending on mortgage backed securities, including the type of securities held by CCC (which he called "Agency CMOs" rather than "Agency RMBS", although I did not understand this to be significant). In 2007-8 he had co-managed Merrill Lynch's repo book with regard to all of that bank's US clients. It in fact emerged in his oral evidence that he had even dealt with CCC occasionally, at times when his colleague and co-head of repo financing, who was the principal contact for CCC, had been absent. Thus, Mr Welles was generally concerned with what is termed the "reverse repo" aspect of the repo market transaction, in other words, with the transaction as viewed from the bank/lender's side. He was thus an example of the counterparty with whom CCC would expect to deal in obtaining its repo financing. The Plaintiffs emphasise that he was the only such expert witness called.

980. Mr Welles explained that he had himself also been involved in direct repo financing, because the bank would itself use repo finance of its own securities to obtain the funds which it would then in turn use to carry out the "reverse repo" side of the investor-facing transaction. This is in itself a salutary reminder that the transactions with which I am concerned are themselves part of a complex network of other, wider, inter-related financial transactions.

981. The essence of Mr Welles' evidence concerned the mechanics of repo financing, and lenders' attitudes to providing it, the likelihood of alternative sources or types of repo financing available to CCC from mid-2007, the likelihood of CCC's facing demands for higher haircuts from its repo counterparties, and repo lenders' attitudes to the leverage level of their counterparties. Mr Welles' views were that the 2% haircut which CCC had obtained on its repo financing was an "aggressive" rate, owing much to CCC's connections with Carlyle, that there was a significant risk of CCC having to pay haircuts of 3% or potentially higher moving forward from June 2007, because of dealers' increasingly defensive reactions to the collapse of the Bear Stearns hedge funds, the perception of default in the sub-prime mortgage market, and their changing perception of CCC's creditworthiness owing to its large, concentrated portfolio of RMBS assets and its high leverage.

982. Mr Welles had given a report and had conferred and given joint statements with his counterparts among the Defendants' experts (Professor Hubbard and Dr Webster). He was permitted to put in a further short report during the trial, as already mentioned. He gave oral evidence for one day. He did so carefully, and with dignity and courtesy. He struck me as a person of good sense and balance. I also have no doubt that he gave me his entirely candid opinions and was doing his best to assist me by giving his best accurate account of the repo market in which he was operating at the time.

983. The Defendants point out that Mr Welles had given his report and evidence on the basis of instructions to assume certain facts, which were not accepted. This is correct. One example is that Mr Welles consequently assumed that CCC had represented to its repo counterparties that it was taking positive steps to deleverage when in fact it then did not do so, which Mr Welles said would have undermined repo counterparties' confidence in CCC (thereby increasing the likelihood of a defensive demand for a higher haircut). The premise of this point was discredited in evidence. I will therefore have to make due allowance for any such

erroneous built-in assumptions which may have affected Mr Welles' evidence, even whilst I am satisfied that the evidence was honestly given.

984. Mr Welles was also criticised by the Defendants for at times relying too much on being literal, and being satisfied that what he had said was literally true even though it possibly conveyed a misleading impression. An example given was that he said he had "known of no transaction of" a particular type during a particular time period in 2007-8, but failed to qualify this by adding that he had later learned of one, subsequently to drafting his report. However, I am quite satisfied that this did not reflect any kind of deviousness on Mr Welles' part (he said that he had brought this fact to the attention of the Plaintiffs' legal team), and that it in no way affected his impartiality. His conscientiousness was very obvious. I note that this was the first occasion on which Mr Welles had given expert evidence, and I therefore put that kind of point, and the way it was handled, down to inexperience.

985. In summary, therefore, I was impressed by Mr Welles as a clear, logical and conscientious witness, with a proper regard to the role of the expert witness. He was very clear that what he was giving me was:

> *"…a repo perspective. It's the perspective of a financing professional, and, as such, certain things are probably going to stand out as more important to me than others. And from my perspective in a very independent and unbiased way, I'm presenting you with the things that I, as a repo professional, would have focused on to a greater degree."*

986. He wanted, very properly, to emphasise that all repo traders would be different, in the sense of having individual characteristics and approaches. Whilst recognising that, I am nonetheless satisfied that he was an example of the kind of counterparty that CCC would have been dealing with in the repo market during its operational period. I found his evidence very helpful in educating me about the world of the repo trader, its workings, motivations and pressures, all at a practical, operational level.

987. Mr Welles' comment quoted above does, though, highlight one important point, which is that, once again, I am receiving evidence about the behaviour and attitudes of a different kind of participant in the market from CCC. Mr Welles' opinions and views come from the perspective of a repo lender, a party with whom CCC's directors and Management would be interacting, but with a different market view, and different objectives from those of CCC itself. Insofar as Mr Welles expresses views about the way CCC's directors conducted CCC's affairs, this is not within his expertise, but it is in any event the product of that differing background of knowledge and experience.

988. My function in this case is to judge the quality, propriety and care of decisions made and actions taken by CCC's directors. I am therefore not so much concerned with what repo lenders were actually doing or thinking at the time, as with CCC's directors' perceptions of this, and, insofar as those perceptions operated on their material decisions with regard to CCC, whether those perceptions were reasonably held, even if not correct. The materiality and weight of Mr Welles' evidence and opinions is therefore relative to that angle.

989. In short, I regard Mr Welles as a reliable and helpful example of the kind of party CCC's directors and management would actually have been dealing with at the time, but his views do

not provide an exemplar of how CCC's directors and Management "ought" to have conducted CCC's affairs.

990. I turn now to the Defendants' financial economics experts.

(d) Professor Hubbard - Financial economics – financial markets, CCC's business and repo financing.

991. Professor Hubbard is a distinguished economist. He holds various degrees in economics from Harvard and the University of Central Florida and is currently Dean of the Graduate Business School at Columbia University where he holds two chairs in Finance and Economics. He is a research associate of the US National Bureau of Economic Research, and an adviser to the President of the Federal Reserve Bank of New York. Since 2006, he has been co-chairman of the Committee on Capital Market Regulation and was involved in that Committee's published study (in May 2009) of the events leading up to the global financial crises of 2007-8 and their implications for financial regulatory reform. He was an adviser on the US President's Council of Economic Advisers in 2001-3 and at the same time was also Chairman of the Economic Policy Committee for the Organisation for Economic Cooperation and Development. He has published extensively and authored many books, including textbooks, on money, financial markets, macroeconomics and principles of economics.

992. Professor Hubbard gave a report, and conferred and provided joint statements with both Mr Welles (to whom his own evidence was mainly directed) and with Dr Carron, insofar as the latter dealt with the topics of Professor Hubbard's evidence. He gave oral evidence for one day.

993. The Plaintiffs point out that Professor Hubbard is entirely an academic. As he readily admitted, he has never been a practitioner, never worked on Wall Street and has no practical experience of ever trading in the repo market. The Defendants say that his evidence is useful for bringing an objective view of the risks faced by CCC in financing.

994. Whilst I take the Plaintiffs' point, it seems to me that Professor Hubbard does, usefully bring a macroeconomic perspective to the case, and an insight, therefore, into what was happening in the financial markets and the economy generally at the relevant time. His expertise lies in his analysis, as an economist, of observed events and data, and ability to draw (hopefully) reliable conclusions from this, and it is a different expertise from those who were directly involved in the events themselves. His opinions are helpfully material to at least some of the decisions I may have to make, not least about the counterfactual hypotheses as to what would most likely have happened if CCC had behaved differently.

995. Professor Hubbard was asked to address three particular points, namely (i) CCC's business model and its associated risks, (ii) the size and characteristics of the repo financing market and the repo terms offered to CCC, and (iii) macroeconomic and financial conditions at the time, and their impact on the availability and terms of repo finance to CCC.

996. His evidence, in a nutshell, was that the principal risk to CCC, right from the outset since it was inherent in its business model, was "financing risk", ie the risk of not being able to obtain affordable - or even perhaps any - finance for its operations. This was the risk which brought it down, and he points out that it was a risk which was disclosed to investors, again, from the outset.

997. Professor Hubbard laid stress on drawing conclusions from observable data rather than "anecdotal" evidence or intuitive judgements. This caused him to question certain assertions, in particular by Mr Welles, which he said were not backed up by the measured data which you would expect to show such evidence. He made this point particularly with regard to Mr Welles' opinion that the effect of "contagion" from the panic over the Bear Stearns incidents (of June 2007) had affected Agency RMBS even before August 2007. He said that you would then have seen evidence of this affecting recorded prices, but there was no such observable data.

998. I was broadly impressed with Professor Hubbard, both as to his obvious expertise and as to the breadth of his knowledge, albeit at a macroeconomic level. He was measured and sensible in giving evidence. Contrary to the submissions of the Plaintiffs, I did not gain the impression that his oral evidence was either incongruent with his written report, or sought to distance himself or to back track from any of his original statements.

999. As a matter of confidence, I would prefer the evidence of Professor Hubbard to that of Dr Carron where they disagree. As regards Professor Hubbard's disagreements with Mr Welles, they tend to be in areas which involve the actual workings of the market at the time. Mr Welles gives his opinions from being engaged in the market, whereas Professor Hubbard does so from his outside observations of data about the market. One explanation for their difference may therefore be that the wider beliefs of those involved actively in the markets at the time were not actually correct, albeit genuinely held. Another may be that their disagreements are about matters on which there is really no right or wrong answer, as they are indeed matters of opinion, and their differing opinions are, both, reasonable opinions to be held. This is a valuable point of evidence in itself. If it becomes necessary to choose between their respective opinions at any point, I will consider that in the particular context, but in practice, I doubt if it will.

(e) Dr Niculescu – Financial Economics – RMBS markets

1000. Dr Niculescu is a Chartered Financial Analyst with a BA in Economics from the University of Wellington in New Zealand and a PhD in Economics from Yale University. His career began in 1985 as an investment analyst, from where he moved on to bond market research and portfolio analysis with Salomon Brothers. He then spent 9 years with Goldman Sachs, from 1990. He was responsible for its Mortgage Research Division from 1993 – 1999. He did not personally trade CMOs, but he said that he advised those who did, and did so from the vantage point of having a seat on the MBS trading desk. From 1999 to 2008, he was an executive at Fannie Mae, and from October 2002 until September 2008 he was in charge of its Capital Mortgage Division. He was responsible, therefore, for the acquisition of mortgage backed securities and loans for Fannie Mae's own balance sheet (up to some $700Bn), and the associated hedging and funding responsibilities, and he was at the apex of the hierarchy of personnel who carried out any transactions. He is currently, since September 2009, a Partner at Capital Market Risk Advisors, a risk management firm providing business and litigation consulting services for US and international financial entities, specialising in portfolio strategy, risk analysis, asset valuation and stress testing, with particular expertise in residential mortgage backed securities. As it was not mentioned by either party, I have assumed that the apparent gap in his CV from September 2008 until June 2009 has no significance.

1001. Dr Niculescu was called for the Defendants because of his expertise in the operations of the RMBS markets, to give evidence in response to Drs Carron and Maini. He was asked to address three matters: (i) the nature, characteristics and risks associated with the RMBS in which CCC invested, (ii) the nature and characteristics of the market for those RMBS and (iii) the manner in which those securities were traded, and valued or priced.

1002. Dr Niculescu provided an initial report, a further "Reply Report" (in response to Dr Maini's Addendum Report), joint statements with both Dr Carron and Dr Maini, and a Supplemental Report during the trial, again in response to further evidence from Dr Maini in the latter's Supplementary Report. He gave oral evidence for two days in total.

1003. The essence of Dr Niculescu's opinions was to disagree with Drs Carron and Maini (in particular) about the size of the market for Agency floaters such as those held by CCC in the second half of 2007, and that it was large and liquid, and to express the view that if CCC had attempted to sell RMBS in the quantities suggested by them in that time, there would have been a real risk that CCC would have been perceived as a distressed seller, could only have achieved significantly discounted prices, and would have risked moving the market (adversely) downwards, thereby recalibrating repo lenders' pricings and generating margin calls which would have required yet more sales, which would have tended to reduce prices still further and create a downward spiral and ultimate failure.

1004. Although he referred to this phenomenon as a "liquidity spiral" it appeared from later evidence that it may be more accurate to confine that term to a market wide such phenomenon, and, in the case of an individual entity, to call it a "repo feedback loop". Nothing of substance turns on this, although I think the possible misuse of the nomenclature by Dr Niculescu may be suggested by the Plaintiffs to be a matter casting doubt on his expertise, which they criticise generally in any event. I do not find it to be of significance.

1005. The Defendants submit that Dr Niculescu's evidence was measured, impartial, detailed and reliable. They suggest that he demonstrated a broad and deep knowledge of RMBS and the relevant markets, understood the purpose of giving independent opinions, and did not speculate or offer opinions about what CCC was doing or should have done. I am not sure that I agree with the last point. Whilst Dr Niculescu may not have stated this directly, he certainly opined that CCC's strategy of holding on to RMBS was "less risky", in his view, than attempting to sell, which comes very close to offering an opinion about what CCC was doing.

1006. The Plaintiffs submit forcefully that Dr Niculescu's actual experience in trading RMBS was really very limited, and insofar as it had any practical base at all, it was very historic; he had always been involved more in either research or consulting and was therefore heavily reliant on data rather than experience. They also criticise Dr Niculescu for giving evidence about the supposed behaviour of repo lenders, when he was neither called to give such evidence, nor possessed any relevant experience. I accept the force in this.

1007. They also attacked Dr Niculescu's independence. They did so on two bases. The first was that his last report, the "Supplemental Report" had been "*at least partially drafted by*" a member of the Defendants' legal team. This assertion then became "*the revelation that Dr Niculescu's Supplemental Report was drafted by the Defendants' lawyers*" (emphasis added) on which basis it was then submitted that this report should be "rejected in its entirety" and the whole of Dr Niculescu's earlier reports "regarded with increased [sic] suspicion."

1008. The extremity of this submission is absurd. The evidence given was that for this final report – the need for which was occasioned by Dr Maini's disorganised approach to getting his own evidence before the court – Dr Niculescu had made a very rough draft which, owing to time pressures in the last couple of weeks or so before his evidence, the Defendants' lawyers had put into a coherent form. His previous reports had (he said and I accept) been entirely written by himself, subject to the (perfectly usual, in my experience) process of review editing by the legal team for accessibility and readability.

1009. It is undesirable for a party's lawyer to have any significant input into an expert witness's statement, and it would have been better if Dr Niculescu had managed to produce a more finished draft for final preparation for the court. This is not least because lawyers must avoid the possibility of influencing the actual expression of a witness's sentiments as a result of their natural authority in the context of appropriate preparations for a trial. However, I also accept the reasons given for the lawyers' increased involvement in this instance. Dr Niculescu endorsed the text of the report, such that I understand that he is content that it conveys his own views accurately, and I am satisfied that he would not have done this lightly. None of this therefore causes me any concern about his proper independence.

1010. The Plaintiffs' second attack on his independence arises out of his evidence, prompted by documents shown to him on the first day of his cross-examination, that in late August 2007, when at Fannie Mae, a subordinate had brought to him the offer of a large block (I think about $1Bn) of Fannie Mae Floaters for sale, but he had turned this down, not because the offer was intrinsically unattractive, but because of a limit at that time on Fannie Mae's balance sheet for undertaking such transactions. He now considered that that offer must have been from CCC. When asked why this had not appeared in his evidence before, he said that his previous recollection of this had been so vague that it had been decided that it should not be included in his witness statement. However, sight of the documents had brought the incident back to him with greater certainty, and so he mentioned it.

1011. The Plaintiffs do not make it perfectly clear whether their attack on Dr Niculescu's independence is based on the fact that he had an indirect business encounter with CCC at the relevant time, or the fact that this was not mentioned in his witness evidence prior to cross-examination. I reject the attack on either ground. The former is not of such a nature as to impair his ability to give independent expert evidence in this case, - any more, and in fact probably less, than were Mr Welles' similarly unrevealed contemporaneous business encounters with CCC. The Plaintiffs seem more to suggest that I should regard the failure to mention it earlier as evidence of deviousness or partisan contrivance by Dr Niculescu. In fact, I found this evidence perfectly natural, and perfectly explicable. I can well imagine that if Dr Niculescu had included evidence of his hazy recollection in his witness statement in the first place, the Plaintiffs would equally have been suggesting that that was an unreliable and partisan attempt to bolster the Defendants' evidence that such an offer had even been made. Whilst, with hindsight (and as is almost invariably the case) it might have been better if it had, in fact, been mentioned and explained earlier, that <u>is</u> with hindsight. Even if the initial judgement not to do so was prompted by lawyers, I do not see it as anything untoward.

1012. In addition to attacking Dr Niculescu's evidence for being purely academic and straying into the expression of opinions in areas in which Dr Niculescu is not qualified (such as the psychology of repo lenders) the Plaintiffs mount more general attacks on Dr Niculescu's evidence, suggesting that it is partisan, and that he has consistently both exaggerated, and

resolved evidential uncertainties, in favour of the Defendants' case. They cite instances where they say he has speculated on matters, such as the reasons behind CCC's reaction to apparent market enquiries about bonds for sale, so as to favour and support Mr Stomber's evidence on the point.

1013. I have certainly had some misgivings about Dr Niculescu's evidence. Whilst I accept that he demonstrated a deep and broad knowledge of the subject of Agency RMBS, this did seem to me to be very much from a technical rather than a practical viewpoint. I also accept that he strayed into expressing opinions about repo lenders' behaviour, although I do not see this as particularly heinous – it seemed to me to be mainly in regard to explaining why he rejected points made by Dr Maini, rather than in support of his own original opinions – and I simply treat this as a matter on which I should place no reliance.

1014. I wished, though, to consider more closely whether there was anything which should concern me as regards the suggestion of a partisan approach to the resolution of evidential uncertainties by Dr Niculescu. My reasons are, as will by now have become apparent, my concerns as to how far I can feel confident in relying on the assertions of opinion made by any expert witness generally, at least as regards their objectivity.

1015. The Plaintiffs, for example, contrast two occasions of Dr Niculescu's approach. The first is his exclusion of certain categories of Agency RMBS from his assessment of the size of the market, at the end of 2007, for RMBS with the characteristics of those held by CCC, as to which (I express this in doubtless oversimplified terms) he dismissed evidence of demand for structured Agency floaters as being any evidence of demand for strip floaters (such as held by CCC), on the grounds that it was impossible to draw reliable inferences about their relative pricing, and therefore too speculative to draw any consequent conclusion about the potential volume of such demand. They contrast this with the fact that Dr Niculescu was ready to speculate that the reasons for a reduction in the market price for Agency RMBS similar to those held by CCC was the market's expectation of the liquidation of certain SIVs (Structured Investment Vehicles), being the "Westways" funds liquidations.

1016. Aspects of Dr Niculescu's evidence in both these respects had given me cause for concern in any event. I had been uneasy at his refusal to include any allowance for private sales of RMBS (as to which there is no available recorded data) in his calculations of market volume. To do so simply in reliance on the fact that there was no recorded data, when the fact of some such transactions having taken place seemed to be admitted, struck me, at first blush, as being unreasonable. I had also wondered at the fact that Dr Niculescu appeared to be suggesting conclusions about the effects of the Westways liquidations spontaneously in oral evidence, and whether the fact that these had not appeared earlier in his evidence cast doubt on the depth of his knowledge of the markets at the time.

1017. Consequently, I have revisited the whole of Dr Niculescu's evidence, and re-read it in context. On doing so, I have concluded that my own concerns were ill-founded. As to the first (refusal to include allowance for private sales) I find that Dr Niculescu explained his reasons cogently in his Reply Report. As to the second, my general reading of Dr Niculescu's evidence reassured me with regard to his experience and knowledge, and I noted that Dr Niculescu had in fact referred in general terms to what were the Westways transactions in his first report, and as Dr Maini had himself produced the detailed Westways data only late in the day, from having followed up references in internal CCC emails for the purpose of his Addendum

Report, there appeared to be no significant difference between his and Dr Niculescu's depth of independent knowledge of the facts of what was going on in the markets, albeit they had operated in different sectors of it.

1018. As to the criticisms of inconsistency made by the Plaintiffs, re-reading the evidence simply causes me to conclude, first, that they descend to a level of detail with regard to technical expertise and judgment that I am not equipped to decide finally, but second, more importantly, that it is unnecessary for me to do so for the purpose of the decisions which I actually have to make in this case. Whilst I have therefore, in the circumstances, applied some caution in regard to Dr Niculescu's evidence, my caution arises from my perception of there being limits to his sphere of expertise, and not from any perception of his being partisan. Whilst his technical expertise is certainly deep, it seems to me that his orientation, from the vantage point of running the capital account of Fannie Mae itself, is not as centrally focused on the general commercial and investment market in RMBS as is the position of Dr Maini, or Mr Welles. However, that does not mean that I prefer Dr Maini's opinion to that of Dr Niculescu on any particular matter, because I look also at the quality of their reasoning, and where it is necessary, I make my preference according to the context. As between Dr Niculescu and Dr Carron, at any point where it should matter, I would on balance prefer Dr Niculescu's evidence to that of Dr Carron, first because I felt that he had paid more personal attention to his evidence, and second because, as I have stated above, I am here more confident of Dr Niculescu's objectivity.

(f) Mr Bezant – Financial economics - damages

1019. Mr Bezant's evidence, on behalf of the Defendants, and his joint statement with Dr Carron, was accepted by the Plaintiffs without cross-examination. Although I did not assess his evidence as oral testimony, it is convenient to make reference to it here, amongst my general assessment of the expert evidence as a whole.

1020. Mr Bezant is an expert in business valuations, with an accountancy background and about 30 years' experience. He is currently a Senior Managing Director at FTI Consulting, based in London, and has previously worked for Deloittes and Arthur Andersen. He appears to specialise in valuations for the purpose of litigation and arbitration, having carried out well over 400 such substantial valuations and given oral evidence on 41 occasions. His evidence had been sought by the Defendants with regard to the damages calculations put forward by Dr Carron, based on his Asset Sales Model, already mentioned. Mr Bezant had been instructed to consider the likely return to CCC as a result of the hypothetical RMBS sales commencing from July 2007 postulated by Dr Carron, and whether CCC sustained any losses which would or could have been avoided if CCC had undertaken such sales.

1021. Mr Bezant examined Dr Carron's Asset Sales Model, with a view to testing its reliability as a tool for calculating such damages The model calculated the potential effects on CCC's ultimate financial position of its having presumptively sold certain quantities of its RMBS portfolio at certain times, and for certain prices, and the extent to which losses eventually suffered on the liquidation of its total portfolio as at March 2008 would supposedly have been reduced, had it done so.

1022. Since Mr Bezant was not called for cross-examination by the Plaintiffs, I will leave giving my views and conclusions about the comparative evidence of him and Dr Carron to the appropriate point in giving my findings on the case as a whole.

Other experts

1023. Before moving on to consider the other material areas of expert evidence, I record that a part of Dr Webster's evidence was concerned with investment banking and repo finance, and she conferred, therefore, with Mr Welles. However, the main thrust of her evidence was in the area of risk management, to which I now turn.

(2) Risk Management experts

(a) Professor Sanjiv Das – Plaintiffs

1024. Professor Das was the Plaintiffs' expert in risk management. He has been Professor of Finance at Santa Clara University since 2000, having previously held faculty appointments at Harvard and the University of California, Berkeley. He has had an academic career for the last 25 years, but combines this with advisory roles relating to investment and financial risk in the United States and internationally, and he has published extensively. Whilst he had once worked for six years for Citibank, he candidly told me that this was to save enough money to be able to pursue the academic career which was his first wish.

1025. Professor Das was called to give evidence on financial risk management and in particular the use and purpose of risk controls. Professor Das provided a report and made a joint statement with the Defendants' corresponding expert, Dr Webster, and also gave oral evidence for 1 ½ days.

1026. The Plaintiffs submit that his evidence was appropriately focused on principles and practices of investment and risk management, this being his sphere of expertise material to this case. I entirely agree. The Defendants point out that Professor Das had never actually worked as a risk manager. Professor Das readily admitted this. His experience in the last 25 years has been entirely academic and advisory. The Defendants also point out that Professor Das's interests are apparently focused on mathematical modelling, rather than risk management as such. He is therefore, they suggest, an academic in the field of risk management, and an academic with a rather narrow focus.

1027. Professor Das concentrated on the risks inherent in CCC's business model of funding long term assets with short term repo funding, and doing so with a very high level of leverage in order to magnify profits to be gained, and, therefore, the appropriate management and operation of CCC's Investment Guidelines in the light of the risks run by this strategy. Professor Das clearly held strong views as to the importance of fixing, maintaining, and operating risk management tools, such as those contained in CCC's Investment Guidelines, and in particular the maintenance of a liquidity cushion. He did not see these as indicative guidance, but rather as rules laid down for the purpose of being observed. His favourite metaphor was automotive; he likened CCC's liquidity cushion to a car's brakes, with CCC's high level of leverage being the car's accelerator, and his point was that if you burned out the brakes, you could not just carry on down the motorway at high speed; you needed to "*slow down or get off the freeway and fix those brakes and come back on".*

1028. Although properly careful not to step outside his expertise, Professor Das clearly had the underlying view that the degree of risk being run by CCC in not actually selling off RMBS to deleverage, even despite other steps taken, was unacceptably great. He stressed that the risk was "asymmetric" meaning that it risked the huge and catastrophic loss of, potentially all

capital, as against the small gain of ultimately realising CCC's assets at par on maturity rather than locking in whatever relatively small losses might have to be suffered by selling in the short term.

1029. Professor Das expressed very firm views that it was wrong to suspend guidelines which could not be adhered to, not just because these had been publicised to potential investors, but because suspension risked removing the internal discipline of striving to restore them, and would also signal to the outside world that you were operating riskily, which perception itself would create risk.

1030. I noted that Professor Das had provided expert evidence before, but in the context of investors suing promoters for negligent misrepresentations, and ratings agencies for negligence. Professor Das's evidence did seem to me to be permeated with an underlying focus on what he saw as the representations made to investors about CCC's business, in particular in its Offering Memorandum. I gained the impression that his views on appropriate risk management action were heavily influenced by his previous involvement in such investor-led disputes.

1031. Professor Das's view was that it was the function of risk management to identify potential risks and bring them to the attention of those whose job and duty was to manage the affairs of the company. He accepted, however (and very properly) that assessing the probabilities of such risks coming to pass was the province of those who were expert in the relevant markets, which he was not. Professor Das also accepted that whilst it might be the function of risk management to draw management's attention to what it needed to achieve in order to mitigate or eliminate the risks which had been identified, it was outside his expertise to give any opinion on the practicalities of any particular measures which might be intended to effect that achievement.

1032. I was impressed with Professor Das's candidness and professionalism as a witness. His evidence was very clear, and balanced and he had an air of being sensible. He was properly careful not to step outside his expertise. He was willing to agree frankly with propositions put to him where he did agree with them, and was not always looking out for a trap. He accepted where there were material matters which he might have been unaware of.

1033. I do thus feel that I can have confidence in the impartiality of his evidence. However, Professor Das was a theoretician and a technician, and I have to evaluate how far his views should influence my conclusions in this particular case. In assessing the significance of the views of an expert such as Professor Das, I also need to bear in mind the limits arising from his ready acceptance that he is not an expert in either repo financing or RMBS.

(b) Dr Lesley Webster - Defendants

1034. Dr Webster was the Defendants' expert witness in the field of financial risk management but her evidence also overlapped into investment management and repo financing, as mentioned. She had initially pursued an academic career, gaining a PhD in economics at Stanford University and also becoming an Assistant Professor of Economics at Washington University, focusing on microeconomic theory. She then moved out into Wall Street. From 1983 to 1990 she worked for Chase Manhattan Bank as head of the Fixed Income Arbitrage Desk in the securities division, where she was involved in trading a variety of securities including Agency RMBS and suchlike, and using repo finance, acting both personally and supervising others. She then worked at Union Bank of Switzerland from 1990 - 1994 as Managing Director in

charge of US Dollar Fixed Income Derivatives. She moved into risk management in 1994, with Chemical Bank as Senior Vice President in charge of Market Risk Management. Over the following years, through several mergers and changes of name, her employer was ultimately JP Morgan. Her role was extended to Counterparty Risk Management in 1997; this involving managing the bank's exposure under trading, secured lending and repo financing, including the establishment of risk management procedures. In 2000 her responsibilities were extended yet further to include Asset and Wealth Management, where she co-chaired the Risk Committee for that Division, and also became head of Global Fiduciary Risk Management, which involved the development and implementation of risk policies and procedures. In such roles, Dr Webster served on many and various committees. She has sat on the Boards of several companies, being currently a Director of Manulife Financial, a global asset management company. On retiring from JP Morgan in 2005, she set up her own consultancy firm in risk and investment management.

1035. During her career Dr Webster points out that she was working in risk management through several international and global financial crises, including the notorious LTCM crisis of 1998, and, as a consultant, through the global financial crises of 2007-8, during which she was engaged to advise a clearing house for mortgage-backed securities, including Agency RMBS, monitoring their daily counterparty credit risk in the markets.

1036. Dr Webster was instructed to provide her expert opinion on three matters namely (i) methods and means of risk management for leveraged investment portfolios such as CCC's (ii) the use, intended operation and purpose of Investment Guidelines for risk management and specifically (iii) the appropriateness or otherwise of suspending Investment Guidelines of the type used by CCC and its consequence, by reference to the standards and principles of prudent investment management.

1037. The essence of her evidence was that CCC's risk management practices and related investment management decisions were reasonable in the light of industry practices at that time. She considered that the suspension of Investment Guidelines was appropriate to enable recovery from what she described as a "passive" breach of these, that is, one caused by external circumstances and not internal bad decisions; she considered it pointless to maintain a guideline when it could not be adhered to. She disagreed with Professor Das as to it being imperative immediately to restore a liquidity cushion to its previous or optimum level after it had been depleted, but saw this as a decision to be taken with regard to the circumstances. She considered that Professor Das had failed to have regard to the risks to CCC of selling its RMBS when he concluded that RMBS should have been sold after August 2007 in order to increase CCC's liquidity.

1038. Dr Webster wrote a report and provided two joint statements with Professor Das and Mr Welles. Most unfortunately, shortly before she was due to give oral evidence and when in Singapore at an international conference, she sustained serious injury in an accident, including fractured bones. Her evidence was therefore postponed for two weeks, and was eventually given over two days, when she had sufficiently recovered, by video link from Florida. Although plainly pale and in obvious discomfort, she gave evidence decisively, and it is not suggested that her unfortunate injuries impacted on her evidence.

1039. Dr Webster was firm, extremely articulate, and certainly spoke with an air of authority. She was also notably concerned for accuracy. I was impressed with both her analysis and her

ability to convey her ideas. Her evidence was measured and, to my mind, very practical and redolent with common sense. Her attitude to statistical analysis was that it was a useful tool, but to be applied with judgement, rather than rigidity. Dr Webster's knowledge of her subject was obvious, but, whilst accepting that others were able to give more expert evidence in other areas than she was, she nonetheless stood up for herself - and it seemed to me with justification - as being knowledgeable in other areas of financial management as well. She was able to support much of her opinion by specific reference to her experiences.

1040. The Plaintiffs dispute Dr Webster's practical expertise on the basis that her direct experience was historic, and that her professions of experience during the 2007-8 crises were undermined by her refusal to disclose the name of her client, claiming professional obligations of confidentiality. I did not judge it necessary to require her to make this revelation. I do not disbelieve her evidence in consequence, but by the same token I cannot attribute any particularly special weight or value to it, as I have nothing against which to gauge it.

1041. The Plaintiffs suggest that Dr Webster was neither candid nor helpful, accusing her of pedantry, exaggeration, being inconsistent, unreasonably argumentative and, most seriously, becoming an advocate for the Defendants' case. I do not agree. Apart from Dr Webster's becoming somewhat discursive, at times, on the second day of her evidence, I saw no such faults at the time, and looking back, I see only an occasional use of hyperbole to emphasise a point upon which she was being challenged, which might have been termed exaggeration, but was perfectly obvious and in no way misleading. I have not found other supposed examples cited by the Plaintiffs to be borne out upon reading the evidential references.

1042. In short, I found Dr Webster to be a knowledgeable, clear, candid and objective witness. Her evidence was convincing and I have confidence in both it and her. Where there is disagreement between her and Dr Das, - and such disagreements are extensive - I prefer Dr Webster. Whilst I respect Dr Das's expertise as an academic and theorist, I am satisfied that Dr Webster's experiences gave her a wide and deep material knowledge of the standards and practice of the times, and I find that her views are more practical and grounded in reality.

(3) The Insolvency Experts

(a) Mr Phillip Wallace - Plaintiffs

1043. Mr Wallace was the Plaintiffs' "insolvency" expert. This of course means that he is, in practice, an accountant who has come to specialise in insolvency cases (ie, acting as liquidator or company administrator) and by extension, giving advice to companies who are, or fear they may be, facing the prospect of insolvent liquidation or administration.

1044. Mr Wallace had worked for KPMG (formerly Peat Marwick Mitchell) from leaving University in 1971, until his retirement in 2006. He has an impressive CV as regards practical involvement in major liquidation situations, several in the financial products sector. He acknowledged, though, that this was the first occasion on which he had actually given expert evidence in court. Hitherto the litigation in which he had become involved as a potential expert witness had always settled. He also, readily and fairly, accepted that whilst he understood the mechanics of RMBS and also the repo financing market, he was not an expert in either (and I have to say that this actually did show up in mistakes which he had made in some of his worked examples, about the financial effects of repo transactions, such as the sum which a vendor would receive back in liquidity when selling an asset as to which the haircut

rate had subsequently increased.) His real expertise, in other words, was in the area of insolvency and insolvency practices on a general basis, although his experience meant that this was also with an emphasis on banking, and large and complex insolvencies.

1045. Since his retirement, Mr Wallace had served in non-executive roles on the Board of the Insolvency Service, (the agency of the UK Government with responsibility for insolvency matters), as Advisor to the Creditors' Committee of Lehman Brothers International (Europe) Limited (in Administration), which needs no explanation, and also on the board of the Financial Services Compensation Scheme, involved with recoveries in the case of the insolvency of regulated financial companies.

1046. Mr Wallace had provided a single report and an agreed statement with the Defendants' counterpart witness (Mr Shaw), and he gave oral evidence for two full days. The Plaintiffs contend that Mr Wallace gave detailed and credible evidence and candidly made concessions where appropriate. The Defendants contend that Mr Wallace's evidence was slanted, judgmental, went outside both his expertise and the proper scope of expert evidence and that the concessions which he made were forced.

1047. I do have concerns about Mr Wallace and his evidence. These relate first to the value of much of it at all, and second to the basis of Mr Wallace's instructions and my views of Mr Wallace himself.

1048. As regards evidential value, I gave leave for the introduction of expert insolvency evidence principally because of my recognition, as already mentioned, of the difficulty of liquidators making a case without live evidence, and therefore being very reliant on expert assistance. The Plaintiffs were emphatic that "insolvency" evidence was essential to an assessment of the care and/or propriety of the Defendants' conduct of the affairs of CCC at the relevant time, as well as to ensuring the correct analysis of facts going to the arising of the requirement to have regard to the interests of CCC's creditors and the complaints of wrongful trading. The evidence of an insolvency practitioner as to the conclusions he would have drawn about the financial state of CCC's business, what needed to be done with regard to its future at any time, and the advice that he would have given to CCC's Board, were of essential importance. I gave leave for such evidence to be called, though with some misgivings as to just how worthwhile it was likely to be in practice.

1049. Mr Wallace was instructed to provide, and did, his opinion on seven topics which I summarise as

(i) the indicators of insolvency for a company such as CCC ("*a leveraged investment company with a strategy of investing in long term assets with short term funding*"),

(ii) the factors affecting and criteria for assessing insolvency or the risk of insolvency for such a company "*exposed to volatile financial markets"*,

and then, with respect to each of four material dates (31st August, 1st October, 30th November - although he amended this to 13th November - and 31st December 2007):

(iii) the financial position of CCC,

(iv) the principal threats to its solvency,

(v) the components of its financial statements and forecasts and the "*veracity"* [sic] of projections as to its financial position prepared by the Defendants, "*including the adequacy of and assumptions underpinning budgets and cash flow forecasts"*

(vi) whether CCC was then in the "zone of insolvency", and

(vii) the nature and contents of the "independent advice" which Mr Wallace would then have given if he had been instructed to advise CCC's Board.

1050. Mr Wallace ultimately expressed the opinion that, had he been advising the directors of CCC at about August 2007, his advice to them would have been that they should sell about $8Bn worth of RMBS in order to restore liquidity to acceptable levels.

1051. The first four items above seem to me to be scarcely matters of insolvency expertise, but to be matters of evidence about the particular operations of a "leveraged investment company such as CCC" which is for experts in that field to deal with, but are otherwise a matter of common sense. At the risk of being simplistic, the indicators of insolvency are an inability, or potential inability, to pay debts, and that is also the usual and obvious criterion for assessing insolvency. The threats to solvency are matters which may bring this situation about. The fact that in CCC's case the overriding threats were of inadequate financing or liquidity to meet financial obligations which might arise is stating the intuitively obvious.

1052. The fifth such matter appears to be a criticism about lack of paper records, although I accept that it could have some indirect bearing on an assessment of the conduct of those in charge of the company. Assuming the phrase "zone of insolvency" to have any legal significance, the sixth is a matter of law or mixed law and fact which is more a matter for the court.

1053. The seventh, I do of course accept, would be a matter within Mr Wallace's personal knowledge and expertise and therefore proper for him to express an opinion on, but its value depends entirely on three factors which are, first, whether engaging the advice of an insolvency practitioner was something CCC's directors not only could, but should (on the test that any reasonable director would) have done, second, whether Mr Wallace's advice is the advice which it can safely be inferred they would then have received, and third, how CCC's directors ought then to have reacted to such advice. None of these points seems to me to be self-evident, and this reduces the value of Mr Wallace's evidence considerably.

1054. My second, and major, concern is as to the objectivity of Mr Wallace's approach and evidence generally. Whilst he was not instructed to give his opinion on the basis of a set of assumed facts, he explained in oral evidence that he had been supplied by the Plaintiffs with a large selection of documents (some of which would plainly not have been available to the Defendants at the time), and had written his report by making his own investigations into and analysis of these, and he had substantially written it before he saw the Defendants' witness statements His approach, on looking at these, was then to ask himself if they showed that he had got anything wrong in his report, and, having generally concluded that they did not, he had continued to write his report as before, preferring (he said) the conclusions that he had drawn from the documents to what was in the witness statements where there were inconsistencies. Couple this approach with the fact that the tenor of his instructions seems to me to have been somewhat slanted towards the conclusions which the Plaintiffs invited, rather than encouraging objectivity, and I begin to feel some doubt that Mr Wallace's report is the product of a fully open-minded approach.

1055. This unease was compounded by some of Mr Wallace's oral evidence and by my impressions of him generally. As to the former, I give just one example; there were others. Mr Wallace expressed criticism of the effects and the actual propriety of what CCC had (he interpreted from the documents he saw) said to dealer counterparties about their intentions with regard to deleveraging, ignoring what was said in relevant witness statements, and even though Mr Wallace accepted that the Defendants' representations in public documents and statements had been accurate. When pressed, he said that he was only saying that "maybe" there was dishonesty. If so, this was gratuitous speculation which was not only outside his expertise, but outside the proper scope of expert evidence at all, and the fact that Mr Wallace felt it appropriate to include it says something about his underlying approach.

1056. As to slant within his instructions, apart from matters of underlying innuendo, it was notable that Mr Wallace was not instructed to consider CCC's position after 31st December 2007. He said that he assumed that this was to ensure that his views were not influenced by the collapse in March 2008, but I note that it also had the effect that his views were not influenced, either, by the fact that CCC's financial metrics improved somewhat in the first six weeks or so of 2008.

1057. Mr Wallace, I regret to say, struck me as opinionated and censorious, initially very much so, although he became less so later in cross-examination. He gave me the clear impression that, consciously or unconsciously, he had set out to write a report which justified the conclusions which the Plaintiffs wanted him to support, but which were also undoubtedly what he expected to find and was looking to confirm. Whilst this approach was encouraged by the flavour of his instructions, I also think it was part of his professional character. He has worked for very many years as a liquidator and company administrator. This function induces such a mind-set all too easily. It is an important and invariable part of a liquidator's role, especially in major insolvent liquidations, to be on the lookout for financial wrongdoing or incompetence, which he is then expected to pursue vigorously, fighting for the interests of disadvantaged creditors or shareholders. However, such a predisposition is not the appropriate approach to bring to the giving of dispassionate expert witness evidence, even about aspects of insolvency.

1058. Mr Wallace did, at times, allow himself to stray well outside the scope of either his expertise or the proper role of evidence, and to become, in effect, an advocate for the Plaintiffs' case - and by this I should say that I mean not just giving a strong opinion which in fact supported that case but arguing the merits of that case. He did so, for example, in volunteering opinions derived from what he perceived from the documents, such as criticisms of Mr Stomber's way of handling negotiations with repo-lenders. It was notable that, throughout his report, his language was routinely pejorative of CCC's Board, and rarely, if ever, could he see anything to approve of.

1059. I need to mention two broad points about the content of his evidence. The first is that insofar as his evidence depended on his understanding of the appropriate concept of insolvency, he was plainly using the concept as he understood it to apply in English law, although I think that even then the Defendants say that he did so incorrectly. I do not think that anything material turns on this, however, for reasons which I have given when considering legal principles.

1060. The second point is that a very prominent aspect of Mr Wallace's criticisms of the Defendants was of the absence of paperwork – such as written and detailed analyses, worst case scenarios with varying inputs, financial modelling, cash flow forecasts, etc – which he said he would

have expected the Defendants to generate in the course of giving any proper consideration to the future options and courses of action for CCC in the circumstances. The lack of such paperwork then led him, in effect, to opine that there could have been no proper consideration of those matters because there was no paperwork to demonstrate it.

1061. Whilst this is, again, a matter for me rather than for Mr Wallace, the importance which he attached to paperwork made me feel that he was inclined to have an undue regard for form for its own sake, as contrasted with substance. (It also, in fact, made me feel that the involvement of someone such as Mr Wallace in CCC's affairs at the relevant times of crisis would have been a major source of irritation and even distraction for its Management.) The Defendants point out that Mr Wallace had spent some time (18 months) as the first accountant ever seconded to the Bank of England, and they suggest that this, and his involvement and familiarity with regulated financial institutions, may well have brought about his concern for paperwork, because regulated financial institutions are obliged to produce so much such paperwork. The Defendants also point out that CCC's investor profile was entirely different from the investor profile of such institutions, which are regulated for the protection of ordinary, average "consumer" customers. It is therefore, they suggest, neither necessary nor reasonable to assume that the same approach ought to apply in a company whose investors are confined to the financially astute and sophisticated.

1062. This may all go to explain Mr Wallace's emphatic desire for paperwork, but in the end, it is the quality of the decisions which were implemented and the evaluations behind them, and not whether there were written exercises in support of them, which is the important matter for me. I will consider any implications supposedly arising from any suggested deficiency of paperwork in their particular context.

1063. In summary, therefore, whilst I accept Mr Wallace's expertise, Mr Wallace did not impress me greatly as an expert witness, but my concerns about the weight which I can place on Mr Wallace's evidence arise from the fact that I do not think he managed to come to his task with a sufficiently detached and dispassionate approach. He let himself be drawn into the role of advocate for the Plaintiffs' case, and was too ready to step outside the limits of opinion which his expert credentials qualified him to express.

1064. My concerns therefore apply principally to his written evidence, because I <u>am</u> satisfied as to his integrity in giving oral evidence. I am quite satisfied that in his oral evidence, Mr Wallace very properly gave completely honest, open, and candid answers to questions. He did, therefore, make concessions where it was demonstrated to him that he should do so, and he did not attempt doggedly to defend the indefensible. Indeed, he was not evasive about the fact that many of his answers about steps which he thought should have been taken by directors of a company in CCC's position, were ultimately very much in line with the Defendants' contentions as to what they did. I felt confident that his answers were genuine, and were not calculated for effect. For all that, he deserves credit, and it means that much of his evidence I do not discount.

(b) Mr Mark Shaw - Defendants

1065. Mr Shaw, the Defendants' insolvency expert, has been a qualified insolvency practitioner since 1998 and a partner in Moore Stephens (subsequently BDO) since 2000, having obtained a first class degree in Accountancy in 1993. He became head of BDO's London Business Restructuring team in and from 2008. He was a practicing Insolvency Practitioner ("**IP**")

during the 2007-8 financial crises. He had direct experience of RMBS and similar assets as such an IP but not (he said) to the level of an expert.

1066. Mr Shaw was asked to consider the same set of topics as had been put to Mr Wallace, as a response to his evidence. He provided a report and a joint statement with Mr Wallace and gave evidence for just over one day.

1067. The Plaintiffs seek to dismiss Mr Shaw as an "unimpressive" witness, who lacked experience, avoided key issues "clearly" relevant to the case, and referred to Mr Stomber's evidence rather than to contemporaneous documents. I disagree. I found Mr Shaw to be an impressive, lucid and thoughtful witness, whose evidence was measured and who was being appropriately careful to confine his evidence to his expertise. I also found this to be perfectly sufficient to qualify him to express an expert opinion in insolvency matters, certainly so far as material to this case.

1068. I found his declared approach to advising companies who sought his advice because of financial difficulties and perhaps the risk of insolvency, to be sensible and, it seemed to me, appropriate. He saw his function as an IP as being to understand the company, and then to ensure that its management understood the risks and consequences of particular actions, and thus made properly evaluated judgements, always with an eye on whether the company was or was not actually insolvent or moving that way. He did not see it as his function to step in and tell management what to do, to make judgements for them, or to effectively take over the company, this being appropriate only when the company was in liquidation.

1069. I have indicated that I do not feel that insolvency evidence is of a great deal of materiality in this case, and in the event I do not think that any insolvency matter is at all likely to require a decision from me, let alone one that could be crucial to the case. I will deal with any specific point which may arise in its context. As will be gathered from the foregoing, I was more impressed by Mr Shaw's approach than by Mr Wallace's.

1070. Mr Shaw appended to his report a set of exhibits charting various financial aspects of CCC's business over the period from 1st January 2007 until March 2008. It was agreed by both sides that these charts were accurately compiled from the evidence and the figures to be found there. I found them extremely useful and they should likewise be regarded as appended to this judgment. I list them below as a convenient account of the matters which they showed.

B1 CCC's daily and monthly net asset value,

B2 the average final price of CCC's RMBS assets,

B3and 4 CCC's average and "effective" repo haircut levels,

B5 CCC's available repo capacity and capacity actually used,

B6 CCC's liquidity cushion measured in both absolute $ terms and as a percentage of CCC's adjusted equity,

B7 CCC's RMBS as a percentage of total asset allocation,

B8 CCC's leverage ratio,

B9 CCC's bi-weekly 20 Day 99% portfolio Value at Risk calculations,

B10 CCC's share price,

B11 The net interest income and principal repayments of CCC's RMBS, by month and cumulatively, together with levels of principal outstanding and repo lines used.

B12 The number of CCC's repo counterparties.

1071. I found these graphs very helpful, but remind myself, as with all such charts, first to be astute to avoid gaining a false impression from (for example) the scale used, or the focus of the graph itself (compare, for example, graphs B-2A and B-2B), and also that, as Mr Shaw himself pointed out, to avoid the influence of hindsight at any particular point on the time-line of such a graph, one needs to cover over the part of the graph which plots events in the future.

(4) Delaware Law

1072. I have read the two reports and joint statements of **Justice Carolyn Berger** for the Plaintiffs and **Chief Justice Myron Steele** for the Defendants. They speak for themselves, and I will refer to their contents if and when required as to any question of the application of Delaware Law.

(5) Audit and Accounting

1073. The reports and joint statements of **Dr Gary Holstrum** for the Plaintiffs and **Mr Scott Carnahan** for the Defendants were all admitted without cross-examination.

1074. Their evidence was mainly concerned with two peripheral issues, going to the Defendants' motives. The first was the potential for Carlyle having to consolidate CCC's accounts into its own and whether this would have a detrimental effect on the interests of any of the Defendants (thus providing a potential conflict of interest or motive for improper behaviour, and possibly of relevance to an issue as to whether CCC was justified in placing reliance on the availability of financial support from Carlyle when considering its prospects). The second appeared to be an opinion as to whether CCC's directors had provided misleading information to PwC, as its auditors, which affected the latter's assessment that CCC was a "going concern" in late 2007/early 2008. Neither point is central to the case. I will therefore only refer to this written evidence if and where necessary on a more detailed consideration of the factual evidence.

(6) Dutch Law

1075. The reports and joint statements of **Professor Matthijs Nelemans** for the Plaintiffs and **Professor Rogier Raas** for the Defendants were also admitted without cross-examination.

1076. This evidence goes to whether or not various actions by CCC breached Dutch regulatory law obligations of public disclosure, in particular. Again, no such breach has any direct materiality to the complaints of loss and damage in this case, as I have already mentioned in noting them on a broad basis above. I will therefore refer to this evidence according to its written terms only if and when necessary.

Miscellaneous - submissions

1077. Lastly on the general matter of evidence and submissions, the Defendants invited me to examine carefully any submissions made by the Plaintiffs as to where evidence supported any particular proposition or inference, to satisfy myself, if I was minded so to find, that their submissions were justified.

1078. I have done so, because the need for such scrutiny became very obvious. I will give here two examples. The Plaintiffs refer, in a footnote in their closing submissions, to the evidence of "*the Defendants' own repo finance expert, Professor Hubbard, who considered that CCC management should have taken into account the real world signals it was experiencing at the time as to the repo market*" *Hubbard XXN {Day 54/76: 2-8*)" (emphasis added).

1079. This was in the context of a written submission that the CCC Management did not do so, and to my mind clearly insinuates that Professor Hubbard was endorsing this judgment. In fact, the reference is as follows:

> "*Q. So would you accept that in considering the risk of [sic] CCC of haircuts rising CCC would be obliged to take into account the real world signals it was experiencing at the time as to the repo market?*
>
> A. *Among other things, yes. My reading of various emails and internal documents suggested they were exquisitely focused on same*." (emphasis added).

1080. It is thus perfectly clear that this answer was not supporting any criticism of CCC at all, as the slight change in the footnote report from "would be obliged to take into account" to "should have taken into account", and the omission of the second sentence of the reply, manages to insinuate.

1081. A second example is that the Plaintiffs, in submissions citing an email of Mr Stomber's late on 14th September 2007, describe him as reporting to Mr Conway and others that CCC "only" stood a 65-75% chance of meeting increased haircut demands for the ensuing Freddie Mac repo roll without recourse to a proposed $100Mn bridge loan from Carlyle. This is reported as if Mr Stomber used the word "only" as a negative and anxious comment from which a state of mind of knowing that CCC was in extreme peril could be inferred. However, the word "only" was actually the Plaintiffs' own comment, and was not included in the original. When its text is examined accurately and in context, it is rather more a positive and encouraging statement, carrying the connotation that matters were not as bad as had been feared.

1082. There have been many other such examples, with the consequence that I have constantly felt the need to examine assertions made in the Plaintiffs' submissions to satisfy myself that they were reasonably accurately based and justified at all as assertions, even before considering whether they supported the conclusions contended for. This has been wearisome. It is only fair to say that there have also been some such instances in the Defendants' submissions, but these have only been occasional.

1083. There have also been many places in which a submission in the Plaintiffs' written closing submissions has been footnoted, with the impression being that this was therefore a reference to supporting evidence. In fact, many such footnotes were simply references to where the allegation was made in the Cause. This obviously adds nothing to the mere assertion. I have, though, assumed that this was not part of an attempt to bolster the appearance of strength in the Plaintiffs' case, but was provoked by the Defendants' complaint, made on many occasions,

that the Plaintiffs' case was constantly going outside their pleadings. I have of course considered whether and if so how far any such assertion is supportable on the basis of the actual evidence.

8. Some general background findings.

1084. Because I will be considering the Plaintiffs' complaints separately with regard to six particular periods of time, it is convenient here to record some findings which will be of general background application at all these times in some way or other.

The central complaint

1085. Shorn of embellishment, the essence of the Plaintiffs' complaints is one matter only. That matter is the Directors' decision, taken at its earliest (if implicitly) at the Board Meeting of 26th July 2007, but certainly and expressly as at the 23rd August 2007 Board Meeting and consistently maintained thereafter, to retain rather than sell at least half (or thereabouts) of CCC's portfolio of RMBS, with a view to surviving successfully the financial market turbulence of mid-2007 and then adapt to market conditions thereafter.

1086. This complaint of not selling is often expressed with a qualification along the lines of: "*at any rate without otherwise raising capital or liquidity for CCC, or restructuring CCC or winding CCC down*". However, this does not change the position. The first element of this qualification is a different method of raising funds, and I will obviously examine this, although it has only been half-heartedly pursued in practice. The latter elements are really just different ways of characterising what would in fact be a sale of RMBS.

1087. It is really only the effects of the decision not to sell RMBS which are alleged in the Cause to have been a cause of loss to CCC. The essence of the complaint is that when CCC's RMBS were later forcibly converted into cash or seized as security, CCC did not receive as great a cash equivalent as it would have done if RMBS had been liquidated earlier. Whilst, of course, the decision not to sell can be broken down into elements by describing exactly what happened, how the decision was made, and so forth, none of these component elements, even if it could be analysed as a cause of action, itself create any further claim unless some loss separately attributable to that element can be found and is alleged.

1088. The Plaintiffs do seem to accept this. In the "Synopsis and key propositions" of their closing submissions they say that

> "*The Defendants' core breach may be characterised as either*
>
> *a.* *a decision to attempt to ride out the market without substantially reducing leverage; or*
>
> *b.* *a failure to take steps to substantially reduce leverage."*

which is again really just two ways of describing the core complaint because the only practical method of reducing leverage was selling RMBS.

1089. The Defendants agree, saying in their footnotes to the unfruitful attempt to agree a Concise List of Issues that

"as the Defendants understand the Plaintiffs' case, the central allegation made is that the Defendants breached their duties by, at various times, failing to "insist" or "recommend" that CCC take urgent steps to

(a) sell down CCC's RMBS assets;

(b) raise additional equity capital; and/or

(c) conduct an orderly winding down of CCC

(see, for example, paras 10 and 11 of Ps' Summary, and paras 308D.11, 308G.10, 308I.10 and 310 of the Amended Cause)".

1090. This seems to me to be quite right, although the Plaintiffs, as ever "standing by their pleadings", have asserted (correctly) that there are many other breaches alleged in the Cause, and they insist that they rely on them. This ignores the fact that those matters, even if breaches of duty in their own right, go nowhere in the absence of it being alleged that they caused CCC any identifiable loss in their own right. Unfortunately this is a recurrent point in the narrative following.

The nature of the relevant markets

1091. The following points are matters of impression which I have taken from the whole of the evidence in the case, and which I regard as significant background for the purpose of evaluating the criticisms made of the Defendants' conduct. They are about aspects of the market in which CCC was operating.

1092. The banking and financial instrument market in the United States is a hugely complex network of interrelated financial transactions. Whilst I am concerned with the bond market, and particularly the buying, holding and selling of Agency RMBS and the financing of such transactions, that market is only part of the picture, and it is not a sealed unit. The banks who lend money on the basis of 30 day repo transactions to entities such as CCC distinguish their own position on those transactions as "reverse repo". But amongst their own activities – as I have already mentioned, they do not leave their own funds standing idle, but deploy them in money-making activity for the bank itself - they engage in direct repo as well. They will obtain further funds by, for example, conducting their own repo transactions with other banks. Indeed, I understand that they would even be using the RMBS purchased from CCC as security for their (the banks') own financings, and that whilst this seems inconsistent with the obligation to return CCC's securities at the end of the repo 30 day period, it is possible because the bank's own repo will be shorter term and even generally overnight repo, rather than 30 day repo. The financial markets therefore have a lot of "moving parts" as Mr Stomber described it. All this illustrates that the interaction of other aspects of the market can, and will, influence the way in which players in the market behave at any particular time, and it emphasises that the actual influences in any particular situation may not be obvious, particularly to an outsider.

1093. Next, but here stating the obvious, every player in this market is in the business of trying to make money, and is therefore negotiating with a view to making profit by gaining an advantage or benefit for itself - or at least not giving one away. Success in achieving a profitable deal will often depend on predicting how others will react, either directly or in their reaction to outside events, so as to be able to position oneself to take advantage of what they

appear likely to do. Actions can therefore be influenced, and deals done or not done, because parties back impressions gained from small pieces of information, gossip, and even mere rumours.

1094. This second-guessing process can become very intricate where predicting how others will react involves anticipating and predicting how those others will themselves predict how yet others will react. This is the kind of psychology which creates "highly correlated" (Dr Webster's phrase I think) reactions in a market, especially to bad news events. The impetus for safety play gains momentum, because as Mr Welles said, when difficulties are perceived, no player wants to be caught as the "last out of the door" compared to his peers. When behaviour starts reflecting this kind of reaction, the result can be what looks like (and very probably is) panic and exaggerated response, and can be very different from what cool-headed logic would predict.

1095. Another consequence is that, as I am perfectly satisfied, one strong underlying characteristic of the market is that information is both highly prized, and strongly guarded. Information is power. Information often unlocks the opportunity to make a profitable deal, or a more profitable deal than the opposition or the competitors who lack that information. It furnishes the opportunity to get in there first, or to exploit a negotiating edge. Almost all communications between market players are negotiations, or potential negotiations, or the obtaining of "colour" (Dr Maini's word) as useful background to potential negotiations, and I am satisfied that communication therefore generally proceeds on the basis of trying to glean as much information as possible whilst giving away as little as possible. No player in the market will therefore voluntarily tell you something that they do not want you to hear, and I have no doubt that experienced market players recognise that it is very often necessary to be cautious, perhaps even sceptical, about information which one is apparently being given. This is not to suggest that the market is rife with misrepresentations and attempts to overreach, and obviously having a reputation for integrity has its own advantage, but beneath all the information being exchanged is the underlying acceptance that everyone is looking to make a profit, that that is why they are dealing with you, that it is therefore important to be alert for the possible implications of any situation, and that one should at least be aware of where the subjective interests of any particular counterparty are likely to lie. Players will always be on the look out for opportunities to do a profitable deal, and one man's misfortune is another man's business opportunity.

1096. The tension between the pull of secrecy and privacy for oneself, but the need for information about others' actions to assist in making an efficient market, is illustrated by the practice which I was told about, that where BWICs ("Bids Wanted In Competition", ie bid lists soliciting offers for particular bonds) result in a sale, it is the second highest bid, or "cover" bid, which is then recorded and publicised as the value of the security, appearing as price "discovery". This seems to be a compromise between the desirability to the community of establishing market values, and the wish and interest of the particular transacting parties to keep the actual strike price away from the community's eyes.

1097. Another point which I glean about the market is that negotiations can be influenced or complicated by factors which are not immediately visible. With a bank, for example, there may be the influence, or even overriding control, of other departments or "desks" (such as credit control, or even relationship management) or other higher policy imperatives from within the bank. These may be general, such as which department has the superior rank in the

bank's internal structure, or they may be merely transient, for example, how the transaction will have to be shown on a balance sheet or in internal reporting statistics and whether this creates any internal issues. These points can affect whether a transaction is or is not concluded and on what terms, quite apart from what may be directly discussed in direct negotiations. There may therefore need to be a lot of reading between lines in interpreting what is going on.

1098. In a similar way the level at which negotiations are conducted, and the internal politics of the counterparty, may come to affect whether a transaction goes ahead or not. What is agreed between Chairmen at a high level meeting may be rather different from what might be agreed at the levels of ordinary dealers, but a transaction proposed through either source will then have to find its way through the internal procedures of the entity in question, and this may produce a re-think or a veto, the reasons for which may then not be obvious to the outsider. Some transactions may be concluded, not for immediate commercial benefit, but because of a desire to cultivate relations in the more medium or long term and with an eye to future business.

1099. I have recorded my impressions as above, because there seem to me to be many examples of such matters within the materials in this case, some reasonably obvious and some not so obvious, and I need to pay appropriate regard to them when evaluating the Plaintiffs' criticisms of the Defendants' actions in any particular respect.

The standards of skill and care applicable to individual Defendants.

1100. Liability in this action is not joint, and therefore has to be brought home to any Defendant individually and according to the legal standards applicable to that individual Defendant.

1101. The standard required of any individual Defendant as a director of CCC (see under "Legal Principles" above) is that of the reasonably diligent person having both (a) the general knowledge, skill and experience that might reasonably be expected of a person carrying out the same functions as those of the relevant Defendant director with regard to the company and (b) the general knowledge skill and expertise of the actual relevant Defendant director insofar as that might raise (but not lower) that standard.

1102. I have therefore considered this test in relation to each individual Defendant. The first limb of the test is, of course, an objective test, and the only difference between Defendants to which it might give rise is therefore that which could arise from differing functions of the individual directors. The second needs to be considered with regard to the individual subjective skills of the particular director. However, I can consider both aspects together because they apply overall as a broad common sense view.

1103. As regards the First to Fourth Defendants (the "Carlyle" Defendants), I do not consider that the difference in the respective positions of these four Defendants as voting directors (Mr Conway and Mr Hance) or non-voting directors (Mr Stomber and Mr Zupon) makes any difference to the relevant general standards to be expected of them; it simply meant that the duties of Messrs Stomber and Zupon were concentrated into a reporting and advisory function. These four directors together comprised the Investment Committee of the Board, which function again does not seem to me to have any practical effect on the position; they would all be expected to exercise a general level of financial knowledge and skill appropriate to directing the general investment policy of a company such as CCC.

1104. As to any other individual functions, Mr Hance was CCC's Chairman, but this position has no direct relevance to the decisions complained of. It threw upon Mr Hance the general function of leading the conduct of Board business and ensuring that this took place efficiently and appropriately and also a duty, I think, to make sure that all matters pertinent to such business decisions were drawn to the attention of Board Members with the opportunity for appropriate discussion, but whilst this added a little to the scope of his duties, it did not, in my judgment, add anything to the general standard of care to be expected from him. Mr Conway had no specific separate function. I do not think Mr Zupon held any other specific appointment to an office with CCC, but certainly nothing of any significance emerged.

1105. Mr Stomber was the appointed Chief Executive Officer of CCC, and this appointment was a Board appointment of one of their number (see Article 118 of the 4th October 2006 Articles). It seems to me, therefore, that he carried out the duties of this office as a Director of CCC, but these duties would be for the purpose of advising and implementing Board policy decisions, and they would in practice overlap with his position on the Investment Committee and would duplicate functions and powers which he would also have had through being the senior member of the CIM team contractually charged with the duty of being CCC's investment advisor with discretionary management powers. In my judgment, these different functions therefore made no practical difference as between themselves to his overall duties as a Director of CCC.

1106. As regards enhanced skills, arising subjectively from their individual backgrounds, Mr Stomber had a particular knowledge and expertise in relation to dealing in RMBS and repo markets, and Mr Zupon had a similar specialist skill with regard to dealing with leveraged finance products. It seems to me that all that this does is to confirm, but from a subjective standpoint, the general level of greater specialist expertise which was to be expected from them because of their particular functions on the Board or through CIM. Mr Conway's financial and commercial experience was plainly at a very advanced level, but this was in relation to more general business management and investment vehicles, rather than specialism in banking and financial markets. Mr Hance's experience was principally in banking, but with accountancy training and some personal business and general directorial experience. Their personal skills do not seem to me to increase, to any notable extent, the general standards to be expected of the hypothetical director in their positions. In essence, therefore, I view each of these directors as financial professionals from whom a high standard of business acumen could reasonably be expected, but with more specialist standards of expertise to be expected of Mr Stomber and Mr Zupon in their particular fields, having regard to their particular responsibilities on the Board or alternatively their particular knowledge, skill and expertise.

1107. Returning to the individual positions of the remaining directors of CCC, as regards the Fifth to Seventh Defendants, (the "Independent Directors") they all had voting status on the Board, and they comprised CCC's Audit Committee. With no executive functions in relation to CCC's day to day operations, their function was to provide intelligent input, challenge and oversight of the decisions proposed or advised by the Investment Committee and by Management, or which they thought should be so considered, and brought to the Board for discussion at that level. They were not pure non-executive directors, however. They were also charged, through CCC's Articles of Association, with the specific responsibilities of approving any changes in CCC's Investment Guidelines, and several other significant financial and policy matters. That being part of their express functions, they were required to exercise the appropriate degree of knowledge and skill for such a function.

1108. In my judgment, and as a matter of construction of these Articles of Association, the Independent Directors were not put in place in order to second guess and re-deliberate the operational management decisions of CCC. That degree of oversight or challenge was, it seems to me, intended for the actual experts, ie Mr Stomber and Mr Zupon in particular, and at a somewhat more general business level Mr Conway and Mr Hance, as the Investment Committee. The Independent Directors' function was to bring a dispassionate oversight view to the Board's decisions, from a more detached perspective. It is of course quite likely that they would ultimately accept and agree with the recommendations of the "Carlyle" directors, provided these appeared rational, because those four persons had a more immediate perspective on major decisions. The Independent Directors provided a further and detached level of scrutiny.

1109. In my judgment it was neither intended, nor practical, that the Independent Directors should be expected to exhibit or apply a similar degree of detailed knowledge or expertise to any decision as would the four more "executive" directors, but an appropriately high degree of general business acumen would still be expected.

1110. Messrs Sarles and Allardice each brought significant but slightly different banking and finance experience, and experience in other directorships, to the table. I do not regard that as increasing the general standards of competence which would be expected of them, but more as the general level of business skill and experience which it would be appropriate to expect of a director with the functions of an Independent Director of a company such as CCC.

1111. Mr Loveridge had a further and more particular function on the Board, being that of providing the necessary point of contact in Guernsey, the jurisdiction of its incorporation, for CCC, and with the responsibility, in effect, of supervising its good standing in Guernsey, as a matter of practicality. That was, however, in addition to the functions of an Independent Director as laid down in CCC's Articles.

1112. I have had more concern about Mr Loveridge's position than those of Messrs Sarles and Allardice. I am satisfied that in general terms Mr Loveridge was intelligent, skilled and experienced enough to take a position as a non-executive director of a relatively major company such as CCC. He was also, I am equally satisfied, well equipped to perform his particular function of being the "resident Guernsey director" of CCC, for the purpose of overseeing the local company administration and relations with authorities. It is quite reasonable, in my judgment, to appoint a non-technical director with administrative skills and experience for that purpose in an off-shore company such as was CCC.

1113. However, Mr Loveridge was a trust administrator, and did not have any real banking or financial markets business experience or expertise. The general duty on Mr Loveridge as a non-executive director would be to acquaint himself sufficiently with the way in which CCC's business worked, so that he would be able to judge whether the actions and proposals of his fellow, more expert, directors or of company management, were proper and reasonable. However, as I have said, his position was more than a mere non-executive director, and this can only have increased that duty in regard to such functions. My concern has therefore been as to whether he was really properly equipped to discharge the particular role of an Independent Director of CCC.

1114. He said in evidence that he acquainted himself with what he regarded as a sufficient understanding of CCC's business to be able, he felt, to discharge his duties properly. I have

no doubt that he thought this, subjectively, and he was not really challenged on this point. Having seen him in evidence, though, and even allowing for his having aged ten years, I do entertain some doubt as to whether he really did understand CCC's business model, its commercial implications, and sufficient of the technical aspects of how the business operated to be able to make any actively independent judgement on matters affecting this, still less follow the meaning and implications of the financial data and jargon which were circulated and discussed. I have not noticed any recorded remark by Mr Loveridge at a Board or Audit Committee Meeting other than reporting on accountancy or administrative matters to do with Guernsey.

1115. I have referred to the executive and oversight role of the Independent Directors under CCC's constitution with regard to some important matters of operational strategy, such as changes to Investment Guidelines, asset allocation, and suchlike. In relation to that, Mr Loveridge could realistically, it seems to me, do no more than listen to fellow board members and evaluate whether what they proposed sounded reasonable but at only a very high level, and with only limited and relatively shallow knowledge and skill to guide him. As long as what was being proposed was not, therefore, egregiously suspect or bizarre, he was clearly likely, with total sincerity and honesty, simply to concur. Whilst recognising that the objective standards of knowledge, skill and expertise expected of directors as a general matter are not particularly high, they do, nonetheless, have to be judged against the functions which the director is expected to perform, and, as I have said, I have had some misgivings about Mr Loveridge. I suspect that Mr Conway instinctively recognised the weakness of Mr Loveridge's position, because at one stage he was looking to strengthen the independent directorship of CCC by bringing in a further such director. I would therefore, if it became material, have to consider Mr Loveridge's position with this reservation in mind.

1116. However, in the end, and whilst not overlooking this point, I do not think it does, for several reasons. First, the Plaintiffs have not attacked Mr Loveridge on the basis of any suggestion that, individually, he was out of his depth or did not teach himself CCC's business sufficiently thoroughly. Their case is made against him on exactly the same basis as against the other independent directors.

1117. Second, Mr Loveridge's background was perfectly obvious to anyone investing in CCC, as his short CV was set out in the PPMs and OM. The implications of his being a trust administration professional from Guernsey, rather than having high finance experience, were therefore readily apparent to anyone who gave any sensible thought to this.

1118. Third even if Mr Loveridge's lack of financial experience could have led him to be in breach of duty for simply acquiescing in decisions he was asked to make, rather than critically judging them for himself on their intrinsic merits, it would not, on the face of it, make any difference to any outcome in this case, simply because of the mathematics. Mr Loveridge was but one of three Independent Directors and five voting directors. All the decisions criticised by the Plaintiffs were unanimous ones. It follows that even if Mr Loveridge had been acting in breach of duty, his single vote made no difference to the eventual result. It would only affect the position if, on the particular facts, his mere concurrence in others' views, rather than injecting some counterfactual personal input, would possibly have caused the views of those others to alter materially, and thus change the result. I am quite satisfied that the possibility and plausibility of this is vanishingly small on the facts as they have unfolded, and indeed no such scenario was even explored.

1119. In the end, therefore, Mr Loveridge's liability (or not) simply stands or falls with the others of the group of directors of which he was part.

Contractual duties of CIM

1120. In addition, to being Directors of CCC, Mr Stomber and Mr Zupon, whose position in that respect I considered above, were also, in effect, the main embodiment of CIM with regard to the general advising on and implementation of CCC's investment strategy pursuant to the terms of the IMA between CCC and CIM, although CIM's responsibilities went further and included responsibility for administrative and operational matters for CCC, these latter functions being carried out by other persons, subordinate to Mr Stomber, in particular. Thus, the loyalty, skill and care of Messrs Stomber and Zupon are also material to the issue of CIM's separate contractual or tortious liability as the investment manager to CCC, under the terms of the IMA.

1121. That is a matter of Delaware law, and the Delaware law experts were not called and their evidence was taken as read. I did not, in fact, receive much in the way of oral submission about Delaware law, although this was partly because of time constraints, as both Advocate Wessels and Advocate Davies courteously made clear. As already observed, the focus of the Delaware law experts' disagreement was mostly, it seemed to me, on the correct legal analysis of the relationship in Delaware law between contractual and common law duties and the true construction and effect of the particular provisions of the IMA with regard to the operation of Delaware law in excluding or limiting exoneration clauses. What I broadly derived from the Delaware law evidence, and from the fact that I received no specific submissions to the contrary, is that under Delaware law and the terms of the IMA, CIM was effectively appointed "attorney in fact" of CCC for the purpose of implementing its affairs, that as a consequence of this and the generally recognised Delaware law duties of an investment adviser with discretionary management authority, CIM owed to CCC "fiduciary" duties which included both loyalty and skill and care.

1122. As regards the content of these duties, the relevant Delaware fiduciary duty (strictly so-called from the Guernsey law perspective) appears to be similar to the fiduciary duties which would be owed by a director of a company or a fiduciary agent in Guernsey law. The standard of the duty of skill and care applied to a fiduciary in Delaware law appears to be somewhat controversial in this case, giving rise even to a dispute in closing submissions as to the correct interpretation of the written expert evidence. There does, though, seem to me to be general agreement between the Delaware law experts that, by whatever legal analysis, the duty of skill and care imposed on a fidiciary is only a duty not to be grossly negligent, although what this entailed would be a higher test for a contractual fiduciary agent than it would be for a "corporate fiduciary", ie a director. Delaware law apparently recognises a "business judgement rule", but as already discussed above under legal principles this seems to me to be no more than a formal label for the general approach which would be applied in both English and Guernsey law, that the court will not substitute its own judgement for that of businessmen who have made honest and conscientious decisions in the conduct of the business entrusted to them.

1123. I do not think it necessary to devote time or discussion to making precise findings as to the Delaware law aspects of this case, or on analysing the subtleties of the disagreements between the Delaware law experts. I consider that I can safely proceed on the basis that CIM's

contractual duties to CCC under the IMA, and its residual tortious duty of care (if any; the experts appear to disagree as to whether there would be one) can be treated as *certainly no lower than* the standard of fiduciary duties and duty of care which would be owed to CCC by its own specialist directors, namely Mr Stomber and Mr Zupon, as the experts in CCC's assets and business. The difference would be that since CIM's contractual obligations and functions extended also to matters of management and the execution of transactions in and about CCC's business, those duties, and in particular the duty of care in that regard, would therefore extend to the further functions undertaken by CIM. These were ultimately under Mr Stomber's control and guidance, in practice. That is therefore the approach which I will adopt in the interests of efficiency and proportionality, always remembering that both experts are agreed that the standard of care imposed on a fiduciary in Delaware law is a duty not to act with *gross* negligence. Until the question actually requires decision, I do not need to consider whether or not that equates to recklessness, or whether, if it does, that makes any difference.

1124. It follows that I can consider the allegations of breach of contract or tort by CIM, together with the allegations of breach of duty made against the individual Defendants, and in particular Mr Stomber, because the material facts and considerations will be effectively the same.

The effects of the culture of "Carlyle"

1125. The next general matter applicable to all the Plaintiffs' allegations and which it is convenient to consider here is their allegation that CCC was subject to "the pervasive control of Carlyle".

1126. Although put in this abstract way, it is a proposition upon which the Plaintiffs rely particularly as part of their case against the Entity Defendants, that those Defendants were *de facto*, or alternatively shadow, directors of CCC and they incur liability to CCC on that basis. The Plaintiffs invite me to find that Carlyle controlled CCC through

(i) its control (in practice) of all CCC's voting shares;

(ii) its consequent ability to control the composition of CCC's Board and Management; and

(iii) Mr Conway's dominance and influence over CCC's affairs.

1127. As propositions of fact, the first two matters are common ground (and in practice indisputable). As to the third, I consider this in more detail later, and for reasons there given I find that that there was no actual or active "dominance" by Mr Conway, either of the Board or of CCC's affairs. Where he took a prominent role in representing CCC this was simply as a director, and was making the best natural use of his particular skills and connections; it was no more than that. The influence which his opinions may have had in any of the decisions made in relation to CCC may have been significant, but was neither undue nor inappropriate, especially given his formal position as a member of its Investment Committee.

1128. In connection with the liability of the individual Defendants, the relevant point here, though, is different and it is the other side of the coin. It is the effect which this alleged factual feature – the cult of "Carlyle" - may have had in influencing the mind-set of the individual Defendants and thus their approach to their separate duties to CCC itself.

1129. This has been a matter which has rather troubled me. The Plaintiffs submit that CCC was "run as a business unit of Carlyle", and this actually seems to me to be a fair broad description of what happened. Much of the Plaintiffs' case rests on the proposition that the Directors of CCC acted wrongfully because they put the interests of Carlyle (Group) ahead of those of CCC itself, and their actions were therefore aimed at benefitting Carlyle (Group) rather than CCC, thereby in fact being inimical to CCC's own best interests. In order to test this proposition with regard to any particular act or decision of the Defendants which is alleged to have caused damage to CCC, the likelihood of a Defendant having been so motivated is obviously material, and any evidence tending to suggest such a likelihood must therefore be put into the balance. That is the materiality of the alleged background influence which I am therefore considering here.

1130. The question is thus whether, and if so how far, there was a corporate culture within CCC that CCC was a part of "Carlyle" to the extent that CCC's separate corporate existence became obscured, with the general interests of the Carlyle Group inviting attention and naturally coming to gain greater prominence. In such an environment, it becomes second nature to think immediately in terms of the group interest and only second, or perhaps not really at all, to look at the discrete interests of the individual entity. Such an ethos could easily come insidiously to have an inappropriate influence on decision-making for CCC. I have therefore looked carefully at this matter to see what (if any) weight it should be given, in fact in relation to any individual Defendant, in evaluating the probabilities as to that Defendant's motivations in making the decisions under challenge.

1131. First, it is clear that CCC was incorporated for the benefit of The Carlyle Group. The whole reason for launching and incorporating CCC was that it should make money for Carlyle, in the ways which I have already described – a source of management fees, and of funds for other Carlyle investments. But there is nothing wrong with this. Carlyle (Group)'s objective was to make money from CCC by providing a service of making money for investors in CCC. Such an investor would not mind Carlyle Group making money, as long as CCC also made satisfactory money for the investor.

1132. Previously, Carlyle had solicited outside investment into managed equity or investment funds, which it administered and controlled fully, and directly. CCC was to be its first venture into the public stock markets with one of the objectives of this being that it would provide a tradable and liquid means of investment to investors. Nonetheless, and for obvious reasons, I infer that Carlyle wanted to retain a similar degree of control over CCC's operations as it was used to having when running its managed investment funds. CCC was therefore structured to meet both objectives.

1133. Although, as a matter of pleading, the Defendants deny that CCC was owned by Carlyle, this is perfectly obviously only at the bare level of form - and even that seems to me to be questionable. Because the shareholding of CCC was divided between the Class "B" shares which were entitled to dividends but not to vote, and the Class "A" shares which carried votes but no dividend entitlement, the investors had no influence or even indirect control over the running of CCC's affairs such as they would have in a conventionally structured company. Whilst TCG and Holdings did not themselves hold the voting shares, these were placed in the willing hands of individual "tame" Carlyle partners. This separation may have been for fiscal reasons, or accountancy reasons or both - I think possibly avoiding balance sheet consolidation, which I accept (I do not think it necessary to go into the detail of the

accountancy evidence on this point) it would have been reasonable to try to avoid, as a matter of trouble and practicality. But it operated as a matter of form only, and even then it might well have been successfully argued that, in substance, the individual "A" shareholders held their shares in trust for TCG or Holdings. The actual shareholders could be relied on to exercise their voting powers in the way in which TCG/Holdings desired. This voting control thus gave TCG/Holdings ultimate control of all the positions on the CCC Board, in fact including the required "independent" directors. TCG/Holdings also effectively controlled the management of CCC because this was confided, by the IMA, to CIM, which was itself a company controlled by TCG and Holdings.

1134. However, this was all disclosed to CCC's investors, and in any event it would have been perfectly obvious to the kind of investor which Carlyle was courting. All of CCC's management team, though nominally staff of CIM (and including Mr Stomber who was officially appointed as CCC's CEO) were actually employed by CGEC, which was wholly owned by the Founders. All the management team could therefore be removed from their positions with regard to CCC by the termination of their employment with CGEC, and my understanding is that American employment law confers little or no employment protection rights on employees.

1135. The shareholding structure was designed to ensure that CCC could never take off independently of the Carlyle Group and dismiss CIM as its investment manager, so as to protect not only Carlyle fees and income, but also the Carlyle name. It was also no doubt designed to provide tax efficiencies, or other advantages, to both Carlyle and the outside investors. The advancement of the investors' financial interests lay in the operation of the company's articles and its publicised intended investment policies, and the management agreements which were intended to implement these to generate income and dividends for them. The investors' protection, if things went unsatisfactorily for them, would lie either in selling their shares and getting out of the relationship, or, ultimately, in the absence of any control over the Board or the Manager, in invoking the assistance of the Guernsey Court on the grounds of "unfair prejudice" about the way in which the affairs of the company were being run (see s.75 of the 1994 Law).

1136. The reality, therefore, it seems to me, is that the structure which was adopted for CCC created a relationship between CCC and TCG/Holdings which was tantamount to that of a subsidiary (CCC) and a holding company (TCG). On that basis, CCC's directors would be required to behave with the same independence of judgement and attitude which the directors of a subsidiary company would be required to apply despite having been appointed to office through the powers of the holding company.

1137. I therefore find it helpful to look at the situation in that light and to ask myself whether they did so. (I repeat that I am here looking at the general situation, as background to the particular alleged breaches of duty at different times and as to which I will make more focused findings.) In the following few paragraphs I therefore refer interchangeably to the "holding company" or the "appointor company" and to the "subsidiary company" or the "subject company" as appropriate to the proposition.

1138. It would be unreal to expect that an appointee director, appointed to a subsidiary company by a holding company, should not himself have the understanding that he has been appointed for the purpose of furthering the holding company's interests in the running of the subsidiary.

There is an uneasy legal analysis of the potential conflicts of interest in this situation to which I have already referred when considering legal principles. To resolve this, it has been firmly laid down in authority that the appointee director's duty of loyalty is unwaveringly to the subsidiary company of which he is a director, with the reconciliation being that the holding company is deemed by the law to have appointed the director with a mandate to take precisely that attitude. However, how the director himself reconciles the situation in his own mind is a different matter. The easiest way to do so is probably to regard the holding company as having appointed him because it wishes properly careful and loyal decisions to be taken in furtherance of the best interests of the subsidiary company, and it trusts him to do just that.

1139. It is obviously very likely that in many, if not most, cases the best interests of the subsidiary and of the holding company will coincide. It is only when the two diverge in some respect, and the interests of one demand a decision which actually has detrimental effects, relative or absolute, for the other, that any actual conflict arises. The law then requires the director to resolve the difference in favour of the company for whom he is acting in any particular instance (ie here the subsidiary) and to act accordingly.

1140. The fiduciary obligation of the appointee director is not to prefer the interests of another party (here, the holding or appointor company) to the detriment of the company whose affairs he is conducting. It is, though, no part of his obligation to demonstrate his independence by acting contrary to the interests of the appointor company. If, therefore, the interests of both companies are the same, no problem arises and the fact that the appointee director may have eagerly and gratefully embraced the relevant decision because it was also in the interests of his appointor does not vitiate his decision - always so long as that decision was independently considered by him to be the best for the interests of the subject subsidiary company. Plainly, if any issue arises as to whether the decision was in the best interests of the subject company, any assertion by the director that he believed it to be so, when the benefit to that company may be small or questionable but the benefit to the appointor company is large or obvious, would be critically examined.

1141. If the companies' interests diverge, though, since the breach of fiduciary duty lies in not acting in good faith in the interests of the company to whom the duty is owed, liability depends on having taken a different decision from one in the best interests of the subject company and doing so for the purpose of benefiting the holding or appointor company. This is the test against which I have later examined the decisions made by the Defendants in and about CCC's affairs, where what is alleged is a breach of fiduciary duty by preferring the interests of Carlyle to those of CCC.

1142. It is worth noting here, though, that where it has been held in the authorities that the directors of a company have breached their fiduciary duty by preferring the interests of a holding or associated company, the facts have always been that the directors have, deliberately or without actual regard for their duty, permitted the assets of the subject company to be used or deployed for the benefit of the holding or associated company with no, or no sufficiently significant, benefit to the subject company. That is quite a long way from the facts of this case, in which, in practice, it was rather the assets of the associated company (Carlyle) which were deployed for the benefit of the subject company (CCC), for example by way of the Carlyle loan to CCC. This is not a promising start for an allegation that the directors of the subject company preferred the interests of the associated company.

1143. I have said that I think it fair to say that in practice CCC was run as a business unit of Carlyle. This is also what the Entity Defendants and the Carlyle Defendants other than Mr Stomber were accustomed to; CCC was conceived as a logical extension of the financial services operations which they had moved into and successfully conducted up to that time. The underlying control exercised by TCG or Holdings and inherent in the structure of CCC was, I am satisfied, also perfectly obvious to all the Defendants. Mr Stomber stated as much in an email to Ms Cosiol of 16th August 2007 ("*he* [sc. Mr Conway] *controls my comp* [sc. remuneration]"). I am also satisfied that Messrs Sarles, Allardice and Loveridge were aware that they effectively held office at the pleasure of the Founders. All these would be factors which would conduce to a tendency to think first of "Carlyle" rather than CCC, even though, as I am again quite satisfied, all the individual Defendants had been provided with a summary of the duties of the directors of a Guernsey company at the time of their initial appointment (with the possible, but if so immaterial, exception of Mr Loveridge who would not have needed it).

1144. The Plaintiffs refer to various statements, particularly in the oral evidence of some of the Defendants, as support for the proposition that they either disregarded or failed to appreciate the fundamental point that their duties were owed solely to CCC rather than to the Carlyle Group. Much of this is unconvincing. The mere fact that, for example, Mr Conway instructed Ms Cosiol to investigate fall-back arrangements for an alternative to CCC's IPO without consulting or informing CCC's Board, or that he considered himself (he said) to be representing both Carlyle and CCC when negotiating with Citi Group in August 2007, do not seem to me to carry any weight as evidence that he actually subordinated CCC's best interests to those of Carlyle (Group). These matters are not inconsistent with recognition that in decision making for CCC, his duty was first and foremost to CCC.

1145. Mr Stomber on the other hand said clearly in an email in June 2007 that he was trying to put Carlyle's interests ahead of CCC's so as to gain the approval of the Founders as a "team player". It is somewhat disturbing to find Mr Conway agreeing and praising this in his response, but looking at the circumstances, I find that this was really said as a quick reassuring response to an apparently insecure and highly-strung employee, even if a senior one. This context means that I do not endow it with significance as regards Mr Conway's mindset in the taking of solemn decisions for CCC.

1146. I gained something of an impression that Mr Hance saw his chairmanship of CCC as being effectively "for" Carlyle, in particular in the context of mentoring and advising Mr Stomber and Mr Zupon. Also, in his oral evidence, Mr Allardice expressed the view that the four Carlyle directors were responsible to TCG and their "*ownership*", and that the three Independent Directors were responsible to the independent shareholders. This is obviously wrong as a matter of legal obligation. Having anxiously considered this, though, I do not find that either of these particular statements really betrays anything more than a recognition of its maker being an appointee of Carlyle (Group) to his position on the Board of CCC. As such it is more a recognition of the obvious than a revelation of an intrinsic conflict of loyalty, as I have discussed above. I am inclined to think that the more formalistic and gruff Mr Sarles kept the proper position clearly in mind. I am certainly satisfied that Mr Loveridge, who not only had experience of Guernsey company structures and directors' duties, but, as the only director in Guernsey rather than the USA, was well insulated from any pervading atmospheric assumption that Carlyle's interests were paramount, did so in conducting his own thinking so far as that went.

1147. As I have said, the findings which I have to make in relation to liability in this action are about accusations of breach of duty against the Defendants individually in relation to particular decisions made by them as directors of CCC. The findings which I am recording here are about whether, and to what degree, it seems to me that any individual Defendant may have had a general disposition to think in terms of Carlyle's interests ahead of those of CCC. Leaving aside Mr Stomber for the moment, I find that the general evidence does suggest grounds to think that Messrs Conway, Hance, Zupon, and Allardice, in that order on the scale, might have had some disposition to do so. This means only, though, that I will need to examine the circumstances of their material decisions in the case with this possibility in mind. On balance, I do not think there is a serious possibility that Mr Sarles lost sight of the fact that his duties were owed first and foremost to CCC, and I am satisfied that Mr Loveridge did not do so because of his more extraneous position. I am quite satisfied that his attention was properly focused on CCC, although subject to his more limited skill and experience already referred to. Mr Stomber's position requires closer consideration, which I give later.

1148. Whilst dealing with general background circumstances, it is right to record, as a matter of balance, that the Defendants have urged, at several points, that there was no question of Carlyle's interests being preferred over CCC's because their interests were both aligned.

1149. Looked at generally, I find a lot of force in this. First, it is obvious that reputational interests were aligned in the sense that CCC carried the Carlyle name. Mr Hance explained clearly in his evidence that CCC and Carlyle were "inextricably linked" as regards reputation and activities, and it was impossible, in practice, for this not to be the case. Second, CCC's financial success would of course mean financial gain for TCG/Holdings and CIM as already described. Third, various Carlyle affiliates, not least including all the individual Defendants, to some degree were investors in CCC. These factors all combined, to mean that Carlyle (Group) had a clear coincidence of interest with CCC in CCC's financial success. This would only go so far, though, because that coincidence of interests could be affected by financial considerations.

1150. This is also material to the findings I need to make, in that, if and insofar as the interests of Carlyle (Group) and CCC were reasonably perceived, consciously or subconsciously, by the Defendants actually to be aligned, it would mean that individual Defendants would have had no cause to deliberate actively the question of conflict of interest and to make any actual choice, still less to record any such decision. The effects of any such apparent alignment of interests being taken as read would therefore contribute to the impressions which I may have gained of their attitudes. This will all have to be considered where material, for any fact-specific determination.

Mr Stomber's "subservience"

1151. I have left Mr Stomber's position and underlying attitude for separate comment because the Plaintiffs have laid great emphasis on this. They submit that I should actually make a finding that Mr Stomber was beholden and/or subservient to Mr Conway and to Carlyle, and acted at all times in accordance with the wishes and interests of Mr Conway, Carlyle, and CIM, the implication being that he thereby ignored or subordinated CCC's best interests to that motivation.

1152. The Plaintiffs cite three particular examples of this in their closing submissions. They point to the fact that Mr Stomber said, several times, that CCC was "*about Carlyle first second and*

third". The second, already mentioned and most striking, is an email of 1st March 2007 in which Mr Stomber told Mr Conway that he "*hope[d] you are getting a sense that I think always about the firm first before CCC*", (emphasis added), with Mr Conway's response being "*you are acting like a team player AND you are thinking of Carlyle's best interests".* The third is that Mr Stomber appears to have actually applied this approach shortly afterwards, in June 2007, in treating the possibility of an adverse effect on Carlyle's own plans for an IPO if CCC's IPO were to be delayed as a material consideration in the decision whether to proceed with CCC's IPO or to delay it. Although this was after the material events, a similar attitude can be said to be shown in an internal email of his of 14th March 2008, which includes comments that the decision to "*let CCC go*" was "*the right decision to protect Carlyle's balance sheet*" and to keep its name out of the headlines, which it could be argued showed continuity of this mindset throughout the intervening period.

1153. In paragraph 412ZA of the Cause the Plaintiffs list 11 quotations from Mr Stomber which they say demonstrate that he generally made Carlyle's interests his first priority, over those of CCC. Looking carefully at these examples, they are indeed fairly stark, in particular the second one cited above. On Mr Stomber's behalf it is pointed out that only five, and indeed not including that stark one, are in fact within the time period of the Plaintiffs' claims in the action. That is correct, but matters outside that time period can still be evidence of Mr Stomber's likely state of mind within the time period. They also point out that, on examination, several of the quotations where Mr Stomber appears to be anxious to take into account Carlyle (Group)'s view, or suggests that a matter is a "Carlyle decision" rather than one for him, are actually justified in context, since the material under consideration was indeed a Carlyle Group concern as much as CCC's. They relate, for example to press releases regarding Carlyle's assistance to CCC, and as regards the "Carlyle decision" as to whether not Carlyle would actually provide assistance to CCC.

1154. I have already referred to Mr Stomber's remarkably deferential attitude to Mr Conway and the Founders of Carlyle. Taking the evidence as a whole, I am persuaded that Mr Stomber did have an underlying attitude that his job, and the better furtherance of his career, lay in ensuring that what he did with CCC accorded with what the Founders perceived to be in the best interests of the Carlyle Group. His obsequiousness and professions of concern for the interests of Carlyle were, I find, prompted by furthering this and trying to ingratiate or rehabilitate himself in the estimation of his superiors, as he saw them to be. To a degree, therefore, I think that they may well have been exaggerated. Nonetheless, I am satisfied that there is reason to think that Mr Stomber would have tended to act in what he thought (or more accurately what he thought the Founders would think) to be in Carlyle's best interests before considering what might, uncomfortably therefore, be in CCC's interests if different.

1155. This means that I have looked with great care at advice rendered by Mr Stomber and decisions made by him in relation to CCC's affairs, when evaluating any assertion of his that such decision or advice was truly regarded as being in CCC's best interests, irrespective of whether it was also in Carlyle's. I will also bear in mind that Mr Stomber may well have been predisposed to find that what was in the best interests of CCC would, fortunately, be what would seem to serve the best interests of Carlyle.

1156. Once again, though, this is evidence which will have to be applied in the specific context of any material decision under challenge. Furthermore, if and insofar as it really does appear that

CCC's and Carlyle's interests were aligned in respect of any particular decision, any wrongful motivation behind the material decision would become irrelevant.

The independence of the Independent Directors

1157. There is a further prominent submission by the Plaintiffs with regard to material general background findings, and this is the allegation that the Independent Directors were not truly independent.

1158. In the Cause the Plaintiffs refer to the tenuous previous acquaintance or connections between each of the three Independent Directors and either the Carlyle Group or one of its Founders or the other Defendants, as if these should give rise to suspicion as to their ability to act independently. In the end, and quite rightly, absolutely nothing was made of these utterly trivial points.

1159. The eventual allegations which are made in this respect are relied on mainly as going to the question of the claimed liability of the Entity Defendants as shadow or de facto directors of CCC. The Plaintiffs cite the Cause at Paragraphs 412ZB – 412ZD as the material relevant to this point; Paragraph 412ZD is the operative one. The assertions there contained, however, are in general terms that they "acceded unquestioningly" to requests that they should exercise their powers to approve reduction or suspension of CCC's liquidity cushion guidelines, and to support decisions to refrain from selling RMBS and not to seek to raise further equity capital, and that they refrained from requiring sufficient Board Meetings, and abrogated their duties to CCC by permitting Carlyle and CIM to run CCC as they saw fit, after August 2007. They are thus allegations of what happened, and do not go to establishing any attributes of these directors which compromised their actual independence.

1160. Insofar as these assertions relate to allegations of breach of duty by these three Defendants, they are thus squarely within the ambit of the duty to exercise independent judgement, this being a duty which focuses on the quality of a defendant's decision-making rather than on the status or characteristics of the defendant himself. They can also possibly be brought under the wider ambit of the duty of good faith. On either basis, I find that they fall to be considered in the context of examining the propriety of the actual decision complained of by the Plaintiffs in detail, and this is what I will do. They therefore require no further consideration here.

1161. Against the above background and findings, I therefore now move on to consider the specific facts and allegations made against the Defendants with regard to their conduct of CCC's affairs from July 2007 to March 2008.

1162. Before doing so, I record here that the parties agreed a document giving the day-by-day amount of CCC's liquidity cushion from 19th January 2007 to 5th March 2008, derived from CCC's files, which contains other details and in particular CCC's then current capital value. This is the last document which should be treated as annexed to this judgment, and I have generally used its figures in the narratives which follow. Figures reported by Mr Stomber in emails during the relevant periods do not always correspond with the figures in this document, although they are not greatly different. I infer that Mr Stomber's figures will have been "on the hoof" calculations derived from provisional reports or information during the day, or that the differences may be because the methods of calculating such figures have been slightly different, eg as to what exactly has been averaged and multiplied up for the purpose of arriving at a total capital value. Nothing turns on any particular such minor discrepancies.

1163. The facts which I state from now on are, except where I indicate what is in dispute, either common ground or are my findings of fact on the evidence.

9. The Claims: JULY 2007

Did the Defendants react inadequately in July 2007 to signs of market instability?

Events of Mid July, up to the 26th July Board Meeting.

1164. I have earlier recounted the history of CCC's business up to and immediately after the IPO. I now take up the story with regard to the events which ground the claims actually advanced in the action. I have referred already to some later events and matters in dealing with the law, the evidence and the witnesses, but it is necessary now to go back to the situation at July 2007, ignoring any knowledge of what ultimately happened.

1165. As at 13th July, CCC's liquidity cushion was viewed as being approximately $281Mn, including the net sums raised from the IPO after repayment of the Bridge Loan.

1166. In mid-July 2007, however, the credit markets showed signs of increased volatility, as "credit risk" - i.e. the risk of default in repayment of loans – became a growing fear in the minds of both investors in and the financiers of such assets. The prices of lower rated subprime RMBS had already begun to be affected by this fear in May and June, and this was made still more acute by the shock of the Bear Stearns incidents, with prices dropping and the costs of financing increasing. However, in July 2007, the highest rated subprime RMBS – ie, non-Agency AAA rated RMBS - saw prices fall below par for the first time. The perception of increased credit risk also began to affect the value of bank loans, the subject of the CCIL portfolio managed by Mr. Zupon's U.S. Leveraged Finance group.

1167. Data show, though, that CCC's Agency RMBS, which effectively had no credit risk, did not experience price deterioration in July. Although prices had declined by half a point in June, they remained generally flat and static in July. Mr Stomber says that he believed (and Mr Conway and Mr Hance either shared or followed his belief) that the Agency RMBS held by CCC would continue to be unaffected, because market participants would appreciate the absence of credit risk and therefore CCC would even be likely to benefit from this appreciation showing in a flight to quality; such assets would be purchased in preference to more risky ones, and this would raise prices and thus the values of CCC's securities. These views are reflected in CCC internal emails of mid-July 2007 and also show up in a general positive circular on Bloomberg, on 10th July 2007, which Mr Greenwood passed to Mr Stomber.

1168. These comments contrast, though, with a warning email sent on 11th July 2007 by Mr Conway, to those in charge of Carlyle's leveraged finance asset funds, urging them in dramatic and very emphatic terms to ensure that they were "*defensively positioned*", and stressing his anticipation of stormy times ahead. In his reaction to this email, Mr Stomber not only reiterated his views with regard to the solidity of CCC's Agency RMBS, but went on to express the view that it was too early to start buying further credit products as their prices still had further to fall. This reaction reminds me (as is salutary where one is examining events whilst knowing what ultimately happened) that events with an adverse effect are not all "downside" in this business. A setback in one aspect may represent an opportunity in another, and skilled businessmen will, quite normally and reasonably, be on the lookout for this.

1169. Before the 16th July 2007 Freddie Mac repo roll, JP Morgan apparently tried to apply a 3% haircut to CCC's repo, but they were, once again, negotiated back to 2% by Mr Ng, apparently with no real resistance.

1170. The Plaintiffs suggest that it was a repeated demand for a 3% haircut from JP Morgan in respect of the Fannie Mae roll on 25th July which caused CCC then to roll its repo off to other lenders. The Defendants say that this is not the case, and that it was the fact that JP Morgan had proposed an interest rate of 5.30%, whilst other dealers were offering 5.29%. I accept the Defendants' submission on this. It is confirmed by Bloomberg Messages of 20th and 24th July 2007, in which a 2% haircut was recorded. The Defendants also point out that shortly afterwards on 27th July, JP Morgan offered a 15 day repo line to CCC for a specific new Freddie Mac bond at a 2% haircut.

1171. The Plaintiffs say that increasing demands for higher haircuts were an unmistakable signal, which could not and should not have been ignored, that CCC's business model was no longer sound and required urgent re-evaluation and change, in particular - as is their recurrent theme - by an urgent and major reduction in CCC's level of leverage. (To give an idea of figures, it is accepted that the total portfolio of about $21.8Bn of RMBS which had by then been acquired by CCC, had been acquired using leverage of 29.6x.)

1172. The Defendants say that this was not the case; the signs were not in fact as significant as the Plaintiffs claim, and certainly were reasonably not perceived to be of such significance; they were judged to be symptomatic of individual and idiosyncratic pressures. CCC still had repo lines far in excess of its borrowings. (Mr Stomber said: $41.7Bn of capacity as against about $22Bn of usage, although I think that at that point in time both figures were actually marginally lower.) Any requests for higher haircuts had come from fewer than half of its cohort of actual lenders, and, whilst it might well have been necessary to "work" the repo line negotiations hard, this was nothing new, and the repo supply market remained competitive.

1173. Mr Stomber recognised that CCC had noted, in July, that some of its repo lenders were now having their CMO desks review asset pricing, rather than automatically applying IDP prices, but he says that he did not regard this as alarming, merely a symptom of the caution which had now affected banks, following their being caught off guard by the Bear Stearns incidents.

26th July 2007 – BOARD MEETING

1174. CCC held a Board meeting in Guernsey on 26th July 2007, followed immediately by an ALCO meeting. This Board meeting marks the earliest point of the Plaintiffs' claims that the Defendants acted in breach of duty.

1175. The entire Board attended both of these meetings, as did several members of Management, including Messrs. Greenwood, Trozzo, and Green. In addition, personnel from PwC and Mourant attended. As was usual, Ms Cosiol, who would later prepare Minutes, took handwritten notes.

1176. The Board meeting lasted about 3½ hours. As with all such meetings, both its formal minutes, and the handwritten notes of Ms Cosiol are in evidence, and the individual Defendants all gave evidence as to their recollections of the meetings, obviously so far as they were able, so long after the event. It is not, therefore, necessary to do more here than given an outline flavour of the meeting, and what was discussed, mentioning points of special relevance.

1177. First, the Board discussed the recent completion of the IPO and the low trading volume of CCC stock.

1178. The Board then moved on to consider a draft of CCC's second quarter financial statements, its financial results and the performance of its portfolio. There had been detailed discussion and review of these accounts at an Audit Committee meeting that had taken place the previous day, and the Audit Committee reported on this to the Board. The Board also reviewed and discussed the disclosures and information intended to be included in the MD&A ("Management Discussion and Analysis") which would provide a commentary on the financial statements for the second quarter of 2007, when these were released, in fact that day.

1179. There was a review of a proposed business model updated from the earlier version of February 2007, with comparative metrics, which was presented to the Board by Mr Stomber and members of the management team. It was highlighted that CCC's asset classes were deliberately "systemically uncorrelated". The metrics showed a reduction in the ratio of CCC's liquidity cushion to its 20 day VaR from above 2 in February, to 1.5. However, it is said and I find this perfectly plausible, that this was accepted as being obviously explicable. It was the natural and mathematically inevitable result of increased price volatility in the intervening period.

1180. Mr Trozzo stated that during the market shocks of early June arising from the Bear Stearns incidents, the liquidity cushion had worked as planned. Mr Stomber confirmed that it had in fact never dropped below 20%.

1181. There was obviously a lengthy discussion of and questions about CCC's portfolios in both of its broad asset classes. The detail of this was not (unsurprisingly and quite normally) recorded in the formal Minutes, but appears in far greater length, although necessarily in a less easily followed form, in Ms Cosiol's contemporaneous handwritten notes. As regards the RMBS section of the portfolio, interest rate cap levels were discussed in particular. There is no recorded discussion of haircut levels, or possible demands for higher haircuts. There was a similar review and discussion about the current credit markets and its impact for the significant but far less highly leveraged (because of its higher level of return) credit product portfolio then also held by CCC.

1182. There is an issue, among other disputes, as to the extent to which concerns about financing "rollover" risk mentioned in Ms Cosiol's notes ("*can't take a flier on liquidity = bankruptcy*") were directed only at the leveraged finance asset portfolio, as the Defendants say, or were really evidence of a deep concern about CCCs business model in general, as the Plaintiffs suggest.

1183. There was discussion about the mechanics of paying consistent dividends during a year, and the timetable to enable a dividend to be declared and paid in December. The Plaintiffs draw attention to this, arguing that it demonstrates an inappropriate anxiety, in all the warning circumstances, that CCC should be able to declare a generous dividend.

1184. Mr Stomber explained that owing to the recent market volatility, ALCO had taken a more prominent role, and was now meeting every two weeks. Mr Stomber invited Board members to attend ALCO meetings. He described the ALCO packs of information sent to its committee members. The Board asked to be copied in on these, and this was subsequently done as a matter of routine.

1185. Following Board discussion, the Independent Directors approved a prospective commitment on CCC's behalf to invest $25Mn over the next three years in a form of Carlyle investment known as Carlyle Global CLP Partners, although in the event this was never implemented. The Plaintiffs suggest that this is evidence of an attitude of either complacency or an inappropriate disregard of an obvious need at the time for extreme caution. The Defendants say that it was a perfectly natural step in taking CCC's business forward in a manner which appeared appropriate as the situation appeared at the time.

1186. There was then a brief discussion of the various administrative, regulatory and compliance meetings which several Board members had attended whilst in Guernsey, including with Mourant, the GFSC, PwC and Carey Olsen. The Board also formally appointed Mr Green as CFO of CCC, and approved payment of the fees owed to CIM under the IMA.

1187. In the Cause, the Plaintiffs stigmatise the approval of the payment of these substantial sums – about $6Mn - to CIM as reprehensible when CCC had recorded substantial, if unrealised, losses on its portfolio. The Defendants say that the fees were properly payable under the terms of the IMA. In fact I do not understand the Plaintiffs to dispute that as fact; they merely contend subsequently that such fees ought to be recoverable as part of their alternative claim against CIM for alleged total failure of the consideration for them.

26th July – ALCO Meeting

1188. The ALCO Meeting which immediately followed was attended by all Board members as well. This was a shorter and more technical meeting, which discussed current market circumstances and outlook, including what action the Federal Reserve Bank (the "**Fed**") might take, and the likely effects on the markets. The main concern - and one which Mr Conway and Mr Stomber had already noted and remarked on - was a reduction in liquidity in the markets generally.

1189. As regards CCC, the discussion focused mainly on the CCIL leveraged assets portfolio, with particular concern about maintaining liquidity and avoiding the risks of "debt maturity concentration", so as to reduce exposure to adverse market conditions. In the course of this meeting, it was agreed, at Mr Stomber's instigation, that there should be an immediate freeze on the purchase of credit products, which would free $30Mn which had been earmarked for that purpose for more general use, including supplementing CCC's liquidity cushion.

1190. This policy was implemented. CCC never purchased any more credit products. Management did, however, on the same day, purchase three more tranches of RMBS as mentioned below.

Other events on 26th July 2007

1191. On the same day as the meetings in Guernsey, a member of Carlyle Group's own management committee drew the attention of certain Carlyle personnel, including Mr Conway, to an analyst's report predicting that house prices might drop by 9% over the following year. Mr Conway recognised the potential seriousness of this in his response "*Tough times and will get worse. Market may melt down. Liquidity has evaporated."*

1192. Also on the same day (26th July) CCC released its quarterly report for the second quarter of 2007. The report began with a CEO Letter to Shareholders, which reviewed CCC's performance from 1st January 2007 to 30th June 2007. It noted increasing signs of volatility in markets, described CCC's investment strategy, explained Management's reasoning behind this

and its intentions going forward. It professed an intention to be "*conservative*" as regards risk-taking. Within the report, CCC's investment portfolio as at 30th June 2007, was described as comprising $22.7Bn in assets, of which 95 % were RMBS and roughly 4 % were leveraged finance assets, with 25 % of capital allocated to the liquidity cushion. CCC's repo agreements, totalling $21.29Bn outstanding, were listed and described in detail, the fees paid by CCC to CIM were disclosed, and CCC's relationship with Carlyle was described.

End July 2007

1193. That market liquidity was a great concern is apparent from internal emails in the last few days of July. The Plaintiffs point out what they say were other, gathering, adverse signs which should have prompted action by CCC.

1194. On 26th July, in fact the same day as the Board Meeting, Bear Stearns tried to secure a 3% haircut for the future but again after negotiation and an "escalation" to higher authority, the 2% haircut was maintained.

1195. On 27th July, two potential new repo lenders to CCC, RBS and Countrywide, quoted 5% and 3% haircuts respectively for the establishment of new repo lines. CCC chose not to proceed with them. Morgan Stanley quoted a 3% haircut on new trade "temporarily', but this was for a mere $57Mn for two weeks and was again not used. CCC's internal Repo Line Summary as at 27th July records the requests for higher haircuts already mentioned, and their resolutions, but also - and presciently - noted that Goldman Sachs were apparently resorting to the backdoor method of increasing haircuts by applying lower asset prices.

1196. On July 25th, 26th and 30th, Management purchased three tranches of RMBS totalling about $364Mn, which Mr Stomber later noted with some satisfaction, were at prices which meant that these were the three best deals in three years. However, by the same token of lower prices, CCC experienced margin calls of another $20Mn which meant that, with the continuing review of market conditions during this short period, Mr Stomber took the view, which he discussed with Mr Conway and Mr Hance on 30th July and obtained their approval, that it was preferable to "*trade off a few cents in dividend yield to maintain liquidity*".

1197. The point behind this was that CCC needed to purchase securities on which to earn the income which would provide the dividend payments which investors expected. An example of this, on 18th July 2007, has been referred to earlier. CCC's assets - both its RMBS and its bank loans - paid off capital each month and CCC's business model was to pay out 90% of income earned in dividends, but to reinvest these capital returns, to keep producing income. However, such reinvestment would also maintain the current level of leverage. If the capital was not reinvested, liquidity would increase and leverage reduce, but at the same time, the pool of capital on which income was being earned would diminish and so, therefore, would income. Increasing liquidity, therefore, was at the expense of income.

1198. However, on the following day, 31st July 2007, there was another adverse event. CCC's bank loan portfolio suffered additional losses, and as a result Mr Stomber took the view that an even more defensive strategy was needed. Again, he so informed Mr Conway, Mr Hance and also Mr Zupon, and he instructed his manager to "*go ultra safe*" and purchase no more securities at all.

1199. One large acquisition of RMBS ($1.34Bn,) previously contracted, was due for settlement that day and was settled. In fact one further such purchase, a secondary bond of some $73Mn, was contracted for that day before the message to cease purchases was sent to the Management team. It, therefore, was also settled a few days later, on 3rd August. That was the last purchase of RMBS ever made by CCC.

The claims - July 2007 – summary of arguments

Plaintiffs' case

1200. The Plaintiffs submit that there were cumulative signs of adverse conditions in the financial markets, which ought to have told the Defendants, by the time of the Board Meeting in Guernsey or at least by the end of July 2007, that CCC's business model was no longer soundly based but ran significantly greater risks than previously believed, and that a re-evaluation of it and remedial action were required, or at least increased caution. They list these signs as:

(i) significant changes in the repo market following the Bear Stearns incidents in June 2007;

(ii) clear signs of impending increases in haircuts being required by repo lenders;

(iii) rises in interest rate volatility;

(iv) recent rises in the APV for CCC's RMBS; data showed that in the first 10 days of June 2007, this metric had increased from a previous 0.55% to 0.79%, which, the Plaintiffs say, was approaching dangerously close to the figure of 0.85% used by CCC for its stress testing, based on the "worst case" of the 1998 LTCM crisis;

(v) the incurring of significant unrealised losses on the market value of CCC's RMBS portfolio since purchase; and

(vi) the fact that the IPO had been "difficult".

1201. The Plaintiffs submit that the Defendants ignored those signs, failed to adopt a risk averse approach, actually purchased – recklessly – additional assets at the end of July, and failed, as they should have done, to reduce leverage and/or increase liquidity by selling RMBS or raising equity capital; they failed to consider any such options, or to conduct an appropriate "worst case" or "downside" analysis to enable them to do so. Such steps as the Defendants actually took – broadly just ceasing investment in credit products, - were plainly inadequate. The Plaintiffs submit that the Defendants' conduct in this regard was a knowing, or reckless, breach of duty (and was consequently misfeasance).

Defendants' case

1202. The Defendants dispute the accuracy of certain of the factual allegations made, but deny, in any event, that any of the matters cited should have been seen, at the time and in context, as having the significance which the Plaintiffs now seek to attribute to them. They submit that, viewed objectively and without the influence of hindsight, their reactions to the events as they happened were appropriate, responsible, and not in any breach of duty to CCC. Taking into account Management's assessment of the causes of market volatility, that a rise in interest rates

now appeared unlikely, and that CCC's liquidity cushion resource had never in fact fallen below its 20% guideline in the aftermath of the Bear Stearns incidents despite fears that it might, Mr Stomber did not consider that any wholesale reappraisal or change of CCC's business model, was required. This view was both reasonable in itself, and reasonably appeared so to the Defendants. Caution was exercised, and the degree of caution was both considered and appropriate.

Discussion and conclusions – the claims relating to July 2007

1203. I deal first with the allegations of breach of duty levelled at the individual Defendants in respect of this time. I will consider the allegations against CIM in contract thereafter. I deal with the allegations as made against the Entity Defendants in a later and separate section.

1204. The Defendants point out, properly and correctly, that the claims which the Plaintiffs are entitled to rely on, and to ask the court to decide, are those which are actually pleaded in its Cause. Submissions at trial amounting to allegations of further or other breaches cannot give rise to any relief; their content can, at best, be treated as submission of evidence. In the absence of an application to amend the Cause further, this is correct.

1205. Identifying the breaches of duty alleged in the Cause in any coherent form sufficient for them to be dealt with methodically is extremely difficult because of its construction. Paragraphs 263 - 263F, contain the allegations said to be referable to July 2007. There is a "summary" contained in paragraph 417 of the Cause, but I do not see the elements of this which are referable to July 2007 as adding anything of any substance to Paragraph 263. Paragraphs 418B-418G and 418I to 418N of the Cause are incorporated into the claims made with regard to July 2007 by Paragraph 264, but they expressly contain only "particulars" of breaches, and thus, implicitly, of substantive breaches previously alleged.

1206. As I am concerned only with breaches of duty or suchlike which actually caused loss to CCC, I need first to identify, amongst the many and various breaches alleged by the Plaintiffs in the Cause with regard to this period (but the same approach will apply to any other period) the complaints of action or inaction which have a direct impact on CCCs' financial position. I will refer to these as "effectual" breaches. Other alleged breaches (framed in terms such as failing to "recommend" or "consider" or "analyse" or "discuss" or "insist on" particular actions, choices or events) are not themselves matters which actually caused any change in CCC's financial position, and are therefore either elements of the alleged effectual breaches at the time, or are evidence of supposed material circumstances.

1207. The effectual breaches are, I judge, those in Paragraphs 263C.5 -263C.8 and 263E.5 – 263E.7 of the Cause. Although these appear to be framed in terms appropriate to claims of breach of duty of care, they are also characterised as breaches of fiduciary duty by paragraph 264, with the particulars supporting this characterisation being those additionally pleaded in paragraphs 418B et seq as mentioned. The allegation of the consequent loss appears at Paragraph 265, (in fact repeating Paragraphs 263C.8 and 263F.8) and is that

> *"The losses incurred in or after July 2007 by CCC would not have taken place if the breaches by….CCC's Directors had not taken place or if the action required had been taken. Such action comprised (a) selling down CCC's RMBS assets, thereby reducing its leverage and/or (b) raising additional equity capital and/or restructuring or orderly winding down of CCC."*

1208. I interpret the first sentence to include the complaint of positive steps taken (ie that the Defendants caused or procured CCC to purchase further assets) found in Paragraphs 263C.7 and 263E.6 whilst the complaint of failure to take any of the three options of the "action required" is the allegation of negative inaction.

1209. As already mentioned, these matters are pleaded both as negligence and, with the addition of allegations as to knowledge or motive against at least some of the individual Defendants, as breaches of fiduciary duty. Although the Plaintiffs claim to put the latter as their foremost case, the particular matters complained of are essentially about commercial judgement; they are about what course of action was best or right for CCC in the conduct of its business. It is therefore more natural, certainly at this first point, to consider the charges against the Defendants first as a matter of breach of duty of skill and care.

(a) Duty of skill and care

1210. The first question is therefore whether the Plaintiffs satisfy me that the decisions complained of were decisions to which no reasonably competent director could have come, making this judgment with regard to each individual Defendant if and where necessary. The Defendants were each cross-examined about their knowledge of the various warning signs pointed to by the Plaintiffs in support of these allegations of breach, and the Plaintiffs have analysed their answers in detail, to support their case.

1211. There is no major dispute as to the facts of what happened. I have, on the one hand, the Plaintiffs' arguments, that the warning signs were such obvious warning signs of impending seriously adverse conditions for CCC with regard to its repo financing, that it was negligent, even to the point of recklessness or irrationality, to act or fail to act as the Defendants did. On the other hand the Defendants ask me to examine such submissions carefully to see whether they really justify the conclusions which the Plaintiffs invite. I have the Defendants' explanations, their submissions that their conduct was reasonable in all the circumstances then apparent, or as ought to have been appreciated, and their argument that the Plaintiffs' case is infected with hindsight.

1212. Weighing all these factors, including material expert evidence, I prefer and accept the Defendants' submissions.

(i) Market turmoil following the Bear Stearns incidents of June 2007

1213. As to this, it is perfectly clear that these events came to the attention of the Defendants (at least Mr Stomber, Mr Conway and Mr Allardice) and were considered by them. The Plaintiffs' contention is that these ought to have been appreciated as a sign of fundamental adverse changes in the financial markets and repo markets in particular, but, and culpably, they were not.

1214. There may be a difference of view amongst the expert witnesses as to how closely these events were connected with the subsequent credit crisis of early August 2007, but this does not really matter. The crucial issue for present purposes is whether or not reasonably competent directors of a company such as CCC ought to have viewed them as a sure sign of problems to come.

1215. There is a difference of opinion here between, in particular, Mr Welles and Professor Hubbard. Having considered their evidence, I prefer that of Professor Hubbard. Whilst some participants in the repo lending market may have been of the ominous views of which Mr Welles gave evidence, I am not satisfied that this was sufficiently pronounced that it was the only tenable view generally, and in cross-examination, Mr Welles appeared largely to concede this. In any event, though, the very fact of the difference in view between them satisfies me that there could reasonably have been differences of view amongst market participants, at the time, as to any wider implications of the Bear Stearns incidents for the markets. I also observe that both Dr Carron and Professor Hubbard agree that the credit crisis itself did not really happen until August, and in fact can be virtually pinpointed to 9th August 2007.

1216. The Plaintiffs suggest that the Defendants are, in effect, damned by their own admissions in evidence that these events were "significant", and even that they appreciated this at the time, because they then failed to act appropriately. They refer in particular the evidence of Messrs Stomber, Conway and Allardice. However, that submission ignores the questions, <u>how</u> significant? And how significant <u>at the time</u>? It is perfectly possible to agree that a market event is "significant" whilst at the same time considering that its significance does not require the reaction of a wholesale change of strategy, rather than a suitable adjustment. I find the Defendants' evidence to be consistent with this latter, and that it was a reasonable view.

(ii) Pressure towards higher haircuts.

1217. Second, is the question of the claimed signs that the 2% haircut rate upon which CCC's business model was predicated, could no longer safely be relied on. In this context, the Plaintiffs first lay stress on its fragility, on the grounds that it was, and ought to have been seen to be, "concessionary". This argument seems to me potentially to prove too much, because it applied also at the time of the devising of CCC's business model, and before its IPO. It would therefore entail that this was devised or pursued without appropriate care. This, however, is a proposition which the Plaintiffs have conspicuously not advanced, and virtually disavowed in their express acceptance that they are not arguing that the original devising of CCC's business model was negligent.

1218. However, in fact I do not find the description "concessionary" either helpful, or actually justified in any material way. I find that the weight of the evidence is that the 2% haircut was at the advantageous end of the range of haircuts for assets of the "safe" quality of CCC's particular RMBS, but that the advantage of being at the beneficial end of that range was a normal and reasonably expected consequence of CCC's connection with a market entity of the size and reputation of the Carlyle Group. It is also clear that Mr Stomber's negotiations with repo counterparties exploited – and none too subtly – this relationship, which was already well-established. I see nothing to criticise in this approach, nor any reason why it should not have reasonably been expected to continue to be exploitable as matters appeared in July 2007.

1219. The Plaintiffs submit that even leaving that consideration aside, it is "*undeniable*" that "*by June* [sic] *and July*" CCC was under mounting pressure to pay higher haircuts. The Defendants do deny it. They say that the pressure to higher haircuts was really not significant, and needs to be viewed in the light of the fact that, as Mr Welles conceded, accepted haircut levels had not changed through the past 20 years, even during earlier times regarded as "crises". They point out that whilst there had been some (but they say fewer than the Plaintiffs would interpret it) attempts to impose higher haircuts, CCC never had to accept any

increase but had always been able to negotiate the rate back to 2%, without real resistance. At this time, July 2007, the warnings and attempts to secure higher haircuts had also come from parties who had apparently suffered directly in the Bear Stearns incidents. A repo lender's attitude to financing will be influenced by its own idiosyncratic financial circumstances, and repo lenders were in competition.

1220. The Plaintiffs stress the seriousness of maintaining the assumed haircut level of the business model for CCC's continuing viability, noting that Professor Hubbard saw funding, or financing, risk as the central and the only real risk in CCC's business model, and was even prepared to describe an increase in haircuts as CCC's "key" financing risk. The Defendants accept this, as indeed they have to; the evidence certainly shows that being subject to unavoidable demands for higher haircuts would be a major problem for CCC on its established business model. It would in effect invalidate this for the purposes of its declared objectives as seen at the time of the IPO, namely the generation of attractive double digit risk adjusted returns, requiring the magnifying effect of a high level of leverage on the small net returns generated by the RMBS.

1221. For every 1% increase in haircut across a portfolio of $23Bn, CCC would be obliged to use $230Mn of its own capital as direct investment in RMBS, instead of being able to use that sum merely to provide the 2% balance required to purchase or hold 50 times that amount of RMBS. The risk of increased haircuts was therefore, intrinsically serious. But the key point is whether, in the circumstances of that time, it was culpable of the Defendants not to read the "signs" now focused on by the Plaintiffs as indications that that risk was so likely to materialise in reality, that it was imperative to take anticipatory remedial steps which would in fact be outside and contrary to CCC's then business model.

1222. In my judgment it was not. I have referred to all the instances of requests for higher haircuts because the Plaintiffs point to and rely on these, but simply doing so runs the risk of giving them the appearance of greater significance than is really appropriate, because it diverts attention from the fact that the great majority of CCC's repo funding was rolling over at a 2% haircut without incident. I am satisfied that CCC apparently had sufficient capacity in available "soft" repo lines to justify confidence, at that time, that it could obtain finance on its chosen terms from elsewhere in the market, despite a handful of individual suggestions of higher haircuts.

1223. I am also satisfied that such requests as were made were reasonably seen as the result of individual lenders' circumstances, and not a problem of wider or deeper significance. A decision as to whether such incidents as there were demanded an unusual course of action in response was a matter of business judgement. Businessmen are required to exercise judgement about the balance of disadvantage between a risk and its potential consequences (the likelihood of materialisation coupled with the gravity of effect if it does) and any possible steps which might avoid or counteract it. I am simply not satisfied that, without the benefit of hindsight, the response of CCC at this time – the end of July 2007 - to the reasonably anticipatable degree of risk of being obliged to accept greater haircuts than the expected 2%, was outside the scope of a reasonable reaction in the exercise of such business judgement.

1224. The Plaintiffs suggest that CCC's action in rolling repo finance away from certain counterparties is evidence of a greater sensitivity to the seriousness of the position at the time than they now admit. They suggest that the explanation that this was attributable to following

better interest rates rather than any effect of requests for higher haircuts is colourable. They cite Mr Stomber's oral evidence that if Mr Ng had in fact rolled finance because of an interest rate of 5.30% rather than 5.29% this would have been "silly". However, I balance this individual answer and its context against other scattered pieces of contemporaneous evidence suggesting that those concerned with effecting repo transactions at CCC did, indeed, seek to keep interest rates down to the minimum, either for the direct saving, albeit small, or as a matter of psychology for negotiation with repo counterparties. I am satisfied that this consideration did come into play. I note that it was Mr Ng, relatively junior, who seems to have been instrumental in this particular transaction. I have no doubt that his general instructions were to obtain the best terms possible including as to interest rates, and I find it perfectly plausible that he would have applied such a general guideline as a rule.

1225. In short, I am not persuaded either that, as at the end of July 2007, there was an ominous intensity of questions as to the level of haircuts, such as to suggest a serious warning of trends to come, or that CCC reacted inadequately or inappropriately to such indications as there were.

1226. In their closing submissions on this point, the Plaintiffs rely on the fact that, in connection with financing risk generally, CCC or CIM for CCC (ie Mr Stomber in particular) had failed to obtain structured repo financing (ie fixed financing for longer terms than 30 days), despite this apparently being intended prior to the IPO, and an intimation to the Board that this was being pursued. The Plaintiffs criticise the fact that this had never been followed through, and rely on this to submit that recognition of the desirability of structured or longer term repo which was subsequently ignored is evidence that the Board appreciated the vital need for securing stability in CCC's repo funding, but culpably lost sight of this.

1227. The Defendants accept that the possibility of structured repo was contemplated and was earlier pursued, to some extent with Bank of America, but that it then fell away. However, this becomes a mere point of evidence (I do not think it is even an allegation made in the Cause), because no negligence before 26th July 2007 is alleged. The only material questions go to the Defendants' reaction to events of July 2007 in the circumstances in which they then actually were. I do not think that the reasons why structured repo was not pursued in earlier times are of any materiality. On the evidence, not only was structured repo unusual but it was likely to be more expensive than the norm of 30 day repo. However, given the Plaintiffs' acceptance, that CCC's business model, which was predicated on the availability of 30 day repo at a 2% haircut to finance the holding of Agency RMBS, was a reasonable model to adopt at the time, this point strikes me as irrelevant.

(iii) Increased interest rate volatility

1228. The third major suggested "warning sign" is increased interest rate volatility. Measures of interest rate volatility showed this to have increased from 15% to 18% in the second half of July, and this was recognised in information provided to the ALCO meeting of 26th July, and, I find, probably discussed at the Board Meeting itself.

1229. Increased volatility is a measure of uncertainty. Increased interest rate volatility is disadvantageous for RMBS capped floaters, because it increases the perceived risk of the cap on the coupon coming into play, limiting the return, reducing the benefit of the investment compared to LIBOR and reducing the attraction of the RMBS capped floater, leading to price reductions in the market and thus to potential margin calls under financing agreements. The extent of this effect, though, will depend on the current levels of interest rates to be compared

to the cap; obviously the effects of volatility will be greater if interest rates in general are already nearer to the cap than if they are lower and with more headroom. No doubt for the above reasons, interest rate volatility was a metric included routinely in information supplied by Management to ALCO, and was regarded as one of the five underlying drivers of the price of CCC's assets.

1230. The Plaintiffs characterise the increase in interest rate volatility mentioned above as "*another critical warning sign*" for the Defendants. I do not accept the description "critical" which I find to be exaggerated. Whilst I accept that volatility is indicative of some instability in the markets and is undesirable, the evidence does not convince me that this change was, or should have been seen to be, a factor of any more than broad significance.

1231. There was much evidence in the case about the effects of anticipated changes in interest rates on the prices of CCC's RMBS in earlier times. This appeared to be being gone into by the Plaintiffs in order to counter an expected claim by the Defendants that falls in the prices of CCC's RMBS in May and June 2007 were attributable to rises in interest rates and the delayed intervention of the Federal Reserve, and that they were (or were reasonably seen as being) something separate and distinct from the matters which subsequently caused either the Bear Stearns incidents, or the later systemic market crisis of August 2007. Owing to its timing, I do not find this point to be of any real relevance in the case, but for what it is worth, I would accept the Defendants' submissions as to whether it was reasonable to interpret those events in that way.

(iv) Increased asset price volatility

1232. The fourth warning sign is said to be the recorded increase in the volatility of prices for CCC's RMBS assets, and the implications of this, which ought to have been actively heeded, as regards the inadequacy of CCC's liquidity cushion.

1233. The Plaintiffs' central argument focused on the conclusions which they submitted should have been drawn from one particular metric, namely that of the APV (Average Price Volatility) applicable to CCC's RMBS assets, and its convergence towards the figure which had been used to stress test CCC's business model and fix the required liquidity cushion to support CCC's leverage, – which was itself claimed even to be conservative. I have previously explained that the stressed VaR test which had been used to calculate an appropriate figure for CCC's liquidity cushion in the light of its highly leveraged business model had used the market conditions equating to those of the worst financial crisis in reasonable memory (in fact those of the 1998 LTCM crisis) to calculate a 20 day VaR at a 99% level of confidence, and then taken 125% of that figure. This computational figure could then be compared with CCC's actual liquidity cushion at any time, to provide a measure of the risk that CCC would run out of cash if presented with margin calls.

1234. The index figure for the APV of CCC's assets which was used in the stress test model had been 0.85%. Between mid-June and mid-July 2007, CCC's ALCO pack metrics recorded an increase in that metric from 0.55% to 0.79%. The Plaintiffs submit that this increase was not merely a warning sign in itself, but its approach to the stress test figure showed that it was a particularly strident such warning sign.

1235. The Defendants submit that this argument is endowing figures and statistical tools for management with undue intrinsic weight, and ignores the fact that they can and should always

be interpreted by those who are in the market and making contemporaneous business judgements. First, they point out that the figure was an annualised moving average of two years' data, which meant that once an extreme spike in the figures occurred, this would affect the figure for as long as that spike was within the range of collectable data; its implications therefore needed to be understood and analysed in context, and with this effect in mind. If the figure turned out to be a mere spike in the general graph, it could justifiably be ignored as a statistical outlier, since otherwise it would create a false perception of a reasonable degree of caution. This could be seen from the fact that the moment this spike dropped out of the historic period being used to calculate VaR, there would be a major shift in the metric, and it would be absurd to treat this as an accurate representation of a change in risk level actually occurring at that point. Second, the apparent approaching of the figure itself to the "danger" level of 0.85% used in the stress test model was not a proper comparison, first because the stress test figure had had to be derived from an index of floater prices at the time because actual data was not available from 1998, and second because the APV used in CCC's calculations was an internal figure derived from CCC's Polypaths software and not actual market data.

1236. I observe, here, that in the course of this argument, the Defendants pointed out that the graphs of this metric provided by the Plaintiffs appeared to suggest that CCC crossed the "danger" threshold of 0.85% during July 2007, but that this was a spurious impression, created by the misleading and illegitimate device of "joining up the dots" on a grid represented by measurements at particular dates, when the transition between measurements was not a straight line progression. I note this criticism. It underlines the need to beware of superficial appearances from expert generated data. It also underlines the reliance of the court on experts appreciating the possibility of creating such erroneous impressions in non-experts. It is the kind of point which has made me feel the uncomfortable imperative which I mentioned above, as to having to have my wits about me with regard to some of the propositions advanced by the Plaintiffs.

1237. Third, and as Mr Stomber emphasised, decisions about appropriate risk management had to be made on the basis of a judgement of all available evidence, and an effort to understand what was actually going on, rather than being mechanically driven by particular metrics. These metrics, including the VaR calculated figures, were simply tools to be used as an aid to judgement.

1238. I accept all these arguments and evidence, which I find to correlate with the expert opinions and approach of Dr Webster, whose views in these respects I find more persuasive than those of Professor Das, as I describe in detail later.

1239. A further submission of the Plaintiffs in this regard was that Mr Stomber ignored and unreasonably overruled warnings from Mr Trozzo with regard to a more prudent operation of CCC's liquidity cushion in the light of fallen prices for CCC's RMBS. On examination I do not find this particular incident to be of concern. It took place in the context of an earlier acquisition of a tranche of RMBS at the beginning of June 2007, in connection with the appropriate reaction to the Bear Stearns incidents. Market conditions and available knowledge were then different, and I am satisfied that they were fast changing. This incident itself occurred before any time when the Plaintiffs make any complaint about the Defendants' conduct. However, as it could have materiality to any general criticism of the attitude of Mr

Stomber towards use of the liquidity cushion, which is a key criticism made by the Plaintiffs regarding later events as well, I will deal with it here.

1240. Mr Trozzo's advice was with regard to how liquidity cushion parameters ought, in his view, to be applied to integrating the acquisition of a new tranche of RMBS into the general existing liquidity cushion scheme. Mr Stomber explained in evidence that the reason for his disagreement with Mr Trozzo was that the liquidity cushion, which had by then been depleted somewhat in paying margin calls, would replenish itself as markets "*came back to normal*" such that no adjustment to its underlying principles needed to be made. The Plaintiffs criticise this as being inappropriate and reckless.

1241. I reject this. Mr Stomber explained – and this was a point which he wished to emphasise in his evidence about the workings of a liquidity cushion – that the monies expended from a liquidity cushion when margin calls are made are not "lost" to the payer. As he put it, it is still the company's money; it is just sitting on the books of the lender. As and when prices rise, there will be a reverse margin call, and the monies will be paid back to the paying company, thereby replenishing the liquidity cushion. The point of a liquidity cushion (he emphasised) is that it is available for use in times of need. Of course, once you have used it to weather times of need, it is not there until it is replenished, but it follows that the real issue is how far it is reasonable (or culpable) to regard it as likely that there will be a return to previous conditions.

1242. In other words, the material judgement is: how long will "abnormal" times continue, whether the current "abnormality" is in fact the new "normality", and how likely is it that times could become even more "abnormal", and therefore adverse, than they currently are? Prediction of these issues is a matter of judgement, obviously to be made in the context of what has happened in the past. An appropriate reaction to the prediction is also a matter of judgement, depending on the balance of risk and disadvantage already mentioned, the degree of likelihood in the prediction, the perceived magnitude of adverse consequences if it is wrong, and the availability of any further safety measures that can be taken in this event. I find that Mr Stomber's reaction to Mr Trozzo's advice was within the range of reasonable judgements of the above matters, at the particular time and in all the circumstances.

1243. I should add that I find Mr Stomber's reaction to the spikes in price volatility in June (which was, on the second such occasion, to suspend asset purchases so as to enable all payments from CCC's assets to go towards increasing liquidity) to have been reasonable and appropriate at the time. It also, and importantly, demonstrates his attention to monitoring market circumstances and trying to react with appropriately fine-tuned responses to events which might need a reaction.

1244. I further add here, that the Plaintiffs appeared to argue, as part of their submissions with regard to the level of liquidity cushion which could properly be taken into account in the context of this warning sign, that this should be based on CCC's equity before the IPO, and that the net proceeds of the IPO should not be included in an assessment of liquidity. The Defendants submitted that this was wrong; CCC had that capital resource, regardless of its origins. It was therefore available for use as part of the liquidity cushion if needed, and calculations, which would now be based on 20% of the increased equity generated by the IPO, could rightly take that into account.

1245. I accept the Defendants' arguments. The Plaintiffs' approach seems to me to be calculated to put a worse complexion on the statistics than they fairly deserve.

(v) Previous loss of asset value

1246. The fifth warning sign was the previous unrealised losses on CCC's RMBS assets since their purchase which the Plaintiffs describe as "significant". They point first to the fact that the decline in prices in May and June was "unanticipated". I agree and find that it was, but this seems to me to be stating the obvious and to add nothing of substance.

1247. They refer (correctly) to the fact that CCC had paid out $82Mn in margin calls, and that this would have been more than half of its liquidity cushion as at mid June 2007. I agree, but, again, it does not seem to me that that comparison adds anything to the circumstances requiring consideration in late July 2007. As long as prices did not decline further, this was not a problem, and in "normal" times, judging by history, it would right itself as prices reverted to previous levels.

1248. Mr Stomber, from his experience and in accordance with market logic, expected a flight to quality, such as he considered had arisen in 1998. The Plaintiffs submit that he was mistaken in this, and that he later acknowledged this. However, I understood his evidence to be simply an acknowledgment of what had happened in practice and that his expectation had been wrong, rather than being an acknowledgment of fault.

1249. Much of the evidence in this regard was highly technical, and consisted of retrospective analyses (by Dr Maini) of component elements which he considered should be assumed to have contributed to effects on asset prices. I am not satisfied that analyses such as these, at this level of detail, were a usual or commonplace requirement in managing an enterprise such as CCC even at the material time, but in any event, it seems to me that they demonstrate only possible conclusions as to such attributions and not necessarily the only reasonable conclusions. These kinds of calculations seem to owe quite a lot to art rather than science, the results often depending on the assumptions which are used, which will be matters of subjective judgement. The nature and quality of such evidence is therefore not such as to satisfy me that it would be right to base findings as to Mr Stomber's contemporaneous judgement upon it. In short, I am not satisfied that Mr Stomber's view of the likelihood of CCC benefitting from a flight to quality was unreasonable, and certainly not so ill-founded as to have been culpable.

1250. In the end, therefore, I find that this fifth "warning sign" is not really anything of separate significance from the other claimed warning signs highlighted by the Plaintiffs.

(vi) The difficulty of the IPO

1251. Sixth, there is the suggested "difficulty" of the IPO. I regard this as a total red herring. The difficulties of the IPO concerned appropriate pricing of the shares, (which had to be reduced) and the ability to generate sufficient take up of them. In other words, the problem was making investment in CCC a sufficiently attractive proposition at the time of the IPO. The Defendants recognised that these matters demonstrated that the financial markets were not as rosy or robust by the time of the IPO as they had previously been. They seem to have attributed the difficulty to either a misjudgement of the appetite of investors for a pure yield vehicle by the time the IPO took place, or simply the general deterioration of market conditions since 2006 when the concept was launched; there is always the risk that market conditions and sentiment will change during the necessary lead time to an IPO. I find this thinking and reaction to have been a reasonable view at the time.

1252. The IPO had, though, still been successful in raising an acceptable amount of capital for CCC, even if less than originally anticipated or hoped, and the features leading to its difficulty, mentioned above, do not seem to me to have any demonstrable link to the main two "threats" facing CCC, namely funding risk (loss of the continued availability of repo lines on satisfactory terms) and asset price decline (the generation of unsatisfiable margin calls), nor to suggest that a reappraisal of CCC's business model was now vital to its survival. In my judgment these were, once again, matters which carry no weight in any assessment of the culpability, or otherwise, of the decisions taken by the Defendants at the end of July 2007.

The 26th July Board Meeting

1253. The Plaintiffs criticise the absence, or paucity, of apparent discussion of the above factors at the Board Meeting of 26th July 2007. They suggest that this was culpable and that if "proper" attention and discussion had been paid to them, then the decisions which are then criticised, the material "effectual breaches" therefore, must have been different.

1254. I do not accept this. First, the discussions which took place at the Board meeting appear, even from the limited formal Minutes, to have been suitably wide ranging. They reflect that there was then (and I find, reasonably,) greater concern for CCC's credit products because the worrying features of the market then appeared to be related to the incidence of credit risk and its effects on the markets. I am also satisfied from the totality of the evidence, including the oral evidence, that the discussions which took place were, in practice, more wide ranging than recorded in the Minutes. I find this to be amply demonstrated by Ms Cosiol's hand written notes, which were themselves not verbatim, even though comprehensive.

1255. The question whether "adequate" consideration or discussion of warning factors regarding CCC's RMBS assets took place at the time of the 26th July Board Meeting depends on the degree of importance which was appropriately attached to those matters at the time. I am satisfied that given the significance reasonably attached to those features at the time by CCC and its Management, the amount of information shared with the Board and the consideration and discussion which was given to them was proper and reasonable. I accept that haircuts are not specifically mentioned in the written records. I find that it was not unreasonable that the degree of risk of higher haircuts should not have been perceived at that time as so serious as to generate a discussion sufficient to find its way into written records.

1256. For the avoidance of doubt I am also satisfied that the reference to *"can't take a flier on liquidity = bankruptcy"* was indeed a reference to the leveraged finance assets in the portfolio. I conclude this from its context in the notes and in particular from a later related reference to "rollover risk" (which was funding, or financing, risk) not being an issue until November 2007, which applied to such credit assets. However, I do also consider this comment to be evidence of a general degree of caution in the mind and attitude of, in particular and centrally, Mr Stomber.

1257. I find this further reflected in the fact that Mr Stomber suggested a possible freeze on the purchase of new credit assets at the Board Meeting, which was taken up at the subsequent ALCO meeting. I note that this shows a distinct change of mind by Mr Stomber from his position only a week earlier, (and during the period when the Plaintiffs make no criticism of the conduct of the Defendants), on 18th July, when he had instructed a $25Mn investment in a leveraged finance asset which had been held up or reserved during the market turbulence associated with the Bear Stearns incidents to be made "asap" in order to facilitate meeting

CCC's dividend target. I find this to be evidence that Mr Stomber was exercising a sensitive approach to CCC's asset holding or acquisition, according to changes in market circumstances.

1258. I am also satisfied that the references in the CEO letter and MD&A commentary for the second quarter of 2007, to CCC's approach being "cautious" or "conservative", were not only genuinely intended but were a reasonably apt description of CCC's attitude at the time. This is always, of course, in the context of CCC's business model, its objectives and the degree of risk which would be appropriate to achieving those objectives.

1259. This sensitive approach is further demonstrated, I find, by the sequence of steps which were actually taken on behalf of CCC by the Defendants or CIM under Mr Stomber's management at that time. At the ALCO meeting immediately following the Board Meeting, it was agreed that CCC would cease all purchase of credit products. In the light of indications of some pressure on repo terms which occurred simultaneously with and in the few days immediately following the 26th July Board Meeting, Mr Stomber announced that he was also considering the suspension of acquisitions of RMBS as well. Then, on 30th July 2007, he instructed this. This was a move which he characterised as going "ultra-safe". I find this progression to have been apposite in the context of how market conditions were appearing at that time, and some uncertainty as to how they might develop.

1260. The Defendants submit that when CCC's position up to the end of July is considered without hindsight, on every relevant measure it appeared to have ample liquidity to meet its reasonable foreseeable needs. Its liquidity cushion was in excess of 20% and in excess of the 20 day VaR for the RMBS portfolio, which translated into the proposition that on the basis of 99% probability, it had enough liquidity still to meet the most severe market disruption recorded in past financial history, for one month. I accept the thrust of this submission.

Other points

1261. Focusing on their submission that CCC's level of leverage was so high as to be clearly unsafe, at any rate in the market conditions beginning to emerge in July 2007, the Plaintiffs have pointed out that this was far greater than that of other entities which CCC regarded (from the evidence of its monitoring of their performance) as its "peers" or appropriate comparators.

1262. It is certainly the case that CCC's leverage ratios were greater, and significantly greater, than those of the funds with which it compared itself. However, I do not consider that this is anything which ought in itself, to have caused CCC to re-evaluate and change its business model at this time. CCC's competitors had different business models, which were influenced by their different aims, different assets and asset allocations, and probably different risk management policies. CCC's intended leverage ratios had been carefully designed and mathematically modelled. They had, together with the risks associated with the model, been stated clearly in its PPMs and OM and were therefore apparent to and accepted by its investors as the concomitant of the attractive rate of return expected to be generated. The fact, therefore, that peer companies either had lower leverage ratios, or reduced these in response to market conditions at this time or later, does not strike me as anything more than a matter to be noted. I certainly do not accept that it is a yardstick by which CCC's performance or actions could properly be measured, and I am satisfied that it could not reasonably be regarded, in itself, as a driver for CCC to change its business model. Any such decision was one to be taken by the Defendants on the basis of their perceptions of market conditions affecting CCC's individual

circumstances and assets, and advice with regard to this, not on the basis of following suit behind others.

Summary and conclusions

1263. In general summary, I find that the position prior to the summer of 2007 was that the US repo finance market had historically been "wide and deep" ie both sustained and solid. In layman's terms, there had been plenty of money around to provide steady and plentiful financing on terms which varied little. RMBS of the type in which CCC proposed to and did concentrate the larger part of its investments, ie Agency capped floaters, were regarded as safe, high quality assets, with no real risk except when benchmark interest rates might rise to near the imposed cap. CCC's business model had (reasonably) been based on the assumption that these two features of the financial markets would endure for the foreseeable future more or less as they had in the established past, and that markets would not suffer temporary shocks of a greater magnitude than that generated in the most severe such shock in financial living memory. The risks of these assumptions being ill-founded were more theoretical than real. They were, however, conceivable, and were effectively flagged up in CCC's offering documents.

1264. During the run up to CCC's intended IPO, there was some downward movement in the prices of CCC's RMBS, but this was reasonably viewed as the result of concerns about possible interest rate rises. The Bear Stearns incidents arose from risks (credit risk) which applied in the sub-prime RMBS market, and which could reasonably be viewed, both from logic and from historical perspective, as not affecting CCC's assets, either directly or by contagion. CCC successfully weathered the immediate jolts in the markets caused by these and reasonably viewed any apparent reactions rebounding on it (CCC) by those with whom it was habitually dealing as idiosyncratic reactions, rather than harbingers of general systemic doom.

1265. CCC's Management had regard to the events of the market and were duly attentive and respectful of them. They (particularly Mr Stomber) kept relevant indications under review. They did not do nothing, but took prompt and proportionate steps to react appropriately to the situation as it appeared, first ceasing the purchase of credit products and then the purchase of RMBS shortly afterwards.

1266. Those with the direct responsibility and involvement amongst CCC's Board monitored and reacted to the events in the market with a degree of care which was appropriate both to their reasonably judged significance and to the personal level of knowledge and expertise of those involved. They took and explained appropriate information to the Board Meeting. Those with less personal involvement, knowledge or expertise, who followed the guidance of their more expert co-directors did so reasonably and appropriately. The Board Meeting, ALCO Meeting and other less formal communications between members of the Board were reasonable, appropriate and sufficient discussions.

1267. Focusing, therefore, on the specific breaches of duty of care alleged against the Defendants with regard to July 2007, I am satisfied that there was no negligence in their failure to sell RMBS at this time. I find that the steps of suspending all asset purchases in slightly staggered timing, was a reasonable prudent reaction to market circumstances at this time. Whilst there is no evidence that the Defendants considered raising equity capital, I do not find this to be in any way a criticism; I do not see the apparent demands of market circumstances and the state of CCC's liquidity cushion as reasonably requiring this, and it would in any event have been

somewhat impractical so shortly after the IPO. As regards the allegation of failure to restructure or carry out an orderly winding down of CCC, in fact the cessation of asset purchases and use of income to supplement the liquidity cushion was itself a form of such restructuring, and it was, as I have said, an appropriate reaction to perceived market circumstances.

1268. As regards the alleged breach of duty by the positive action of making further purchases of RMBS even after the decision of 30th July 2007 to cease to do so, I reject this as a matter of fact. I find that these were in fact the completion of orders, reasonably placed at the time when they were placed, before the decision to cease purchases of RMBS was made.

1269. The Defendants described this allegation as a misunderstanding by the Plaintiffs; they had not allowed for the gap between contracts and settlement dates. I find the Plaintiffs' riposte, that in that case it was a breach of duty not to unravel the transactions, quite extraordinary. There is no evidence that this could have been done, still less as to the beneficial financial consequences of doing so, and the reputational consequences of seeking to undo such commitments could plainly be damaging. There can be no criticism in CCC's not considering doing this at the time.

1270. The above discussion embraces my findings on all the incidental matters alleged as breaches of duty in paragraphs 263C.1-4, and 263E1-4.

1271. I conclude that the Plaintiffs do not satisfy me that the decisions complained of were decisions to which no reasonably competent director could have come, and this judgment applies to each of the individual Defendants, taking account of his particular skills and experience. The Plaintiffs therefore do not satisfy me that there were any breaches by the Defendants of their duty of care towards CCC in July 2007.

(b) Breach of fiduciary duty

1272. The above findings mean that I regard the Defendants' decisions and actions as reasonable, viewed objectively as well as subjectively. It is therefore not really necessary for me to consider the Plaintiffs' plea that breaches of the Defendants' duties at this time were not merely negligent but were improperly motivated. This is because, if the Defendants, or any of them, did not give proper consideration to CCC's best interests or any other aspect of their fiduciary duties, the *Charterbridge* test would apply. My findings above means that I am satisfied that, viewed objectively, the decisions which are criticised were within the range of decisions which a reasonable director could properly regard as being in the best interests of CCC, and therefore there would be no liability on the *Charterbridge* test.

1273. In fact, the Plaintiffs did not seem to me to argue their case with regard to the end of July 2007 seriously on the basis of breach of fiduciary duty as distinct from duty of care. Their arguments in general raise possible motivations on the part of certain of the Defendants, which they suggested drove the conduct which they complain of as being reckless or irresponsible. The only aspects of this pertaining to claims of breach of fiduciary duty as opposed to negligence at this time (July 2007) were that Mr Conway and Mr Stomber were not prepared to suffer the reputational damage to Carlyle which the actions of CCC's selling RMBS or seeking to raise further equity capital were likely to cause so soon after CCC's IPO, and an unduly singleminded pursuit of CCC's dividend target, particularly on the part of Mr Stomber, and insofar as that was a further reputational consideration for Carlyle.

1274. In practice, these points were relied on more strongly in respect of later allegations of breach of fiduciary duty, and I therefore do not see the need to consider them here, as it would be pointless to do so. I would not have regarded them as made out in respect of July 2007, but, for reasons already given, any other such finding would be immaterial in the light of my conclusions that the decisions actually made and implemented by the individual Defendants were within the range of decisions which a reasonably careful and properly loyal Board of Directors could have made for CCC in all the circumstances.

(c) Contractual/tortious claims against CIM

1275. The allegations of breach of contract (or tort) made in the Cause against CIM appear in Paragraphs 419.1-21 and Paragraph 424B. Paragraph 419 contains a list of aspects of what was done or not done on behalf of CCC throughout the period from July 2007 to February 2008, at varying levels of specificity, which are attributed to the advice of CIM. Insofar as they are at all specific they set out matters of complaint which are also made against the individual Defendants as directors. Paragraph 424B refers specifically, but with the convolution of also cross-referring back to numerous other paragraphs, to actions alleged also against TCG and Holdings as well as CIM, with additional assertions that they constituted breaches of fiduciary duty in not being in CCC's best interests but rather being in, or prioritising, the best interests of TCG or Holdings. Insofar as these matters are apparently alleged as totally freestanding breaches of fiduciary duty, that basis of claim is, as I understand it, no longer pursued. It appears to leave, however, these same allegations against CIM made on the basis of breach of a fiduciary duty implied into the IMA.

1276. I have explained above my general finding that a working starting point with regard to the content of the contractual duties owed by CIM to CCC is that they can be treated as co-extensive with the similar claims made against those individual Defendants who had the relevant increased material expertise which one would expect to find in an investment adviser providing the services supplied to CCC by CIM under the IMA. This is because I find, for practical purposes, that the contractual duty of care imposed on CIM under Delaware law under the IMA is materially indistinguishable from the duty of care which I would find to be imposed in similar circumstances in Guernsey law, and is further materially indistinguishable from the duty of care resting on a director of CCC with the relevant increased material expertise. In effect, this means Mr Stomber, and in principle, it would also mean Mr Zupon, although in practice this does not seem to arise on the facts.

1277. Mr Stomber was for all practical purposes the personification of CIM with regard to the performance of CIM's advisory functions and duties under the IMA. He was also responsible in a supervisory capacity for CIM's operational functions and duties and would have been responsible for the execution of these by his team of subordinates. As regards this particular period, it is the case that, apart from Mr Stomber, Mr Zupon was in a comparable role as both an employee of CIM for the purpose of acting for CCC, and a non-voting Board Member of CCC. It is also the case, though, that Mr Stomber was senior in the hierarchy and effectively in ultimate charge of policy advice, with the ability to call on the advice and assistance of Mr Zupon as he saw fit, having regard to Mr Zupon's different sphere of expertise.

1278. I have held above that the decisions in which Mr Stomber advised or participated were not in breach of his duty of care to CCC as a director of CCC. By the same token, I find that those decisions, taken in his dual role of advising CCC as a non-voting director of CCC but also as

part of investment advice and management functions provided by CIM, were no breach of CIM's contractual duty of care to CCC either. I would find the same in respect of Mr Zupon, so far as material.

1279. Assuming the existence of a contractual fiduciary duty, I cannot see any grounds of substance for suggesting that that was breached by any matter of complaint regarding July 2007, but if any further reasoning with regard to this is needed, it will be found later where I consider these allegations at the point in the history where they have more substance.

1280. The upshot is that I dismiss the claim of breach of contract (or tort) against CIM.

(d) Wrongful trading

1281. There is no claim for wrongful trading at this time.

10. The Claims: AUGUST 2007

Did the Defendants react culpably inadequately to the market crisis conditions of August 2007?

1282. This and September 2007 are probably the key months as regards the Plaintiffs' case.

Market conditions in early August 2007

1283. On 2nd August 2007, Mr Stomber reported to Messrs Conway, Hance and Zupon that CCC's RMBS portfolio value had improved by $4Mn, but that its bank loan portfolio value had lost another $10Mn. There was email discussion about whether the widely reported problems in the sub-prime market would now spread to other sectors; on 1st August, the two failed Bear Stearns hedge funds had declared bankruptcy. Mr Stomber's view from his previous experience in 1998, recorded in emails in early August 2007, was that the contagion caused by general apprehension of anything which was mortgage-backed should not persist, because the market was now beginning to understand and differentiate risk. Whilst on the look out for a beneficial opportunity to buy assets, he would still, though, operate defensively.

7th August

1284. However, on 7th August 2007, matters took a turn for the worse. CCC's RMBS portfolio declined in value by $30Mn and Cantor Fitzgerald, one of CCC's repo lenders financing about $3Bn of its $23Bn portfolio, made a margin call of $70Mn. Management and Mr Stomber regarded this as extraordinary and quite out of line with any reduction in the value of CCC's assets held by Cantor. Whilst the demand was negotiated back to $30Mn, even this was unacceptable, and CCC rolled its repo away from Cantor to Citigroup and BNP Paribas, conjecturing that Cantor was in fact in financial trouble.

1285. Mr Stomber reported these facts, first to his fellow Investment Committee Members (the Carlyle Directors), and later to the full Board. He also recorded that he would now not buy new securities, even though the reduction in their pricing presented a buying opportunity, but would focus on ensuring liquidity, whilst also recording that this would inevitably put CCC's dividend yield in question.

1286. The Plaintiffs have suggested that various contemporaneous references by Mr Stomber to the prospects of jeopardising the payment of dividends are evidence of an imprudent, excessive,

and in fact improper, concern to pay dividends rather than adopting appropriately careful measures to protect CCC's capital; paying dividends is the very opposite of reducing leverage. I have considered these comments by Mr Stomber where they occur, and I do not find that to be the case. Mr Stomber had been recruited in the first place to devise and run an investment vehicle whose attraction was to be the generation of a high dividend. It was therefore only right that he draw the Board's attention to factors which might impair that prospect, but furthermore, at these early stages after CCC's IPO, it was still, I find, reasonable that he should have this point in mind, and be alert to any opportunities which would further that aim, as well as hinder it. Purchases at apparently advantageous spreads, when these could be effected, were the natural and obvious course. There was no reason at this time, ie the beginning of August 2007, (I find) for Mr Stomber to have regarded it as inevitable that such prospects should be abandoned entirely. Any inferences to be drawn from his emails and so forth in the first half of August need to be considered against this background. I therefore do not find references at this time to dividend prospects to be any evidence of an inappropriate prioritisation of paying dividends.

1287. In further response to the signs of turbulent market conditions, though, Mr Stomber also asked for Independent Director approval to reduce CCC's minimum liquidity cushion requirement to 15%. The previous reduction to 10% (requested for a different purpose, namely in order to facilitate advantageous purchases prior to the IPO), appears to have been assumed to have ceased to operate. The current request was so as to enable the cushion to be applied, if necessary, to meet possible margin calls.

1288. There was no formal Board Meeting to discuss the request. Whilst the Plaintiffs criticise this, the Defendants point out that it was relatively soon after a Board Meeting, and there was to be an ALCO meeting in two days' time, which would discuss the position and which Board Members had an invitation to attend. It was also the very purpose for which the liquidity cushion was intended and therefore not a matter outside expectations as to the way in which CCC would operate.

1289. The Independent Directors later gave their approval informally, over the following two days. They say that they understood that this was precisely the situation for which CCC's liquidity cushion was established. Although not required to vote on the matter, Mr Conway also indicated his approval. The Plaintiffs point out that this was never discussed at a CCC Board Meeting, either before or after it happened, and they also point to Mr Conway's intervention as an indication of what they characterise as his overarching "dominance" of the Board and CCC's affairs.

9th August 2007 - ALCO Meeting

1290. Mr Allardice and Mr Sarles attended the 9th August ALCO meeting at Mr Stomber's invitation. The other members of the Committee comprising CCC's Management attended as usual.

1291. Earlier that day, BNP Paribas announced that it was freezing redemptions from three of its hedge funds because of inability to value the subprime RMBS which they held, and a "*complete evaporation of liquidity*". This unusual and disconcerting event, with the likely reactions of authorities and other banks and the consequences for CCC, was the first topic for discussion at the ALCO meeting.

1292. CCC's liquidity cushion, which was nearly $203Mn, was recorded as at 3rd August to be at 25.4%. Just as in June, the Polypaths software was throwing up prices lower than IDP prices, and suggesting that if repo counterparties followed CCC's own pricing methodology, a further $32Mn of margin might be called up. This would reduce the liquidity cushion to 22.3%, but still not below the magic 20% level.

1293. The meeting discussed the usual deck of slides containing metrics such as CCC's 1 day and 20 day VaR calculations (Mr Stomber asked that in future these should also have the previous meeting's figures for comparison), and the ratio of its liquidity cushion to VaR. These ratios had roughly halved since the 18th May meeting, but this of course reflected the fact that APV had doubled in the interim. However, even these figures suggested that CCC then still had a safety margin in its liquidity.

1294. The meeting discussed CCC's relations with its repo lenders. It was reported that Cantor Fitzgerald was out of line as the only lender trying to rely on aggressively adverse pricing. There was as yet no indication that other lenders would follow suit, or attempt to impose higher haircuts, although it was noted that all CCC's repo counterparties had likely begun to come under pressure to look after their own liquidity needs. Thus, it was recognised that this could be a factor which would affect their dealings with CCC.

9th – 15th August

1295. The evidence shows that the BNP Paribas announcement heralded or prompted a sharp decline in demand for all asset backed commercial paper ("**ABCP"**) products, a sharp rise in interest rates, a reduction in liquidity as banks with a large exposure to RMBS – particularly in sub-prime - began hoarding cash, and a collapse in the market for short term loans. This was, however, a global rather than a local event, and both the Federal Reserve and the European Central Bank took emergency measures by providing liquid funds at record breaking levels.

1296. CCC gradually began to receive increasing margin calls during 9th and 10th August, initially from ING and JP Morgan. These increased from Monday 13th August throughout that week with calls from Citi, Credit Suisse, repeatedly from Lehman Bros and finally from Bear Stearns. In the course of six business days, CCC paid out over $120Mn in margin. The liquidity cushion fell below 20% on 14th August and continued to decline.

1297. This period saw repo lenders begin to abandon IDP prices and make margin calls based on their own prices, as well as to start demanding higher haircuts. This was a difference from the 1998 LTCM crisis, which marked it out as being more severe in nature. Mr Stomber appreciated the implications of such behaviour, and what it indicated about pressure on banks. He noted in an email to Mr Conway of 10th August 2007, that his biggest worry was now the availability of repo lines (banks simply withdrawing their funding), and banks attempting to increase haircut levels.

1298. On 13th August UBS and JP Morgan intimated that they would be seeking haircuts higher than 2% at the forthcoming repo roll of 15th August - which annoyed Mr Stomber because any such change was unprecedented, and he maintained that the 2% margin was quite enough to protect their security interests on a statistical basis. He noted in an email of 13th August that he was therefore going to meet with their senior management and proposed, typically, to use the Carlyle connection for pressuring at this higher level for the usual (and in his view more appropriate) terms.

1299. A review of the figures prepared by Mr Trozzo on 15th August for report to the Board shows that CCC was at this time utilising about $22.2Bn of repo, but had more than $37Bn of available (soft) line capacity in total. CCC would roll about $10Bn of repo on 15th August, of which about $2.3Bn was attracting a haircut demand possibly higher than 2%.

1300. The then strategy which the Defendants say had been discussed and agreed, generally in emails, between Mr Stomber and at least Mr Conway and Mr Hance, was to focus energies on repo negotiations both to manage haircuts and maintain line availability, to exude an image of strength and confidence, and to take advantage of the Carlyle name. Mr Stomber now sought to draw on the skills of Mr Rubenstein and any connections of his at a high level with JP Morgan and UBS, to persuade them to hold their haircuts steady at 2%.

1301. The reason for his concern about the maintenance of this figure lay, he said in evidence, not just in its financial effects but also in appearances, and market intelligence. If JP Morgan obtained a 3% haircut, this could produce *"a stampede"* by other dealers, who would scent the possibility to do likewise. Mr Stomber explained the obvious and previously noted mathematical effects of a 1% general increase in haircuts, ie that this would require CCC to find an extra $230Mn in available cash of its own.

1302. The number and urgency of emails on these days, between (principally) Messrs Stomber, Conway and Hance, but later extending to Mr Rubenstein and Mr D'Aniello show that the severity of the liquidity crisis which had developed and was continuing - and which was severely impacting on the immediate availability of sufficient affordable finance for CCC and capable of causing its collapse if not managed effectively - was fully appreciated.

1303. It is common ground (but I would so find in any event) that a universal haircut increase to 3% on RMBS repo finance could not then have been sustained by CCC on the basis of its current business model; this would have had to be changed, and the practical options for such change were not obvious. There is a dispute about the extent to which CCC could reasonably be expected to sustain an average haircut level in excess of 2%, although in the event it actually did so for a period, as will appear.

1304. Given the Plaintiffs' complaints, it is important to record that on 15th August, Mr Hance raised the possible course of selling some RMBS and taking some losses to free up some capacity. Mr Stomber replied that he would "*hate to sell",* giving as his reasons that the current depressed prices of the RMBS were, in his view, only temporarily bad and were likely to improve, and that the trade-off between generating liquidity and realising losses by selling was not a worthwhile one. He saw the reduction in prices as being the product of an oversupply of RMBS as against demand, with demand itself being limited by the lack of financing liquidity to fund purchases. Mr Stomber did not, however, see these conditions as likely to persist.

15th August – repo roll

1305. CCC negotiated the 15th August repo roll by moving approximately $750Mn away from JP Morgan, about $400Mn each away from BNP Paribas and UBS, and increasing its line with Citi Bank by about $1.5 Bn. It left about $2.6Bn with UBS, but UBS refused to reduce their haircut demand below 2.5%. Thus for the first time, CCC actually suffered a nominal haircut in excess of 2%. It was warned by UBS that the figure would rise to 3% on the next roll, as at 27th August.

16th – 17th August – the Carlyle loan

1306. Mindful that problems were not at an end with the negotiation of the 15th August repo roll, Mr Stomber was looking at options going forward, including a potential rescue package for CCC from Carlyle, and also how to manage the next roll, on 27th August. On 16th August, he approached Mr Conway, as to whether the Carlyle Founders (effectively TCG) would be prepared to provide a $100Mn loan to CCC as emergency funding, provided its repo financiers could be persuaded to agree to keep their haircuts at 2% moving forward. In a further, heartfelt, reporting email of that same day he noted that the current state of the markets was unprecedented and acknowledged that it had been "*a mistake"* to assume that markets would react in the same way as in 1998; CCC's repo counterparties were now marking the value of CCC's RMBS to their own distressed prices, and more margin calls could therefore be expected. CCC's liquidity cushion had fallen to 7%.

1307. Mr Conway's response to the loan request was that he was only prepared to advance the funds if it would solve CCC's funding problems, and on the basis that the repo counterparties would remain at a 2% haircut. However, although initially it was proposed to use this as a negotiating tool with the repo counterparties, Mr Conway quickly revised his view and decided that the loan should be advanced anyway, as the most expedient way of helping CCC out of what were expected to be temporary difficulties. From that perspective, the loan could be presented as a sign of Carlyle's own confidence in CCC, rather than attempting to use it as a bargaining chip.

1308. Independent Director approval for such loan, as required by CCC's Articles of Association, was sought and obtained, apparently through telephone contacts and discussions, especially between Mr Stomber, Mr Sarles and Mr Allardice, on 16th and 17th August 2007. When the matter was put to Mr Loveridge, in an email from Mr Allardice of 17th August which succinctly explained the position and invited discussion by telephone if necessary, he too agreed.

1309. The arrangement was to be for an unsecured, subordinated $100Mn loan, repayable in one year, at an interest rate of 10 %, with no penalty for early repayment. The figure had been suggested by Management. The interest rate was higher than the then prevailing U.S. prime rate of 8.25%, which Carlyle typically used when providing secured loans to its affiliates, because this loan was to be unsecured. The rate was proposed by Mr Stomber, who thought it was fair and advantageous; he did not think (and, as it looks highly unlikely, I would so find) that CCC would be able to obtain better terms elsewhere.

1310. The Plaintiffs' attitude to this loan, and the part it plays in their criticisms, has been rather difficult to divine during the trial. At times they have suggested that its terms were an unreasonable exploitation of CCC by Carlyle in terms of interest rate. At other times and actually in the Cause itself, they argue, bizarrely, that it was a breach of duty for the Defendants to cause CCC to accept the loan because it was manifestly insufficient to solve CCC's difficulties (although it is not suggested how refusing to accept the loan would have been a better course for CCC). However, on any basis, a point which the Plaintiffs stress as significant is that in the term loan taken by Carlyle itself (technically I think TCG) to enable it to provide this funding – in fact as an acceleration of finance which it had previously been negotiating for its own business purposes - Carlyle insisted that the bankruptcy of CCC should not be treated as an event of default. This, say the Plaintiffs, is evidence that Carlyle, and by

extension Mr Conway at least, knew and feared that CCC might well go into insolvency, and that assistance from Carlyle was not open-ended. By 19th August, a formal resolution to take the loan had been signed.

1311. On 17th August, the general market situation improved slightly as the Federal Reserve Bank lowered its discount rate by the significant amount of 50bps and extended the terms of its loans to banks, to enable them to keep lending to others.

1312. Over the period 15th – 17th August, Mr Stomber followed up on the further question of the minimum liquidity cushion guideline, and now sought Independent Director approval to suspend it entirely, so as to enable CCC to get through what he described as an "*extreme period".* This approval was discussed and obtained, again largely in telephone conversations, over the following two days. On the same day as Mr Conway initiated the acceleration of the first tranche of the credit facility which Carlyle had started negotiating for itself with its own bankers, so as to enable it to provide the $100Mn loan to CCC, as mentioned above, the Independent Directors formally, but by email, gave approval to the suspension of the minimum liquidity cushion guideline, with which CCC was, of course, already non-compliant.

1313. In the evening of Friday 17th August, Mr Stomber sent an email report to the full Board, reviewing the effect of the events of the previous week, highlighting the tendency for repo lenders to start using their own pricing and the general demand for 3% haircuts now being faced by CCC for the forthcoming roll. He explained the potential loan from Carlyle, and that he had scheduled meetings with CCC's six underwriting banks, who were also repo lenders, with himself and Mr Conway on the following Monday – 20th August. The involvement of Mr Conway was in order to deploy the full effect of his seniority, reputation and influence with those of similar power and weight at the banks themselves. The aim was to use Carlyle's willingness to loan funds to CCC to incentivise the repo lenders to be reasonable and keep their haircuts down to 2%. Mr Stomber hoped to put pressure on the underwriting banks because of their implicit support of CCC at the time of the IPO only about six weeks before, although that seems to me to be moral pressure only – perhaps not worth much in a crisis.

1314. Whilst recognising the need for a future revised plan, such as obtaining longer term repo, Mr Stomber said that it was as yet too early to devise this and it would be a matter for a future Board Meeting. This view appears reasonable, because at that time the circumstances were clearly still very unsettled.

18th August - insolvency fears

1315. On 18th August, Mr Ferguson, Carlyle's head in-house legal adviser, recommended to Ms Cosiol, Mr Buser and Mr Nachtwey that legal advice should be sought about the potential bankruptcy of CCC and what would be the duties of directors if CCC were in the "zone of insolvency" – a term of art in Delaware Law. Ms Cosiol sent on this request to Carey Olsen in Guernsey, and the Attorney firm Skaddens in New York, to schedule a conference call to discuss the point. This was arranged and took place on 20th August, an important date for CCC's business.

1316. There are notes of this conference call, which record that "*one of the board is uncomfortable"* (it has proved impossible to identify whom) and also that "*Carlyle legal are panicking".* Following this call, Carey Olsen sent to Ms Cosiol copies of Sections 67B and 67C of the Companies (Guernsey) Law 1994 with notes on directors' responsibilities. Ms Cosiol later

reported to Mr Stomber (although not to other board members) with a summary of directors' responsibilities, in particular reporting that once a company entered such "zone" the directors owed their fiduciary and other duties not just to the company and its shareholders "*but also to its creditors, and must take their interests into consideration*". She advised that the Board should meet on a weekly basis by telephone, but in the event this did not happen. Ms Cosiol also advised that the taking, and making, of the intended Carlyle loan was perfectly proper.

1317. On 19th August Mr Trozzo recommended to Mr Stomber and Mr Greenwood that if CCC survived the current turbulent period, it should "*deleverage and re-set the LC [*liquidity cushion] *levels",* these having been set by reference to the 1998 crisis as to which current conditions were much worse. Mr Stomber agreed, saying that CCC needed *"to rethink everything".*

20th August - CCC meets its lenders

1318. 20th August 2007 is a very significant day in the story. Mr Stomber and Mr Conway had been scheduled to attend hour long meetings with very senior personnel at their six underwriting banks - Citigroup, Goldman Sachs, Deutsche Bank, Lehman Brothers, JP Morgan, and Bear Stearns - throughout the day from 9 am in the morning to 5 pm in the evening. This was a concerted attempt to try to rally support from CCC's bankers who, after all, had only just underwritten and impliedly approved CCC's business model as appropriate for public offering.

1319. In the event, the results of the six meetings were mixed, and the following facts appear from Ms Cosiol's notes of a telephone call, in which Mr Stomber and Mr Conway reported back to Mr Hance as further mentioned below. It appears that Citi and Lehman agreed to maintain 2% haircuts, although as Lehman were now setting their own marks, this rather negated the direct beneficial effect of this for CCC. Deutsche Bank was described as being "*reasonably calm.*" Bear Stearns indicated that their attitude would have to depend on the haircuts they were themselves being subjected to for the repo funding by which they provided their own funds. CCC had no repo lines outstanding with either JP Morgan or Goldman Sachs at the time, and Mr Conway apparently asked Goldman to consider providing CCC with a $1Bn line at a 2% haircut. It was the final meeting with JP Morgan which both Mr Stomber and Mr Conway recall most vividly, although partially. They say that this was because the attitude of Mr Steven Black of JP Morgan gave them a shock.

1320. Whilst the Plaintiffs criticise their evidence for being either less than honestly complete, I find this incorrect and unfair. In fact, I find this evidence, and the piecemeal memories which each of them describes, to be very natural and plausible. They both accept that, shortly after exchanging pleasantries, Mr. Black recommended that CCC should immediately (it may be that the phrase used was "first thing in the morning") undertake the sale of $10 Bn of its Agency RMBS, and he offered JP Morgan's services to assist in such a sale without charging. The evidence as to whether he said he actually had a buyer in mind - albeit unidentified - is not clear; neither Mr Stomber nor Mr Conway recalled him saying this. No price indication was given. Mr Black apparently also said that CCC could expect to receive $100Mns of margin calls the following day.

1321. From this, I accept that it would have been apparent that there would be no prospect of persuading JP Morgan to advance repo finance to CCC at a 2% haircut. None of the other Underwriters had made such a drastic recommendation although it seems that Bear Stearns probably gave some rather less extreme and less forceful advice about selling assets if

possible. Mr Stomber recalls this, but says that he took it to refer to bank loans rather than RMBS. I would accept that this interpretation could have been pre-conditioned by his own views of the undesirability of selling RMBS, although in the end I do not think it really matters.

1322. There is also a dispute of which a lot has been made about whether Mr Black actually used the word "de-lever" or "deleverage", with neither Mr Conway nor Mr Stomber believing that he did. This dispute is entirely arid, because both of them accept that they knew and would have known at the time that selling $10Bn worth of RMBS would have the effect of deleveraging CCC. I therefore cannot see what importance the use of that precise word would have had.

20th – 22nd August – potential sale of $4Bn RMBS to JP Morgan

1323. Mr Stomber and Mr Conway both say, in different words, that Mr Black's "advice" was shocking. However Mr Black was a very senior and successful banker, and it was certainly Mr Conway's view that if someone like him expressed an opinion or advice, it was well worth thinking about. Mr Stomber was more cynical; he took the view that Mr Black had a buyer, and his "advice" was prompted by his trying to soften CCC up to provide a good deal with which he could impress his client.

1324. Mr Stomber and Mr Conway conferred that evening with Mr Hance about Mr Black's advice and options and implications, in a telephone meeting of which, as already noted, Ms Cosiol took notes, underlining the recognised importance of the meeting. They were three of the four members of CCC's Investment Committee. They agreed that an immediate sale of $10Bn of Agency RMBS was too draconian a step; it might cause the market, and in particular CCC's bankers, to question CCC's ongoing viability and it could have adverse consequence in triggering lower marks to market for the value of CCC's remaining RMBS, with a consequent liability for margin calls which would reduce or wipe out the liquidity gain.

1325. However, they, and also later Mr Zupon, agreed that if CCC could obtain a fair price for its Agency RMBS at or round about its existing marks, then it should pursue a sale to JP Morgan of up to (say) $4 Bn of Agency RMBS in order to generate additional liquidity. Each $1 Bn sold would raise $20Mn in liquidity and would also reduce the requirement for repo capacity. The central point was whether this could be achieved at a price which would not have the result of crystallising and locking into CCC's financial position a simply unacceptable amount of realised – and therefore never recoverable - loss. The Investment Committee Defendants came to the conclusion that a quiet sale, pursued through a single dealer that was not one of CCC's repo lenders, might be achievable at a fair price and without sending a risky and troubling message to the market about CCC's liquidity; if so, that would potentially be worthwhile, even though it would mean realisation of some losses.

1326. Therefore, later on 20th August, Mr. Greenwood was instructed to and did send JP Morgan a list of 7% Agency capped floater securities for pricing for a potential sale transaction. The list included only 7% (highest) capped floaters, because JP Morgan had advised that these had the best chance of attracting investors. One would naturally expect that the highest cap value RMBS would be the most valuable, and although I accept that this is not necessarily synonymous with attracting most interest, the evidence does suggest that that is be likely to be the case.

1327. However, when, on 21st August 2007, JP Morgan reverted to CCC with a list of prices at which it proposed to purchase the offered 7 % Agency capped floaters, their average price for CCC's Fannie Mae capped floaters was $97.63, which was 165 bps (1.65%) below IDP prices, and represented a very substantial discount, in market terms, from the $99.35 price at which CCC was carrying those RMBS on its books. Their proposed prices for CCC's Freddie Mac floaters were similarly discounted.

1328. This vastly altered the attraction or value of doing the deal with JP Morgan, and, based on these prices, Messrs Conway, Hance and Stomber were agreed that CCC should not proceed with the proposed sale of Agency floaters to or through JP Morgan.

1329. Importantly, it is universally agreed by all the expert evidence, that the decision which was then taken, not to pursue a sale of $4Bn or any other quantity of capped floaters at the prices offered by JP Morgan, was not only reasonable but indeed correct, even in the circumstances in which CCC found itself.

1330. An email of 21st August shows that Mr. Stomber and his team analysed the JP Morgan prices and other options for raising liquidity, which they ranked in order of efficiency. First, CCC could sell its CLOs (interests in leveraged finance funds) to Carlyle at their purchase price, raise $60.5Mn in equity, and suffer no loss. Second, it could sell 25 % of its bank loans to raise $26.5Mn in equity, and suffer an $11Mn loss, or sell 50 % of its bank loans to raise $53Mn in liquidity and suffer a $22Mn loss. Third, it could sell $4Bn of its Agency RMBS to JP Morgan at the prices quoted, which would raise $27.7Mn of liquidity, and suffer a $97.3Mn loss. This analysis was sent to Mr Conway and forwarded to Messrs Hance and Allardice. Later, Mr Stomber also analysed the expected returns, to the end of the year, from natural amortisations on CCC's RMBS portfolio ($25Mn), which would also reduce repo requirements by about $1.2Bn. These figures could obviously be compared with the financial effects of selling RMBS at the prices suggested in the JP Morgan offer.

1331. Quite apart from the arithmetic, the Defendants say, that there were other matters taken into account in influencing their decision. Mr Stomber and Mr Conway have said in evidence that their various reasons were, the incurring of large and crystallised losses (around $100Mn); the likelihood that sales at the proposed prices could actually worsen CCC's liquidity problems by fixing a market mark for CCC's remaining assets which would generate yet more margin calls, thereby eliminating the increased liquidity and with the potential to set off a further downward spiral; the belief that the RMBS could be financed until such time as prices improved and margin calls reversed, and that there were other assets which could be sold first to produce liquidity. These ideas are reflected in further notes taken by Ms Cosiol. There was also concern about the message of CCC's being in difficulty which such a sale might send to the market.

1332. Interestingly, Mr Black's warning that CCC would receive $100Mn of margin calls on 21st August also proved wrong. In fact, CCC received no margin calls on that day.

1333. On the same day as Mr Stomber and Mr Conway were doing the rounds of the banks, one of CCC's investors, Mr Louis Reijtenbagh, whose family were, I understand, the biggest investor in CCC under the private placement, was writing to Mr Conway to complain at the performance of CCC, both as to the absence of any dividend payment and the fall in share value, and also to complain at lack of information from CCC to investors. This last complaint does seem to me to have had force, although I do not regard it as sinister. It was, rather,

evidence of a lack of public relations sensitivity, (with Mr Conway and Mr Stomber having a lot to occupy them) and perhaps the Defendants' lack of experience at running a public company. In the evening of 21st August, Mr Conway wrote a reply to Mr Reijtenbagh describing the situation in simple broad terms and explaining what CCC and Carlyle were trying to do about it. That email is consistent with a high level overview of the deliberations and discussions which are said to have gone on in more detail internally at CCC, and with the professed belief of the Defendants at that time that market conditions ought to improve.

1334. Mr Reijtenbagh's email seems to me to support the view that the implications of CCC's business model as regards leverage were quite apparent from its PPM and OM documents. Moreover, as I read Mr Reijtenbagh's message, far from being a call to sell RMBS, it acknowledges that "*sell[ing] the underlying collateral at depressed levels*" would be a bad idea. Mr Reijtenbagh also urges the course of allowing current positions to "*roll off without new risk being taken*". Since he referred to "*spread trades*" I am not certain that he was really focused on CCC's business model being "buy and hold" with regard to RMBS as it actually was, but nonetheless, I read this as an acknowledgement, in principle of the general wisdom and acceptability of a course of natural deleveraging and resulting build up of assets. Underlying Mr Reijtenbagh's email, though, I detect a frustrated desire, now, to get out of the investment, and an attempt to pressure Carlyle itself into making good to investors the losses arising from CCC's poor results, at least to some extent.

1335. As a public company, CCC was obliged to give press releases to disclose information which might be regarded as material by investors and thus price-sensitive. The $100Mn loan from Carlyle fell in this category, and it, and the first $10Mn drawdown, was therefore announced to the market by a press release issued on 21st August 2007.

1336. Mr Conway had been shaken by the advice of Mr Black the previous day, and he received another shock at the media reaction to the news. Those Defendants who were directly involved, and in particular Mr Conway, believed the $100Mn loan would be viewed by the market as a positive sign for CCC because it showed that CCC had Carlyle's support. To their surprise, the media reaction was the opposite. Although bank analysts' reports were coolly responsive to the news, the Wall Street Journal portrayed CCC as a "troubled" fund that needed to be "rescued". The result was a panic reaction amongst CCC's repo lenders who now almost all began demanding haircuts of 3%.

1337. Mr Conway was both shaken, and, I suspect, even rather hurt by this, and I have no doubt that this unexpected response coloured Mr Conway's attitude towards managing the actions of CCC and information about it in the future. Mr Stomber, with a more cynical disposition, I have no doubt was less surprised. The reaction itself, though, is strong support for the reasonableness of fears expressed by the Defendants generally, about causing unpredictable or extreme market reactions adverse to CCC's interests, and the need to avoid risking this possibility if at all possible.

23rd August 2007 - Emergency BOARD MEETING

1338. CCC's full Board of directors convened in an emergency joint meeting of the Board and ALCO by telephone on Thursday, 23rd August 2007, to discuss the deterioration in market conditions and its impact on CCC. It seems that this was prompted by Ms Cosiol, and the Plaintiffs point to this as evidence of the actual Defendants' shortcomings in holding sufficient and sufficiently frequent discussions to meet the situation. There is perhaps some force in this

as at that moment, but the more important point is the actual actions taken by the Defendants, and whether any alleged paucity of such meetings had any adverse effect on these.

1339. Shortly before this meeting, Mr Stomber sent a regretful email to the senior founders of Carlyle, recording that it was clear that the business model of CCC, especially regarding the funding of its RMBS, did not work, and apologising for the consequent "*terrible burden on Carlyle's liquidity and reputation.*" The Plaintiffs rely on this as an allegedly clear admission of fault by Mr Stomber and evidence of the control and power exerted over him by the Carlyle Founders, and Mr Conway in particular. I do not see it this way. I find it to have been driven by Mr Stomber's personality traits which I have already mentioned, and by his perception of the required due deference to those above him in the hierarchy (and he undoubtedly saw Mr Conway as, effectively, his "boss"), being a perception which is perhaps more pronounced in his case than in most people's.

1340. Mr. Hance opened the meeting by commenting that CCC's "*very survival*" was at stake, (again a dramatic statement which the Plaintiffs invite me to take at face value) owing to the hugely worsening market conditions which had developed in the four weeks since the Board's meeting in Guernsey. He outlined the changes in market conditions (mentioned above), that CCC had consequently exhausted its liquidity cushion having gone through $200Mn of liquidity, and that it was likely to draw the full amount of the recently offered $100Mn loan from TCG in order to meet the 27th August repo roll.

1341. Mr Stomber advised that CCC needed to preserve capital where it could, that it would be prudent to wind the company down to its "core level", (Ms Cosiol confirmed that that was the wording she had written in her notes) and that in the future a new business model would need to be established, as market conditions were now unprecedented. He reviewed with the Board the state of the financial markets, and the ALCO pack information which had been distributed to the Board, illustrating present conditions and the state of CCC's investments. He and Mr Conway reported on their meetings with the underwriting banks, and the unsatisfactory suggested sale of RMBS to JP Morgan. There is criticism that insufficient detail of this was conveyed to the other members of the Board, but I cannot see that this made any difference to anything material.

1342. A central part of the discussion which then took place was that of the risks and benefits of selling RMBS (illustrated by the figures and calculations thrown up by the JP Morgan affair, and concerns about the knock-on effects of such a transaction) as compared to the risks and benefits of holding on to the RMBS, namely the problems of obtaining repo funding on manageable terms in current market circumstances and with current levels of leverage, as against the benefits of the underlying fact that the RMBS themselves were quality assets which would slowly but surely pay off capital through amortisations and prepayments, and ultimately pay out at par, such that logic dictated that their value must return to par in the future. After weighing the risks of holding as against selling, the general conclusion was that the potential gains in liquidity from selling RMBS were only small, and were far outweighed by the risks entailed in doing so; CCC would be better off taking less risky options which provided a low key route to generating liquidity.

1343. After discussions, the Board adopted a number of measures intended to support and preserve CCC's capital and liquidity, with a view to ensuring its survival. These were seen to be, first, the sale of CLOs to Carlyle. Those were relatively illiquid but could be sold to Carlyle quite

favourably, generating about $60Mn in liquidity for little or no cost or loss. After discussion amongst the Board, the Independent Directors approved these sales. Second, it was reported that CCC was already in the process of implementing the sale of certain of its bank loans. Although these were performing well, they were less levered than RMBS and could be easily disposed of at little or no loss, thus generating more liquidity; there was the promise also of a second short term bridge loan of up to $100Mn from Carlyle to bridge the receipt of the proceeds of these loans if these were urgently needed to meet margin calls in the interim. The Board discussed and approved these sales, and the Independent Directors voted to approve the bridge loan from Carlyle. The third matter was formally accepting the unsecured $100Mn loan from Carlyle, which had already been put in place as an emergency measure and was likely to be drawn upon. The Board endorsed and ratified this step.

1344. Further measures to improve liquidity were discussed, noted, and approved, namely that all asset purchases were suspended, and that, as the Board unanimously agreed, there would be no payment of any dividend in the third quarter of 2007. Efforts would be concentrated on working on the company's lenders to increase the size of repo lines at reasonable cost; the Board discussed potential negotiations with those banks, and especially Citigroup. In this context, Mr Conway reported that he had already opened discussions with Citi about potentially doubling CCC's repo lines, and other measures, and stated, enigmatically, that Citi was "*asking for other things from Carlyle*" which Carlyle was "*willing to do*". He did not elaborate beyond saying that CCC was not likely to get all they were asking for. This matter is the subject of major and heavily critical submissions by the Plaintiffs, which I will come back to later.

1345. Lastly, the appropriate attitude to sales of RMBS was discussed. It was a point actually raised by Mr Zupon. It was noted that these assets were "money good", meaning that, ultimately, they bore no credit risk and would pay, in full, as to both interest and capital at maturity. The argument against selling them was that the prices currently available were just too low to be justified having regard to both the net financial benefits and the associated unquantifiable risks. However, it was recorded that if CCC could accomplish sales at prices at or about CCC's marks (ie at a sufficiently small actual loss) then CCC should be open to doing so. In other words, it would take advantage of sales opportunities, if these presented themselves. This was now described as "opportunistic sales". In this context, the Board was also briefed by Mr. Stomber on discussions with Fannie Mae and Freddie Mac with regard to the investigation of possible sales back to them of RMBS.

1346. The Board asked Mr Stomber to provide them each with daily email updates as to the company's cash flow position, and suchlike, suggesting its clear appreciation of the gravity of the situation. The Board also requested that Management develop a suitable system for keeping shareholders informed of recent events.

1347. Mr Conway seems to have wrapped up the meeting, by concluding it with two final thoughts. The first was the need for Management and the Board to assess whether CCC's business model was "*permanently broken*" and how to adjust to "*new market realities*". The second was to express his strong opinion "*that the last assets that should be sold are the AAA rated mortgages*"; it made sense for CCC to sell other assets first. He concluded by hoping for some "good luck". The Plaintiffs make much of these comments, and I will consider their significance later.

Approaches to Fannie Mae and Freddie Mac

1348. Selling RMBS back to Fannie Mae or Freddie Mac was regarded as less risky, in terms of adverse publicity, than open market trading would be. Already on 21st August CCC had approached Freddie Mac to investigate possible off-loading sales of RMBS in that direction. After an initial meeting, CCC sent a list of its securities on 22nd August, which Freddie Mac were looking at the following day. However Mr Stomber later reported that the prices which were offered were a "*non-starter*". The Plaintiffs criticise the lack of apparent information about the prices actually offered, but as detailed consideration of prices had already taken place with regard to analysing the JP Morgan offer, it does not seem to me that the fact that no figures seem to have been recorded or survived should cause me to doubt the appropriateness of Mr Stomber's assessment. Although Freddie Mac remained interested, and Mr Greenwood was willing to work with them, CCC indicated that it was not willing to sell at fire sale prices, and, with crisis conditions having eased slightly by 28th August, no further progress in that direction was made.

1349. On 22nd August, Mr Greenwood had also sent a list of securities to Fannie Mae. Nothing transpired there, either. As already mentioned, it appeared, in the course of evidence, that Dr Niculescu, the Defendants' RMBS expert, who had been in charge of Fannie Mae's capital division at the time, recalled being consulted about an offer of a large block of RMBS at about this time, but could not offer to buy it because of balance sheet constraints on the Agency; he inferred that this was probably the approach from CCC, and I accept that it probably was. The approach to Fannie Mae therefore also proved to be a dead end.

The Citigroup affair

1350. Citigroup had a strong relationship with Carlyle and was keen to win additional business from the Group. As part of his avowed plan to "leverage" the Carlyle connection to assist CCC and persuade Citi to increase its repo line to CCC to $10Bn, Mr Stomber had already asked Mr Conway for permission to promise Citi the "upper left" (ie the lead underwriter position) on a potential future IPO of the Carlyle Group itself, a possibility which was under consideration in 2007. Mr Conway agreed to this proposal and he began, as he reported to the Board on 23rd August, to negotiate with Citi directly, himself.

1351. The negotiations proceeded apace on 23rd August, and by that evening there was an agreement in principle that Citi would provide CCC with a continued repo line of $5Bn for 60 days at 2% and another $2.5Bn at 2%, provided that the collateral should not be 6 ½% capped floaters, and in return Carlyle would pay Citi $30Mn in guaranteed fee income and would also guarantee Citi against losses up to $45Mn if Citi ever had to liquidate its collateral; there was also to be agreement on a liquidity/deleveraging plan for CCC. Mr Conway reported the repo line availability to Messrs Hance and Stomber, but as to the other terms, he reported merely that he had had "*to agree to a few things.*" Mr Hance and Mr Stomber both regarded this as extremely good news, an extremely beneficial deal, and Mr Stomber, in particular, was hugely appreciative of Carlyle's support, and the pressures this would therefore take off CCC. He was, I am quite sure, conscious of the advantage of being able to tell other repo lenders, and in my judgment perfectly accurately, that Citi were maintaining a sizeable repo line for CCC at a 2% haircut.

1352. However, this was only an agreement in principle; its terms had not been finalised in detail, and in the event they never were, because practical difficulties emerged. It is convenient to recount these here, although this takes the whole matter beyond August and into September.

1353. The provision of the guarantee by Carlyle proved problematic. The first problem was that it would give rise to disclosure obligations, a point considered at the end of August by CCC's/Carlyle's legal department (Ms Cosiol and Mr Ferguson) and not clearly resolved then, but confirmed at least by 5th September 2007. Neither side wanted such disclosure. (I am satisfied that it was neither side, although the Plaintiffs have of course emphasised Mr Conway and CCC's aversion to such disclosure.) The natural reasons were those of relationship management with third parties who found out. The second problem was that Carlyle's accountants were concerned that the guarantee provision might then require that Carlyle consolidate CCC's accounts into its own, which would be both complex and was, again, not desirable from a publicity perspective.

1354. Carlyle therefore did <u>not</u> in fact provide Citi with a $45Mn guarantee. Citi then determined that, in order to achieve the same level of protection against potential losses, it needed to raise CCC's haircut on the $7.5 Bn repo line from 2 % to 2.5 % (which Mr Conway conveyed to Mr Stomber) and from 10th September 2007, Citi began to phase this in, by obtaining additional collateral from CCC – as Mr Stomber had been warned they would do – although not the entire $45Mn as CCC was only utilising $6 Bn of the $7.5 Bn repo line at the time. The engagement letter which was intended to provide the $30Mn in fees was never completed either, as details of the timing of payments and charging were not agreed. In the end, the matter therefore came to nothing, but its possibility, and Citi's initial lenient implementation of it despite the fact that the intended agreement had not been finalised bought CCC time, or "*breathing room*" as Mr Rubenstein called it at the time, and Mr Conway repeated in his witness statement. Citi, Carlyle and CCC also maintained cordial business relationships, largely, I find, because of Mr Conway's charm and negotiating skill, and Carlyle's business clout.

1355. In the event, and as the residual upshot of these negotiations, Citi continued to provide CCC with repo lending at a 2.5 % haircut, although it advised (on 14th September 2007) that the haircut would increase to 3 % for any amounts over $6 Bn, Carlyle retained Citi as an advisor on its sale - currently in negotiation - of an ownership interest in TCG to Mubadala, which generated fee income for Citi although not the contemplated $30Mn, and Mr Stomber met with Mr Katzenberg of Citi to brief him on CCC's planned capital preservation strategy as it had been agreed at the 23rd August Board meeting. The Citi repo line was ultimately reduced to $5 Bn at the end of October, at the then existing 2.5% haircut.

1356. The Plaintiffs seek to make a great deal of the interactions between Mr Conway and Citi. They label it the "secret" Citi deal, and they condemn, in particular, Mr Conway's "failure" to volunteer all the details of what Carlyle was promising to Citi to CCC's Board, first at the outset and then also subsequently as a "failure" to disclose the variation of those terms when the TCG guarantee was not given - to avoid, they say, the obligation to disclose such a guarantee under the rules of the Euronext exchange. They submit that these failures were a breach of Mr Conway's fiduciary duties to CCC, and that the failure of the remaining directors to insist on knowing all the details and, as to the latter point, why Citigroup was increasing its haircut between repo rolls, was also a breach of their fiduciary duties. Alternatively they submit that this incident demonstrates Carlyle's (or Mr Conway's) pervasive control of CCC, and that the Board were mere cyphers.

1357. I will consider elsewhere whether there is any substance in these latter allegations, but I observe here that I can see no allegation of any loss caused to CCC resulting from such alleged breaches of duty. The only consequence alleged appears to be that CCC's Board apart from Mr Conway was kept in ignorance of the "true" (as the Plaintiffs characterise it) terms of the support which Carlyle was giving CCC, and its value to Citi which therefore should, they contend, be translated into support for CCC, and should have been viewed as additional costs of CCC's financing. No consequent counterfactual allegation of what otherwise would have happened is made, though. Otherwise this incident appears to be relied on merely as evidence supporting the allegation of Carlyle's "pervasive control".

27th August - repo roll

1358. The most pressing issue for CCC after the 23rd August Board meeting was, of course, its next scheduled repo roll on its Fannie Mae securities on Monday, 27th August. With the assistance of the increased Citi repo line, and the benefit of the other steps CCC already had taken to increase liquidity, CCC was able to complete this successfully.

1359. Mr Trozzo summarised the position for the Board, providing a review of the status of all CCC's repo lines. In summary CCC had active repo loans with twelve counterparties, of whom half were at 2% and half at 3%, the major counterparties being Citi ($6Bn) and Lehman Bros ($3.8Bn) at 2% haircuts, although the latter was marking the collateral at low prices. CCC had agreements in place with five other banks, and was seeking to reactivate lines from JP Morgan and Bank of America. Mr Stomber calculated the weighted average haircut being paid by CCC at this time as 2.3%. CCC had also begun discussions with four more banks. It was about to approach Wachovia, a bank with a strong banking relationship with Carlyle, with a view to securing longer term repo financing.

1360. CCC had therefore survived. Given the severity of the August liquidity crisis, CCC's success in rolling over the finance needed to support its RMBS portfolio – now all that remained of its asset base after the sale of its CLOs and bank loans as agreed at the 23rd August Board Meeting, apart from an insignificantly small bank loan which it was problematic to dispose of - was viewed positively by Mr Stomber and Mr Conway. They considered that CCC had gained time and with time, would be able to adjust to new haircut levels and recover its equilibrium.

End of August 2007

1361. During the period following the Board Meeting, the Board members were kept updated daily by Mr Stomber's emails as to the current financial position.

1362. On 26th August, owing to concerns about Mr Stomber's public relations skills and diplomacy, Carlyle (in particular Mr Rubenstein) resolved to appoint, at its own expense, a public relations/investor relations firm to "assist" CCC with public communications.

1363. On 27th August, after much discussion, drafting and redrafting amongst CCC and Carlyle personnel, and with external and internal legal input as to the amount of detail which was appropriate or advisable, and how far actual figures should be included, CCC published a press release, and also sent a "CEO letter" to investors - individually to the private round and also published on its website - explaining the events of recent days, and CCC's consequent decisions as to how to secure the future and the steps taken to this end.

1364. This suite of decisions has subsequently been dubbed the "capital preservation strategy" by the Defendants, although it is a title which, at least at the outset of this action, the Plaintiffs have derided. They suggest that it was concocted after the event to dignify what they suggest was just disorganised inactivity. Even though it may never have been solemnly formalised as a "strategy", the term "capital preservation strategy" is a convenient label for the broad general policy decision to retain RMBS and not sell them (unless a sufficiently advantageous opportunity presented itself) and to seek to ride out the crisis, relying on income, and ultimately when markets had stablised, to examine the appropriate future for CCC's business. I will use this term in the future to refer to that course.

1365. The Defendants say that these circulated documents provided a clear, straight-forward summary of the company's situation, the steps it had taken to address the unprecedented market conditions, and the strategy selected by the Board for moving forward. They disclosed that CCC's liquidity cushion had been exhausted, that an additional $100Mn loan had been obtained from TCG and expended to meet margin calls, and that CCC was selling assets (a reference to bank loans) to rebuild its liquidity cushion. They explained CCC's market view, namely that Agency floaters were likely to see price improvements over time and remained amenable to financing on reasonable terms.

1366. The Plaintiffs say that with these documents, and in the subsequent investor telephone conference call set up on 29th August, the Defendants "misled the market". They criticise the absence of any mention, in the final version of the press release or the letter, of the suspension of the liquidity cushion guideline (which omission they say was also a breach of Dutch regulatory law) or the additional financial support given to CCC by Carlyle, and they say that CCC attempted to downplay the severity of the impact of market events upon it. Again, it is not at all clear what operative legal consequences the Plaintiffs contend follow from these facts, in any way material to this action. However, the amount of argument suggests that the Plaintiffs attach a great deal of importance to the point, and so I will return to it later.

1367. The media appear to have homed in on the reference to a further Carlyle loan to CCC. On 28th August, this produced further negative media reactions. On that day, Ms Cosiol counselled care to Carlyle that statements of support for CCC made by Carlyle should not be open-ended. However, this seems to me to betray no more than the lawyer's natural concern to ensure that no-one who heard or saw such statements could later allege reliance upon them as some kind of warranty. Mr Stomber, who had a tendency to make open statements of his disappointment, regret and acceptance of responsibility, respectfully accepted that his proposed remarks for the upcoming investor conference call arranged for the following day should be approved by Messrs Conway, Rubenstein and Hance.

1368. The investor conference call, as well as the written publicity, had been prompted, mainly by Ms Cosiol, because of investor questions received as a result of the negative publicity a week earlier, following the disclosure of Carlyle's first loan to CCC. The call was conducted on 29th August by Mr Stomber and Mr Hance. Both of them made clear that CCC had avoided selling its Agency RMBS and intended to continue to hold those assets. Mr Stomber said that once markets had stabilised, CCC intended to return to a more diversified and less leveraged investment vehicle. The Defendants suggest that the tenor of questions from lenders and analysts suggests that they fully appreciated CCC's reasons for holding on to its Agency RMBS.

1369. Mr Gerstner, Carlyle's Chairman, emailed Mr Conway privately subsequent to the call, commenting that Mr Stomber "*should not be running a public company".* Whilst the Plaintiffs point to this as contemporaneous evidence that Mr Stomber's skills were regarded as lacking, I am satisfied, from the context, from Mr Gerstner's lack, otherwise, of direct knowledge or involvement in how CCC was being run, and from having observed Mr Stomber in evidence, that this was said with regard to Mr Stomber's interpersonal and presentational skills and not as regards his business competence.

1370. CCC continued to work on securing repo lines, with the ups and downs of negotiations which are a familiar part of business activity, albeit no doubt more nerve-wracking at this time. There was, for example, a flurry of consternation when an apparent promise of an increased repo line of $3Bn at a 2% haircut, secured by Mr Rubenstein from Mr Ackermann, the CEO of Deutsche Bank on 23rd August, was then denied at the repo desk level, and CCC was confined to the existing $1.8Bn line for the 27th August roll. A meeting between management personnel from CCC and Deutsche Bank, including Mr Shah (whose unsatisfactory evidence I have already examined), took place on 31st August and appeared to resolve the matter, but once again, on 4th September, the repo desk denied any knowledge of Mr Ackermann's promise, refused to agree any extension and intimated that they would require a 4% haircut as from the next roll in September. Resort to Mr Rubenstein's high level good offices this time produced confirmation of the repo desk position, although in the end, Mr Stomber predicted that the $1.8Bn would be granted at a 3% haircut – and this is in fact what transpired.

1371. The account of this incident reveals several of the idiosyncracies of dealings in the market which I find need to be appreciated in assessing people's conduct, and which I have already mentioned generally. It shows how transactions can be negotiated at different levels, but whether they will finally come to pass may depend not just on the level of seniority of the parties involved, but the power or priority of one desk or department over another, systemically or temporarily. It shows how senior personnel who may agree matters on a broad brush basis can then change their minds when representations are made by those at the every day working levels, and how deals will be done on the basis of a compromise to save face to both sides. This sequence of events is a good example of the wheeling and dealing which seems to me to be quite common before a final position is agreed at the level where it matters most; those with the actual authority to instruct repo line availability.

1372. With the then combination of potential lenders, Mr Stomber still calculated the weighted average haircut being paid by CCC at this time as being 2.3%. This was manageable. Indeed CCC had received modest repayments of margin as IDP prices had improved.

1373. At the end of August there were signs which suggested that the markets were calming down somewhat, although there was still little trade in high quality assets such as CCC now held, and it still could not be said that market conditions had stabilised. CCC had, though, survived the biggest stress point of the crisis. With Carlyle's assistance, it had met its 27th August repo roll. Although its repo line capacity had shrunk in August, it continued to have repo lines in excess of the volume of securities it now needed to finance. Whilst the 2.3% haircut average could of course be anticipated to rise at the 15th September repo roll, as more lenders increased haircuts in line with the apparent new "normal", this did not appear to be unmanageable. CCC's liquidity cushion, if the expected proceeds of bank loan sales were included, was about $146Mn, or 14 % of capital. CCC was invested almost solely in Agency RMBS, with no credit risk.

1374. However, at the end of August, it was necessary for CCC to seek waivers from Lehman Brothers, Credit Suisse and Deutsche Bank with regard to its prime brokerage agreement with the first and its MRAs with the others because breaches of covenants contained in those documents entitled the banks to issue notices of default if CCC's NAV declined more than 20% in any one month. This had happened in August. These waivers were granted in early September 2007. For present purposes, however, the Plaintiffs use the fact that such an event had actually occurred as support for their contentions that CCC was, and ought to have been seen to be, fatally wounded by the events of August 2007.

The claims - August 2007 – summary of arguments

Plaintiffs' case

1375. The Plaintiffs say that the events of August 2007, and in particular the decisions made by the Defendants in or about late August (in particular at the 23rd August Board Meeting) are the heart of their claims. The essence of their case is that the decision made by the Defendants (although they characterise it as a decision made by Mr Conway but acquiesced in by the other Defendants) was

> "*to continue to run CCC with a $23Bn portfolio of RMBS with 30x leverage funded by 30 day repo without risk controls, in an attempt to ride out the market."*

This, they submit,

> *"was a reckless and patently inappropriate decision, because the Defendants knew that CCC was no longer viable on that basis in the new world of August 2007 and urgent action was required."*

1376. The Plaintiffs set out, in their closing written argument, 46 findings of fact and conclusions of law which they invite the court to make in support of this claim. Once again, these relate to many matters which in my judgment go nowhere in practical terms, because they are not alleged to be the direct cause of any damage and are therefore irrelevant to any operative cause of action. I will therefore make only such findings as I consider are material to an effectual cause of action or where, for some other reason, I think it appropriate to do so.

1377. The Plaintiffs' case has several steps, which seem to be these. The Plaintiffs submit that:

(i) even if it had not been the case in July, the changes to the markets in which CCC operated which took place in August 2007, triggered by the collapse of the three BNP Paribas funds and the subsequent collapse of the ABCP market, were so fundamental as to render CCC's business no longer viable;

(ii) absent urgent action, this was terminal for CCC;

(iii) the required urgent action was to reduce leverage, and specifically to do so by selling $10 Bn of RMBS. Their ultimate submission as to what CCC ought to have done is that the Defendants ought to have put in place

> "*plans to sell at least $10Bn of CCC's RMBS in an orderly and disciplined manner over the next quarter*"

but this has been refined, on the basis of evidence from Dr Maini, to being the effecting of net sales of some $2.5Bn to $3Bn per month;

(iv) the Defendants either did, or ought to have perceived this; but

(v) they in fact did nothing in this regard, and even made a decision that they would not sell RMBS;

(vi) this failure so to act or decision not to act was a breach of the Defendants' fiduciary duties to CCC, or was negligent to the point of recklessness.

1378. The signs which they cite as sufficiently demonstrating the first three points are:

(i) increasing RMBS price volatility, the index figure for which had by early August exceeded the 0.85% stress test figure originally applied by CCC in devising its business model, discussed above,

(ii) the increase in haircut rates being stipulated by lenders, and decline in lenders' willingness to advance funds, generally,

(iii) the "substantial decline" in the value of CCC's RMBS, leading to margin calls, and

(iv) CCC's repo lenders beginning to price RMBS according to their own more "conservative" internal pricing services rather than FT/IDP pricings, which had the practical effect of a haircut, by the back door.

1379. The Plaintiffs say that by, at the latest, 17th August, when Mr Stomber made a report to all the Directors, all the Defendants knew (as the Defendants indeed accept they did) that market conditions were worse than those of the 1998 LTCM crisis. CCC had had to pay out $200Mn to its repo lenders during the month. It had run out of liquidity (this having fallen to just $5Mn at one point) and it faced a cash shortfall at the 27th August repo roll calculated to be $58.7Mn.

1380. The Plaintiffs complain that in response to the development of these problems, CCC's Independent Directors agreed, in the early part of August, first to reduce (to 15%), and then to suspend entirely, CCC's 20% minimum liquidity cushion requirement, but did so without any proper discussion or deliberation and in effect simply as a rubber stamp; this was a reckless abandonment of risk controls. Whilst this breach of duty is not claimed to have directly caused any financially damaging consequences for CCC it is (presumably) relied on as paving the way for the subsequent claimed breaches of duty which did so.

1381. By 23rd August 2007, the plan to persuade CCC's bankers to maintain haircuts at 2% by tackling them at the very highest executive levels on 20th August, had failed. Three of CCC's underwriting banks (JP Morgan, Bear Stearns and Citi) had advised that CCC needed to deleverage, and Mr Black had advised that CCC should immediately sell $10Bn worth of RMBS. The Plaintiffs submit that ignoring this advice from Mr Black, whom they first describe as a "senior and highly respected banker" but later elevate even further, to a "trusted adviser", was wrong and reckless.

1382. They suggest that the unsatisfactory prices quoted by JP Morgan for the $4Bn worth of the best quality RMBS owned by CCC should have made it clear to the Defendants that an emergency sale of large blocks of RMBS at a time not of CCC's own choosing would all too likely result

in distressed prices such that CCC could not rely on selling these assets at reasonable prices at the last moment to raise cash urgently. However Advocate Wessels submitted in closing, that by the same token those prices would not be indicative of prices obtainable for smaller tranches on sales conducted in an orderly fashion. As CCC obviously required urgently to deleverage, it therefore needed to take a pro-active approach to doing so, by selling RMBS in amounts and at times of its own choosing from that time on. CCC in fact did the precise opposite in that Mr Conway had made a decision not to sell RMBS at all, probably by the time of the emergency Board Meeting on 23rd August, (but at the latest, by the end of September 2007), and the other Directors acquiesced in this. That decision was reckless.

1383. The focus of the 23rd August Board meeting was simply on surviving the 27th August repo roll rather than, as it properly should have been, on future longer term strategy. The Board in effect instigated no (or no sufficiently effective) steps towards generating liquidity, and barely discussed RMBS sales. It was informed of the steps taken and decisions made by the majority of the Carlyle Directors (Messrs Stomber, Conway and Hance) in the previous few days rather than being asked for its approval and being afforded the opportunity to discuss these and the matter generally.

1384. It was not told (by Messrs Stomber or Conway who knew, or Mr Hance, who had been informed) of Mr Black's advice to sell $10Bn of RMBS nor that he had advised that Carlyle should not make the proposed $100Mn loan, with the obvious implication that Carlyle was likely to lose the money. Neither was the Board told that Bear Stearns had advised that CCC should sell assets, nor all the details of the aborted JP Morgan offer.

1385. It was not told (by Mr Conway) the full details of what Carlyle was having to give to Citi to obtain support for CCC, and the true extent - which the Plaintiffs calculate at $60Mn– $75Mn – of the "cost", therefore, of this support even though this knowledge was (say the Plaintiffs) "highly material". Mr Conway was in breach of his fiduciary duties to CCC in failing to tell all and the consequence was that the rest of the Board was unaware of the "true" cost of the finance from Citi, who had in practice required the equivalent of a 3% haircut, and were also of the view that CCC urgently needed to deleverage. The Plaintiffs point out that the Citi deal enabled Mr Stomber to represent to other repo dealers that Citi was supplying repo to CCC at a 2% haircut, which, they say, was therefore a misrepresentation. They rely on this deviousness as further evidence of CCC's effective insolvency.

1386. They submit that, therefore, the Board did not have the information which it needed so as to be able to have a sufficiently thorough and considered discussion of the situation and to be in a proper position to take decisions about how to deal with it. It took the decisions which it did in a state of inadequate knowledge and did not ask all the questions which it ought to have done. They also submit that the Board did not actually hold adequate discussions or deliberations on such matters in any event. Ms Cosiol's suggestion of weekly Board meetings was not taken up. The Board did not discuss any strategic matters, such as what level of liquidity CCC really required, or how its funding could be improved, or the difficulties for CCC's obtaining finance generally.

1387. Mr Stomber did not relay to the Board either the fact that legal advice had been obtained about the duties of Guernsey company directors when the company was in the "zone of insolvency", or its content; this was further information which they ought to have had. Mr Stomber was thus in breach of duty. He also failed to implement most of that legal advice received, and

neither he nor CCC took any further or other professional advice until CCC was in default, in March 2008.

1388. The Plaintiffs add further allegations that the Defendants, (here Mr Stomber and Mr Hance) "misled the market" and violated Dutch law in failing to disclose the suspension of the liquidity cushion in the press release and the CEO letter of 27th August 2007; they continued to do so at the investor and analyst conference call of 29th August, in the same respects, and also by representing that CCC intended to reduce leverage in the future (the complaint being, by implication, that it had no such intention).

1389. The Plaintiffs also assert that in taking the decisions and actions which they did, the Defendants had no regard to the interests of CCC's creditors which they were obliged to do because CCC was clearly "in the zone of insolvency" through its precarious financial position at and around 23rd August 2007.

1390. They repeat their key complaint namely that CCC ought to have either sold RMBS (in argument, elaborated in more detail, as above) or taken action to raise more equity capital, or to carry out an orderly winding down of CCC, but instead carried on running CCC "*with a $23Bn portfolio of RMBS levered at 30 times leverage and funded by 30-day repo*". If CCC could not raise more equity capital then its alternative courses were reduced to those of selling RMBS or winding down CCC which would involve much the same thing, but the Defendants did neither. These failures, it is said, were breaches of duty, and also constituted misfeasance.

1391. The Plaintiffs submit, though, that there is in fact no need for the court to come to any adverse conclusion as to the Defendants' honesty or good faith in order to find liability even for breach of fiduciary duty. However they do raise matters which they say disclose conflicts of interest on the part of the Defendants, or "explain" what they otherwise characterise as the Defendants' "inexplicable" failure to take what they say was the obvious step required for urgent deleveraging – namely to sell RMBS. They rely on these matters as adding support for the findings of breach of duty, which they seek.

1392. I infer that these allegations are therefore pursued in order to support an argument that the alleged breaches of duty constituted a "*wilful act, neglect, default, misfeasance or misconduct*" within the meaning of one or more of these words as they are used in the exceptions to the exoneration and indemnity provisions in CCC's Articles of Association, or (as regards CIM) in the IMA, but falling short of dishonesty. If necessary, I will refer to this as the "wilful breach" argument. The factors are:

(i) a wrong-headed pursuit of a double digit dividend target for CCC

(ii) the desire to avoid embarrassment and negative effects on Carlyle and CIM (thus wrongfully prioritising Carlyle's and CIM's corporate and reputational interests over those of CCC), in various respects, such as having to take realised losses on CCC's accounts, thereby reducing capacity to pay dividends, losing fee income for CIM and effectively having to admit that CCC had been a failure

(iii) the personal interests of Mr Conway, and to a lesser extent Mr Zupon and Mr Hance, as part owners of Carlyle, in

a. selling an ownership interest in the Carlyle Group to Mubadala in or about September 2007,

b. securing a $1Bn term loan for Carlyle, in August and November 2007 and

c. progressing Carlyle's own potential IPO,

(iv) Mr Stomber's subservience to Carlyle, CIM and Mr Conway, and

(v) the fact that the so-called Independent Directors were not truly independent.

The latter two are not so much ingredients of a cause of action but general underlying factors which may have contributed to or motivated the specific matters of alleged breach of fiduciary duty, and I have considered these above on a general basis. I take them into account when dealing with the three particular allegations of breach of fiduciary duty, below.

1393. As regards wrongful trading, repeating the above matters, the Plaintiffs submit that from at least 17th August 2007 CCC was either cash flow insolvent or bordering on such insolvency, and needed urgently to reduce its leverage. Without doing so it stood no reasonable prospect of avoiding insolvent liquidation and the Defendants either knew or ought to have concluded this. The Defendants did not cause CCC to reduce its leverage as was required, and they therefore became guilty of wrongful trading from this time.

Defendants' case

1394. The Defendants deny the above allegations, not so much at the level of primary factual occurrences, but rather at the level of fair and correct interpretation.

1395. Broadly, the Defendants say, just as they do with regard to July, that when one examines all the evidence as to the actual course of events in August, taking matters as they appeared at the time and without the benefit of hindsight, their decisions and actions remained perfectly rational, prudent, proper and reasonable, in context. They were an appropriate response to market events as they unfolded and affected CCC, and were properly taken in what each of them believed, on adequate and careful consideration, to be CCC's best interests. They further submit that not only were the steps taken reasonably perceived to be in CCC's best interests, but on the evidence, they actually were the safest and best course for CCC to adopt in the circumstances. It certainly cannot be said, they submit, that the relevant ultimate decisions of which the Plaintiffs complain were outside the range of decisions which a reasonably diligent, competent and loyal director of CCC could have made, at the time.

1396. The Defendants point out that in opening their case (and having already drawn back from the extravagant way in which it was initially put, to which I refer later) the Plaintiffs appeared to be arguing that the Defendants' culpability lay in not having any strategy to deal with the problems posed to CCC by the market conditions of August 2007. They now, instead, disputed that the "capital preservation strategy" had actually been any such thing, asserting that this description was an *ex post facto* rationalisation of (culpably) doing nothing. They had submitted that the Defendants had "had no plan" as regards how to deal with CCC's future. However, Mr Wallace, the Plaintiffs' own insolvency expert, had accepted that "doing nothing" is, in appropriate circumstances, just as much a plan as doing something, and, at any rate with regard to selling RMBS, this was actually a positive decision by the Defendants.

1397. The Defendants further submit that the Plaintiffs' case in effect comes from the wrong starting point. In their dogged concentration on RMBS sales as a means for reducing leverage and increasing liquidity, they overlook or underrate the other steps which CCC actually did implement at this time, and which it was clearly fair to describe as a "plan" or "strategy". The steps which the Defendants cite, in the order in which they were taken, were first,

(i) the suspension of purchases of credit products on 26th July (recovering $30.7Mn previously earmarked for this purpose) and then

(ii) ceasing all RMBS purchases as from 30th July, both as already mentioned, and as first steps towards preserving cash and liquidity

which had been implemented previously. This had the effect of retaining $60Mn of the $131Mn net proceeds of the IPO as cash, and halted any increase in leverage ratios. It also had the effect that income, amortisations and prepayments on existing RMBS would be retained in order to bolster liquidity, rather than applied in purchasing more assets, as the business model previously had predicated. The consequence of this also meant that, albeit very slowly, the total size of CCC's RMBS portfolio would shrink, thereby naturally (again, albeit slowly) gradually reducing leverage ratios.

(As an aside, they observe that such a process – that of natural deleveraging by retaining income - was expressly recorded as being recognised by Annaly, one of their peer/competitor group entities, as a potential response to an increase in debt to equity ratio. I suspect that this was in the context of the expectation of rather more modest market fluctuations than occurred in August 2007, but the basic point remains valid; this was not an outlandish technique).

When CCC received margin calls and demands for increased haircuts, the immediate reaction of Mr Stomber – who had in fact been alert and proactive – was the next step, which was

(iii) to seek a loan of $100Mn from Carlyle.

Whilst Mr Conway's immediate reaction was that he would want to know that this was going to be effective, the fact is that, in the event, this sum was made available.

The fourth step taken, and discussed and authorised at the 23rd August Board Meeting, in fact was

(iv) the sale of assets (just as the Plaintiffs argue should have happened) but it was the sale of CCC's two different kinds of credit assets, CLOs and bank loans.

1398. The Defendants complain that the Plaintiffs keep overlooking or ignoring the fact that they did sell assets. The Plaintiffs' complaint that the Defendants did not consider selling RMBS at the 23rd August Board meeting ignores the fact that the merits of doing so at that time related to doing so as an alternative or additional course, and were being considered in the context of the option of selling credit products instead. The relative demerits of selling RMBS were at the time, simply so obvious that they did not need to be considered in laborious detail.

1399. The credit assets were, in fact, re-sold to Carlyle and otherwise extremely skilfully sold, and produced about $160Mn in total further liquidity. Furthermore, this step was supported by the

promise, obtained from Carlyle, of a loan of $100Mn, as a potential bridge pending receipt of the funds for these sales if necessary (although this was not in the end called upon).

1400. The Defendants say that the sale of assets with credit risk rather than RMBS at the time of the August crisis was a prudent one in the light of the price indication obtained through the JP Morgan offer and the other risks of selling. As to these, there was, first, the risk of moving the market and defeating the whole object of the exercise. They point out that Mr Wallace, the Plaintiffs' own insolvency expert, had agreed that there was the potential risk that a sale of RMBS at low prices would move the recorded market prices downwards, causing repo lenders' price marks also to move down, and thereby generate margin calls, the amount(s) of which might actually exceed the cash obtained from the sales, and therefore completely wipe out any additional liquidity which had been obtained. The second, more subtle but no less serious, risk, also agreed by Mr Wallace, was that if it became known or suspected that CCC was trying to sell RMBS, particularly in any quantity sizeable enough to make the transaction at all worthwhile, having previously proclaimed that its business model and investment strategy was to "buy and hold" these assets, that could cause a perception that CCC was in trouble - and a loss of confidence in CCC with its repo lenders, which could well cause their withdrawal of finance or increase in haircuts, thereby damaging CCC even further, and potentially catastrophically.

1401. They submit that the Plaintiffs' stark assertion that CCC "should have sold RMBS" thus failed to have due regard to the two vital factors of (i) the likely achievable price, and (ii) the risks, not just arising from actually selling, but even from being seen to be investigating selling. Deciding not to sell RMBS because of these risks was a decision which, the Defendants submit, was rational and sensible, and well within the range of reasonable and responsible decisions for directors of CCC to have made in the circumstances.

1402. As to the mechanics (rather than the effects) of such decision, the Plaintiffs were just wrong, on the evidence, to suggest that there had been no "analysis" of undertaking the sale of RMBS assets. The degree of analysis required was only such as was necessary to make a sensible decision, and the decision was not a fine one. The evidence showed that it was a considered decision, in the light of Management's explanations, sought and given at the Board Meeting, as to why it was proposed to sell the credit assets.

1403. It was also wrong to characterise the Board decision as either a rigid decision not to sell RMBS at all, or not to sell RMBS at a loss. Messrs Hance, Stomber and Conway, the majority of the Investment Committee, had, immediately after the 20th August meetings with the banks, approved a potential sale of up to $4Bn of RMBS provided this could be carried out at prices close to CCC's own marks, even though that would incur a loss. The key once again was price, and whether the liquidity generated at a particular price was sufficient to make the sale worth the disadvantages of (i) locking in the concomitant quantum of realised and irrecoverable capital losses on assets which, by common consent (and the Plaintiffs' macro-economics expert, Dr Carron agreed this) would "inexorably" rise to par value with time, and (ii) running the imponderable risks of selling RMBS, which risks would be outside CCC's control.

1404. There was never, they submit, a fixed decision "never" to sell RMBS, and the Plaintiffs' characterisation of the position as such a decision was unjustified. Mr Conway's closing "wind up" remark at the end of the 23rd August Board meeting could not be interpreted as

such; it was simply a summary of his view at the time. The investigation of sales to Fannie Mae and Freddie Mac (their advantage being that they would be more discreet than attempts to sell in the general over the counter markets) demonstrated this. The policy endorsed at the Board Meeting, and thereafter, included that CCC should be responsive to "opportunistic" sales, ie sales, at affordable prices but coming from "reverse enquiries", the advantage of these being that CCC would not then be perceived to be eager to sell. But apart from that scenario, the risks of selling were too great, and the more approaches CCC actually made to third parties, the greater was the risk that the perception of CCC being in trouble, and potentially being a forced seller, would leak out into the market.

1405. The Defendants submit that the reasonableness of deciding not to sell RMBS at this time should also be viewed in the context of the Board's approving other indirect actions namely the active management of CCC's repo relationships, and communicating CCC's intentions to its bankers to maintain their confidence. There was thus a properly considered approach, and not just inaction.

1406. They say that CCC's intentions were clearly stated both in the 27th August press release and during the 29th August investor and analyst conference call and were fairly described as a "strategy" and also as a "capital preservation strategy"; it is factually wrong (as well as being irrelevant in the action) to suggest that CCC misled either its repo counterparties or its investors.

1407. The Defendants submit further that was nothing culpable in the way Mr Conway made efforts to assist CCC by using Carlyle's influence and resources, nor about the degree of disclosure which he gave to CCC's Board. The essential thing for the Board was simply to know what help CCC could expect from Citibank.

1408. As to the alleged conflicts of interests, the Defendants deny the fact of any conflict, but submit that in any event there is no evidence to suggest that any such matters were remotely operative on the minds of the Defendants at all. The evidence shows (they submit) that the Defendants believed that the course of action which was pursued in August (and indeed subsequently) gave CCC reasonable prospects of surviving and recovering sufficiently to be able to formulate a new business model, once market conditions had stabilised and hopefully returned more to the previous "normal", and that such belief was both honestly and reasonably held.

1409. In objective support of the reasonableness of the Defendants' persisting in the belief that CCC could and would survive, they rely on the following general facts:

(i) CCC had positive net asset value on its balance sheet of over $600Mn in August 2007.

(ii) It also continued to make an income profit from its RMBS holdings. The Defendants remind me that CCC's RMBS did, in fact generate income at all times, from the difference between the interest payable on its financings and the income receivable from the RMBS bonds themselves, a point which they (rightly) submit tends to get overlooked; CCC was actually, from that perspective, still a profitable business.

(iii) CCC had managed the 15th August repo roll, took steps, on 23rd August, to enable it to manage the 27th August repo roll and beyond, and in fact succeeded.

(iv) The monies which it had had to expend on margin calls were not lost to it, but would be returned if and when market prices of RMBS rose again, and an expectation of this was not unreasonable.

(v) At and from the end of August, so long as CCC could maintain the financing of its RMBS holdings without defaulting it would remain solvent.

(vi) It would not be forced into default so long as market conditions did not grow significantly worse than they became during the middle two weeks of August, and there was a reasonable expectation that market conditions would improve.

1410. In those circumstances, there was no reason to conclude that CCC stood no reasonable prospect of avoiding insolvent liquidation.

1411. In short, in August 2007 (and indeed at any time) the Defendants contend that there were no breaches of duty, nor any wrongful trading.

Plaintiffs' reply

1412. The Plaintiffs respond that the risks of selling RMBS now claimed by the Defendants to be so major and to have played such a great part in their thinking are being hugely exaggerated after the event. They say that this is supported by the absence of any record of any major or serious discussion of such risks to be found in the contemporaneous documents.

Discussion and conclusions - August 2007

1413. Again, I identify the breaches of duty actually alleged against the individual Defendants in the Cause (as before, I deal with the contractual allegations against CIM and the position of the Entity Defendants separately) as being the matters listed in Paragraphs 308D – 308H of the Cause, again as further particularised in paragraphs 418B-418G and 418I to 418N, incorporated here by Paragraph 309. The effectual breaches, ie those capable of causing direct financial consequences for CCC, are alleged at paragraphs 308D.11 and 308G.10 although framed as "*failing to insist upon*" the required action being taken. They are reiterated at 308E, with additional allegations of improper motivation. They are

> *"failing to insist that CCC either (i) sell down its RMBS assets to generate liquidity and reduce leverage, and/or (ii) raise additional equity capital to reduce leverage and/or (iii) conduct a restructuring or orderly wind down".*

1414. It is convenient from now on to refer to this formulation as the "core breach". The remaining allegations are, once again either elements of the core breach, or, insofar as they are separate, are not matters which themselves had financial consequences. As to this latter point, whilst the breaches of duty alleged at paragraphs 308D14 and 308E13 (the complaint of causing CCC to accept the Carlyle loan of $100Mn) relate to financial matters, no financial consequences are alleged in the pleading.

1415. The actual facts as to what actions the Defendants took or did not take with regard to managing CCC's assets are scarcely in dispute. It is clearly the case that, during August 2007 and in particular at the 23rd August Board meeting, they did not resolve or insist on selling $10 Bn of CCC's RMBS - either immediately or as to $2.5 Bn - $3 Bn per month for the following three

or four months, - as the Plaintiffs now say they should have. Nor did they consider raising further equity capital. The resolution to sell the company's credit assets might be regarded as a form of "restructuring" of its business, or even of winding it down, but that is obviously not what the Plaintiffs mean by restructuring, as they criticise those steps as being ineffectual or inadequate. The dispute is therefore whether the actions just referred to constituted breaches of the Defendants' duties as directors of CCC.

(a) Breach of duty of care

1416. Again taking breach of duty of care first, the issue at this point in time is therefore whether the essential decisions and actions of the Board of CCC noted above were decisions and actions which no reasonably competent director of CCC could have made in all the circumstances at the time, again being judged on an individual basis, with regard to any particular director's enhanced level of skill and knowledge if any. I have already indicated my broad assessments of each of the individual Defendants in this regard.

1417. Having considered all the evidence and the respective submissions which I have summarised above, I accept the Defendants' submissions. I find the decisions made by the Defendants in August 2007 and in particular at the 23rd August Board Meeting to have been within the range of decisions which a reasonable director of CCC, possessed of the level of financial skill and expertise of any of the Defendants, could reasonably and responsibly have come to in all the circumstances. My reasons are largely those which appear in my summarising of the Defendants' submissions above, because I find their arguments convincing.

1418. I fully accept that the reasons now articulated as being behind the decisions taken and followed at the August 23rd Board Meeting and ALCO meeting were not recorded in the detail and coherence with which they have been expressed in the course of this trial, at or around the time the Defendants claim that their strategy was devised. However, this does not mean that there was in fact no such strategy, nor that it was an "ex post facto rationalisation" as the Plaintiffs claim. At the time, it was not necessary to articulate everything as comprehensively and clearly as has been prompted by the Defendants' being called to account in this action. I am quite satisfied that the aspects of the strategy now explained and articulated were present in the thinking of the Defendants, and in particular the material Defendants (principally Mr Stomber, but also Messrs Conway and Hance and to a degree Messrs Zupon, Allardice and Sarles) at the time. I am satisfied that, given the Defendants' personal knowledge and experience, those considerations were appreciated and weighed up by those Defendants, but to some degree intuitively and without being expressly articulated. As to Mr Loveridge, given his lack of specialist knowledge and his role in the company, it was, in my judgment, reasonable for him to endorse decisions which were not obviously unreasonable or illogical and which were arrived at by common consent of his more expert fellow directors based on all the materials which he could see had been supplied, and the discussions which he had observed taking place. I can see no reason why he ought to have doubted or mistrusted what they said.

1419. The Plaintiffs seek to characterise the decisions made at this Board Meeting as an irresponsible gamble; they lay stress on Mr Sarles' use of this language in evidence as disclosing the Defendants' underlying attitude, when he said

"In August we made our bet as to what the best plan was….".

However, this is just the kind of informal figure of speech which ordinary people use, and I am quite satisfied that the word "plan" more correctly describes the decision made and what the Board thought it was actually doing than does the word "bet".

1420. I am therefore satisfied that none of the individual Defendants was in breach of his duty of care towards CCC in August 2007, in making the relevant decisions or agreeing the relevant actions or policy, either at the Board Meeting or the ALCO meeting, or with regard to any other aspect of their implementation.

1421. For completeness, given the specific points raised by the Plaintiffs, I add the following comments and findings.

1422. I have already held that the reduction and suspension of the liquidity cushion requirement by the Independent Directors is one of the many breaches of duty alleged which themselves have no financial consequence. This allegation of breach goes only to form and not to substance. The reduction/suspension of the minimum liquidity cushion requirement not only did not cause damage, but did not even cause the decisions which are alleged to have done so. The decisions to reduce or suspend this requirement were ancillary and consequential, being required for good order having regard to the potential need to use liquidity cushion assets. I am satisfied that even though these decisions were made without formal meetings, of either the Board or the Independent Directors, the process by which they were dealt with and made was adequate and reasonable in all the circumstances. I reject the allegation of inadequate deliberation or lack of independent thought. I am satisfied that each of the Independent Directors gave appropriate thought and judgement to these decisions, in the light of his personal level of expertise and the recommendations of those in direct charge of CCC's business. Whilst obliged to give the matter critical and independent thought, with their queries or suggestions being reasonably answered they were entitled to accept those recommendations.

1423. I find the Plaintiffs' criticism that the Defendants paid insufficient regard to the "advice" of Mr Black of JP Morgan to be unreal. Mr Black may well have been a senior and highly respected banker, but the suggestion that he was a "trusted adviser" to CCC (or anyone else in this case) is absurd. Mr Black's bottom line agenda was the best interests of JP Morgan. Mr Stomber was suspicious that Mr Black was trying to obtain a good deal for a client buyer whom JP Morgan had lined up, and felt that his suspicions were confirmed by the low prices eventually offered for the $4Bn of RMBS. I am inclined to think, on the evidence in the case (which does not include any evidence from Mr Black), that Mr Stomber was probably correct. In any event, the eventual offer price seems to me to support the view that Mr Black was not considering CCC's interests, certainly in the depth which would be necessary to judge them accurately. It is also notable that his advice that Carlyle should not make the $100Mn loan to CCC was not only gratuitous, but was obviously addressed to Carlyle and not CCC. His advice was also not that good, in that his prediction of large margin calls against CCC the following day did not materialise.

1424. I therefore do not attach any, let alone significant, weight to the reported comments of Mr Black. At his high executive level, I find that they are more likely to have been made for effect and general relationship purposes than to be regarded as "advice" which CCC "ought" to have taken. It was Mr Black's observable attitude, rather than the content of his comments, which it was appropriate for Messrs Stomber and Conway (and Hance) to evaluate and have regard to, and I find that they did just that. I do not find it a matter of any great moment that

they apparently did not relay to the Board the precise figure ($10Bn) which Mr Black had "advised" should be sold, shocking though it might have been. It was not necessary to do so. The general seriousness of the situation and the tenor of Mr Black's attitude was perfectly adequately conveyed without reference to this figure, which I also suspect was deployed in the meeting as much for dramatic effect as anything. I also find that the experience of the low price offered by JP Morgan following on from Mr Black's "advice", far from suggesting that CCC ought to sell RMBS as he advocated (which is what the Plaintiffs argue), actually tended to underline the risks and dangers of doing so.

1425. Next, I find as a fact that Mr Conway did not "decide not to sell RMBS" as any kind of fixed and final decision. It was, rather, a part of the exercise of his general business judgement that, in all the circumstances, other assets should be sold first, and other measures taken to improve CCC's financial position (such as taking a loan which TCG was willing to provide) ahead of selling RMBS, and that sales should not be made except where the balance of advantage and disadvantage favoured selling. This in turn meant where there was a suitably worthwhile price, preferably achieved through a favourable opportunity such as a reverse enquiry.

1426. I also find as a fact that Mr Conway did not impose his view on the other Defendants, nor generally exercise control over the Board of CCC or CCC itself. He merely made his views known clearly. He was not only entitled, but obliged, to do so, and he did so in a manner which was not inappropriate. I have no doubt that he was aware that his views would carry weight with other members of the Board, but it is no part of the duty of an experienced and powerful director to refrain from expressing his views clearly so as to avoid this. It may give rise to influence, but it is certainly not undue influence.

1427. I do not find Mr Conway's insistence on reviewing CCC's future press releases after the adverse reaction to that of 21st August to be any evidence of undue control of CCC, but rather of a concern to try to head off potential damage to CCC in the future.

1428. As to the "Citi deal" it is of course the case that the full terms of the proposed arrangement with Citibank were not disclosed by Mr Conway to CCC's Board, but I do not accept that the undisclosed details were "highly material" to the Board's decision making process, let alone to the impugned decisions themselves. Of course the undisclosed details enabled a theoretical computation of the notional value (to Citi) of additional support from TCG to be made. It is almost always possible to reduce advantage and disadvantage to financial parameters, and it is often a tool which is of assistance in making skilful business decisions. However, the making of such a comparison does not mean that this figure was the cost of such financing to CCC; it did not affect CCC's own financial situation. I find as a fact that revelation of the further details of what Carlyle was prepared to do with Citi would not have affected the material decisions taken by the Board of CCC; it would simply have increased gratitude to Carlyle.

1429. I therefore reject the submission that the extent of non-disclosure was a breach of duty on Mr Conway's part, and whilst I am not persuaded that Mr Conway would have revealed the further details to CCC's Board if asked – I think he has a natural "need to know" approach with regard to business – whether or not he would have done so is therefore irrelevant. I reject the similar, but even more tenuous, allegations with regard to his "failure" to disclose the variations to the agreement which had never been disclosed. For the avoidance of doubt I also reject the convoluted allegation that the remainder of the Defendants were in breach of duty for failing to "insist" on receiving such disclosure. For good measure, I record that even if Mr Conway had

disclosed the full extent of the Citi Deal to the other Defendants, I am not satisfied that it would have made any difference to the decisions which they then took, or even that it should have done.

1430. I am also satisfied that any failure by Mr Stomber to pass on Ms Cosiol's legal advice as regards taking account of the interests of creditors was not of materiality or significance to the relevant decisions. Such failure was, I find, explained by his view that at the time CCC, whilst not in a comfortable place, was not "in the zone" or on the brink of insolvency.

1431. In short, for the avoidance of doubt, I see no matter of any sufficient materiality to the decisions made at the 23rd August Board meeting which was not disclosed to the Board and I can see nothing to suggest that any matter which was arguably not disclosed to the Board, whether individually or in any combination, would have changed the decisions actually made.

1432. Lastly, in regard to the 23rd August Board Meeting, the Plaintiffs' attribution of such solemn significance to Mr Conway's recorded closing remark at the end of this meeting, as to "hop[ing we] have some good luck" that it can be regarded as evidence of recklessness is fanciful. Having seen Mr Conway give evidence and observed his occasionally ironic style of email, I am perfectly satisfied that this was a jocular sociable remark, probably to lift the morale of those attending. It is not deserving of the attention that has been spent on it. It is another illustration of why the material in this case (and this judgment) has had to swell to the disproportionate level which it has done.

1433. The Plaintiffs' accusation that CCC was enabled by the non-disclosure of aspects of the total proposed Citi deal to "misrepresent" to other repo lenders that it was obtaining substantial repo finance from a major player such as Citi at a 2% haircut (Citi having itself calculated the intended deal as equivalent to at least a 3% haircut, but without –unsurprisingly – itself revealing this to CCC) has no relevance to any claim in this action, even if it were justified as an accusation in itself. However, I reject it as fact and would regard it in any event, as trivial. The statement was literally true. It was also in CCC's interests to be able to make such a statement in the market - and I am far from satisfied that the making of such a statement in the circumstances, even if arguably incomplete, would or should be regarded as outside the ambit of acceptable practice. The law needs to have regard to the attitude of the ordinary reasonable person, and it would be quite unreal to expect that traders and dealers should couch their "chatter" with the careful qualifications which might be expected in a solemn document. I emphasise, though, that even if any such statement were to be classed as a misrepresentation, I do not find it to have any relevance to the claims in the action.

1434. I also reject the submission that the Defendants misled the markets in either the press release of 27th August or the investor and analyst conference call of 29th August 2007. These allegations again have no direct materiality to the claims, and the associated allegations of breach of Dutch regulatory law are similarly immaterial. For reasons which appear later, I do not consider that they require a decision.

1435. Finally, I reject the allegation that it was any breach of duty for CCC's Directors to approve the taking of the first Carlyle loan of $100Mn. No evidence was called to suggest that the terms of the loan were unreasonable (and on balance of probability I would find that they were not). In any event, the allegation that it was wrongful conduct to accept the loan because it was "insufficient" is bizarre.

1436. Although the alternative claim that the Defendants ought to have considered, and, by implication, sought to raise, further equity capital at this time was scarcely persisted in, for the avoidance of doubt I reject that allegation as well. I accept that there is no evidence that such possibility was deliberated on, but I am quite satisfied that it was so obviously unrealistic as to require no debate. The IPO was only recent. There was no party who might be expected to inject further capital into CCC in the then market circumstances except TCG, and TCG was assisting by providing the term loan. There was therefore no breach of duty in failing to waste time and effort discussing this.

Extended duty to have regard to interests of CCC's creditors

1437. This is as good a point as any to give my findings with regard to the potential extension of the duty of CCC's directors to CCC becoming extended to include the interests of its creditors.

1438. The Defendants argue that this duty never in fact arose, because CCC was neither insolvent nor, if properly viewed, on the brink of insolvency in August 2007, or, indeed at any time up to the days before its final collapse.

1439. I find that CCC was not insolvent within the meaning of the material Guernsey statute, ie the 1994 Law, either "as from 17th August 2007" as the Plaintiffs submit, or at any time during August 2007 - or, in fact, at any time prior to the days immediately before its actual collapse when it received the first margin call which it did not pay. I do find, however, that CCC was in a sufficiently difficult financial position that a real possibility of future insolvency, even within the meaning of the 1994 Companies Law, could not be ruled out.

1440. As I put it no higher than this, applying the test which has been considered and refined in English law would seem not to be sufficient to trigger the extended duty. However English law has formulated the refined version of its test whilst having regard to a test for actual solvency which is less strict than that which I find to operate under the 1994 Companies Law. Given the rationale of the extended duty, it seems to me that it would be right to regard it as applying in any situation where the interests of creditors in an insolvent winding up have a discernible possibility of becoming operational. I will therefore assume, in favour of the Plaintiffs, that the extended duty did arise.

1441. The materiality of that was then, in my judgment, that CCC's directors, the Defendants, were obliged to have proper regard for the interests of CCC's creditors, with "creditors" meaning, as already discussed, CCC's potential unsecured creditors in general, and with "proper regard" meaning: taking a responsible view of the consequences of their actions on CCC's behalf to the interests of such creditors insofar as such actions might potentially impact on them.

1442. In fact, CCC had no unsecured creditors at the relevant time except, ironically, TCG once the unsecured loan of $100Mn was drawn down. However, this legal principle ignores the actual personality of such creditors; their "interests" are to be treated as those of the impersonal general body of unsecured creditors. CCC's repo lenders were not unsecured creditors. Their interests, at any moment, lay, as a matter of practicality, in CCC's being able to secure affordable funding to pay off their current repo loans at the end of the next repo period, and otherwise in the maintenance of the value of their security. However, insofar as their security might be insufficient to pay them off, the unpaid balance would place them in the position of unsecured creditors *pro tanto.* They did, therefore, have interests at this remove, as potential unsecured creditors to the extent of any potential inadequacy of their security in the event.

1443. I accept that there is no evidence of the Defendants' actively considering the interests of CCC's creditors at all, unsecured or otherwise. In fact, though, legal identification of the relevant creditors' interests in CCC's case is rather technical, as indicated by the above. I do not think that the Defendants, as businessmen, were required to embark on any such analysis. Neither, is it necessary for me to do so here.

1444. The bedrock of the principle underlying the obligation to have "proper regard" to the interests of the unsecured editors of a financially fragile company is that of drawing a fair balance between the interests of creditors and shareholders in the remaining assets of the company where these may start to diverge. If there is no practical divergence, then "proper regard" for the interests of unsecured creditors will be subsumed in having regard to the interests of shareholders as to preservation of the company's capital. If there is such a divergence, then the director's duty is to pay regard to the balance of such interests in making relevant decisions.

1445. I cannot in fact see that there was any discernible divergence or conflict between the interests of shareholders and the interests of any perceivably possible unsecured creditors of CCC at the time. I certainly cannot see that there was any conflict between those interests as regards a decision as to the desirability (or otherwise) of not immediately selling or embarking on a plan to sell up to $10Bn of CCC's RMBS portfolio.

1446. The repo lenders were, in my judgment, reasonably viewed as being well-secured for the moment. The factors which might cause them to become at all unsecured would be the failure of CCC's repo funding arrangements or the heavy marking down of the market value of its RMBS. Apart from those eventualities, CCC's business would continue to tick over and slowly recover the safety net of liquidity, and the repo lenders would come out of their current loans with these being repaid, and might or might not choose to roll them over. Those factors were the very same factors which CCC and its Management were striving to hold together in the interests of CCC. There was therefore, in my judgment, no divergence of interest between CCC and the general body of its repo lenders (whether or not they are viewed as contingent unsecured creditors) so as to make it necessary for the Board to identify those differences of interest, let alone to make it plausible that the Board would have concluded that those interests would benefit from any different course of action from what appeared to be in the best interests of CCC itself.

1447. In the circumstances, I am satisfied that there was therefore no failure by the Defendants to have the required proper regard to the interests of CCC's creditors as embraced within the Defendants' duty to have regard to CCC's best interests, either at this time, or indeed at any subsequent time.

1448. I should point out, of course, that my reasoning above is of very narrow effect in this case because it is primarily in relation to the 1994 Law. The corresponding provisions of the 2008 Law are different and more akin to those of the current English Acts. Even applying those, though, my conclusion would be the same, because it depends on the general coincidence of the shareholders' and creditors' interests, and not on the detail of what might technically amount to "insolvency".

(b) Breach of fiduciary duty

1449. In view of my finding that the challenged decisions were not only appropriately carefully taken, but were objectively well within the range of possible reasonable decisions which could be made by a duly diligent competent and careful director of CCC, they fall within the *Charterbridge* principle in any event, and it is again not strictly necessary for me to consider whether any of CCC's directors acted in breach of their fiduciary duties when making such decisions.

1450. However, the Plaintiffs have made much of various allegations in this respect, both on their pleadings and in aspects of cross-examination, and as this is the point in the history where such matters would have significant impact if they did apply, I will review the relevant allegations here and give my findings. However, I still confine this to such of the allegations as are capable of causing loss, in effect, therefore, the elements of the "core breach".

1451. Some of these allegations are framed as breach of fiduciary duty in failing to disclose a conflict of interest to the Board and not then ceasing to participate in the decision- making process. These complaints go nowhere as regards any claim sounding in damages. Indeed, there is no assertion as to what it is alleged would have happened without their occurrence. For those reasons I do not propose to consider such allegations further.

1452. I have referred above (as at July) to the five factors cited by the Plaintiffs as vitiating the propriety of the material decisions made principally in August 2007, and rendering them breaches of fiduciary duty. I have examined the last two – Mr Stomber's alleged "subservience" and the claimed lack of "true" independence of the Independent Directors - as a general point because they are of general application. I will indicate in context where and how far they affect my approach to any particular material allegation. I need here, therefore to consider only the first three matters of breach of fiduciary duty.

1453. These are subordinating CCC's best interests to:

(ii) a wrong-headed pursuit of a double digit dividend target;

(iii) the Entity Defendants' corporate and reputational interests in the avoidance of taking losses into CCC's accounts, reducing capacity to pay dividends, losing fees for CIM, and the embarrassment of effectively having to admit that Carlyle's first enterprise to "go public" had been a failure; and

(iv) the personal financial interests of Messrs Conway, Zupon and Hance, as part owners of Carlyle, in

a. the most lucrative sale of an ownership interest in the Carlyle Group to Mubadala in or about September 2007,

b. securing a $1Bn term loan for Carlyle, in August and November 2007 and

c. progressing Carlyle's own potential IPO,

1454. As allegations of breach of fiduciary duty, they all go to the issue of the propriety, in August 2007 (or thereafter), of making the decision not to attempt significantly to reduce the leverage operating on CCC's RMBS portfolio by selling a significant quantity of RMBS, or of raising

further equity capital, or otherwise restructuring or conducting an "orderly winding down" of CCC. They all go to inappropriate or improper motive.

1455. The Plaintiffs' position at the end of the trial hearing was that it was not necessary, in order for me to find a breach of fiduciary duty, to make a finding of dishonesty on the part of any Defendant. Indeed, Advocate Wessels went even further, and in the course of closing submissions, expressly disavowed any submission that any of the Defendants had been guilty of dishonesty. This was a welcome, but remarkable, contrast to the tone of previous submissions.

1456. However, I find the effect of this concession both puzzling and concerning. "Dishonesty" entails conscious wrongdoing. You cannot have inadvertent, involuntary or accidental, dishonesty. Here, having regard to the nature of the accusations, "dishonesty" would naturally mean: prioritising the interests of either the Carlyle Group or a Defendant personally above the interests of CCC, *whilst knowing that it was improper to do so*. The Plaintiffs' concession appears to mean that they disavow any intention to argue that the second limb, (knowledge of impropriety) occurred, whilst submitting that the court can still find a breach of fiduciary duty by simply upholding the Plaintiffs' submission that the elements of the first limb (actual prioritisation of Carlyle or personal interests over those of CCC) are proved.

1457. Quite where there is room for such a scenario in practical terms is difficult to see. "Prioritisation", which is what the Plaintiffs have alleged, is an act of active consideration, comparison and preference of one interest over another. The hypothesis itself therefore excludes the possibility that the Defendants simply did not consider CCC's interests at all. The concession therefore entails that the Defendants should have considered those interests and deliberately given priority to competing interests of either Carlyle or themselves, but should have done so in an innocent state of mind, ie without knowing that this was improper. This is patently impossible in the case of personal interests. In the case of Carlyle's interests the only possible material states of mind are either a positive belief that it was in CCC's own interests to prioritise Carlyle's interest over CCC's own interests, (an inherent contradiction which is clearly absurd), or an innocent failure to appreciate, even though actually thinking about it, that prioritising Carlyle's interests over those of CCC was something which might be improper at all.

1458. Whilst I can just about enunciate the bare logic of this latter, I find it completely unreal. The reality is that the Plaintiffs have alleged, and indeed are still alleging (see below), a disgraceful attitude by the Defendants to the importance of CCC's best interests. They do so in the shape of a positive allegation that they were motivated by the overriding wish to prefer the interests or perceived interests of all or some of the Entity Defendants or, in the case of Messrs Conway, Hance and Zupon, of themselves personally. But, having thus sown the seeds of an allegation, effectively, of dishonesty, the Plaintiffs now seek to distance themselves from this, whilst still relying on the actual building blocks of such an allegation.

1459. In the middle of a trial of this length and complexity, with pleadings as labyrinthine as these, and with time limited oral submissions, the effects of the Plaintiffs' concession were not analysed by close reference to the pleadings. It may well be that if this had been done (and I do not criticise anyone involved for not doing so in all the circumstances) I might have been persuaded to refuse to accept this concession unless the Plaintiffs simultaneously withdrew formally the allegations which carry such a strong and necessary implication of dishonesty, on

the grounds that those allegations should not be allowed to remain in the action if the Plaintiffs were not prepared squarely to support the implicit allegation of dishonesty.

1460. This approach was not argued, but it seems to me that, with the precise factual allegations being so redolent of an implication of dishonesty, then even if the Plaintiffs disavow any reliance on dishonesty, it would be wrong for me to reduce the scope of my judgment so as not to deal with that point simply because I could do so by relying on some procedural or logical consideration. This is for two reasons. First, the unreality which I perceive about it all means that I find it impossible to carry out any such exercise succinctly or efficiently. Second, the seriousness of these allegations for the reputation and integrity of the Defendants, means that I think it would be wrong, and unsatisfactory for the interests of justice, for me now to refrain from making the findings I would have made if the Plaintiffs had not offered this concession. I shall therefore proceed on that basis.

1461. The Defendants submit that the history of these allegations is pertinent to evaluating their quality. They therefore begin by inviting me to consider their background in the pleadings. These allegations are all that remain, in substance, of allegations of improper conduct made against the Defendants in the "Introductory" section of the Cause in its first 35 paragraphs. As a sample, the Defendants cite the central allegation made in Paragraph 21 of the Cause, that

> "*To meet the margin calls and increased "haircuts" imposed by CCC's repo counterparties during August 2007, the Defendants propped up CCC with ineffectual, artificial, covert and self-interested short-term measures and continued to generate high fees for CIM rather than implement a long term solution for CCC. They did not sell any of CCC's RMBS assets, which would have resulted in the recognition of losses, a loss of "incentive fees" and in turn would have been damaging to the reputation of the Carlyle Group…",*

doing so in pursuit of

> *"… a predetermined strategy* [sc on the part of TCG and Holdings] *that in the event of CCC's collapse, they would blame adverse market conditions and the actions of others to avoid scrutiny of their own misconduct."* (see Paragraph 18).

1462. This puts the Plaintiffs' case very high. It makes extreme allegations of negligence ("ineffectual") and, even more emphatically, misconduct ("artificial", "covert", "self-interested") and indeed expressly uses the word "misconduct". These hugely pejorative characterisations of the Defendants' actions, they point out, have never been withdrawn from the Cause despite significant subsequent amendments, generally adding more and more detail of matters which could be pressed into service as some form of arguable breach of duty, with or without material consequences.

1463. The Defendants next observe that once they had answered these accusations of improper motivation (by setting out their account of the actual process of consideration by the Defendants of what was perceived to be in CCC's best interests and justifying this), the Plaintiffs' response was to continue their extreme assertions, by dismissing this explanation as *ex post facto* rationalisation, in furtherance of the alleged plan to prop up CCC for improper reasons and to blame it all on extraneous circumstances "*when*" the inevitable collapse of CCC occurred. This stance was maintained even up to and including the Plaintiffs' opening submissions in the case, but these serious allegations have gradually been backtracked and

downplayed, culminating in the latest and last minute disavowal of any allegation of dishonest conduct, but whilst still retaining the claims of breach of fiduciary duty and the general accusations in the Cause.

1464. The Defendants submit that the Plaintiffs have not come close to making out these extravagant allegations, and, indeed, did not even put the specifics of several such allegations, such as prioritising the generation of high fees to CIM, to any of the Defendants at all.

1465. I did gain the impression in the course of the trial that the Plaintiffs were persisting in these allegations somewhat half-heartedly. My overall impression was certainly that there was never any direct tackling of the allegations of improper purposes as a topic of cross-examination, although it may well be possible, within the extent of about 25 days of cumulative cross-examination, to find some questions put to a Defendant which could be construed as relating to these allegations.

1466. However, they remain on the pleadings in the circumstances already noted. I have therefore evaluated them, but in the end I do not find them, or indeed the breaches of fiduciary duty, to be made out on the evidence.

The suggested conflicts of interest

(i) Reputational interests of Carlyle including payment of dividend

1467. The Plaintiffs' first two allegations are of the pursuit of a high rate of dividend and the prioritisation of the corporate and reputational interests of Carlyle over the interests of CCC. It is submitted that these factors are established by the evidence. They improperly motivated the Defendants in the impugned decision not to sell RMBS, and thus rendered those decisions a breach of the Defendants' fiduciary duties – specifically the duty of good faith, the proper purposes duty and the no conflicts duty.

1468. I can consider these together as the first (the alleged improperly motivated pursuit of a high rate of dividend) is simply part of the second, (the alleged prioritisation of Carlyle's corporate and reputational interests over those of CCC). The allegation is that the continued dogged pursuit of paying a high level dividend was motivated by the fact that Carlyle had sponsored CCC on this basis, and it would be hugely embarrassing to Carlyle's reputation for this not to be achieved.

1469. I find no sufficient evidence to support any finding that the core breach decision was driven by a rash desire on the part of any Defendant for CCC to pay a dividend, high or otherwise, to its investors, let alone motivated by the notion that this was in the Carlyle's Group's interests regardless of CCC's.

1470. The payment of a dividend is one of the raisons d'être of a company, and in CCC's case it was really the raison d'être; CCC was conceived as a yield vehicle. In general terms it is in the interests of the company (ie the general body of shareholders) for the company to pay a dividend, always on the basis of having sufficient funds legally available. Whether it is in fact in the best interests of the company to do so at any particular time, and in what amount, is a matter for the judgement of the directors, based on the relative merits of paying such a dividend or preserving funds which would otherwise be used for this or other needs or purposes of the company, more or less pressing. It is therefore not only natural, but to be

expected, that the company's directors will keep the prospects of paying a dividend in their sights at any time. It is also, therefore, more than likely that references to this being raised will be found in the company's papers. To justify any inference that this was a driving factor as regards any other decision, or that it governed the priorities applied in making such decision, therefore requires clear evidential support of that prioritisation. It must go beyond the mere fact that the possibility of a dividend payment was actually thought about.

1471. I have already found above that there were perfectly reasonable and respectable explanations for Mr Stomber's email references to dividend levels in August 2007 and to the prospects or possibility of declaring a dividend. I am satisfied that these sentiments were not what drove his recommended course of action for CCC at that time. I have equally found no evidence that the consideration of paying a dividend was what drove the decisions of the voting Board members at the 23rd August Board Meeting - quite the contrary. Whilst these findings were made in regard to the duty of care, and therefore from the perspective of that duty, the same practical considerations apply from the perspective of the duty of good faith.

1472. Having looked at all the material cited as evidence of the Defendants' respective attitudes to the desirability of CCC's paying a dividend, not just in August (with which I am concerned here) but also later, I see nothing which convinces me that the payment of a dividend was a factor which even contributed to any Defendant's reasons for making or supporting the decision not to sell, rather than attempt to sell, RMBS, or indeed anything else. There is certainly evidence that paying or not paying dividends was thought about; Mr Stomber and Mr Hance in particular, were very conscious that investors would expect a dividend and be disappointed and possibly critical if they did not receive one. However, this was, I find, simply as a recognition of the principle that, as Mr Allardice remarked, "*any yield vehicle needs to have a dividend that is declared*". Considered in context, the terms of these references, at the time, show only that inability to pay a dividend was seen as regrettable but as a matter which was firmly secondary to taking what appeared to be the course which was most conducive (balancing all considerations) to preserving CCC's capital, and its return to strength and health.

1473. In short, to make good this allegation of breach of fiduciary duty, the Plaintiffs would have to satisfy me that the desire to pay a dividend was at least a critical factor, if not the critical factor, in the Defendants' decision not to sell RMBS, and that the reason for this being so critical was furthering the interests of the Carlyle Group in disregard of those of CCC. They do not do so, on either score.

1474. With regard to the allegation of refusal to countenance taking realised losses into CCC's accounts, this appears to be linked to the allegation of prioritising a dividend payment, on the basis that realising losses on the sale of RMBS would have limited CCC's ability to declare and pay a dividend. To that extent, it is dealt with above. The Defendants submit that this allegation, once again, ignores the fact that the Defendants were willing to take losses on to CCC's books, and in that the sale of credit assets did just that. Even if this allegation is benevolently interpreted as confined to realised losses in respect of RMBS, the fact that Messrs Stomber, Hance and Conway were prepared to sanction the sale of $4Bn of RMBS to JP Morgan belies this submission, as that sale would have been on terms which did realise a loss.

1475. The Plaintiffs submit that Mr Hance accepted that this consideration "impacted" the decision not to sell RMBS, but that was not my understanding of his evidence at the time, and on

examining the transcript I find that, having regard to the way in which the questions were put, this was a statement made on the basis of general hypothesis, and not with regard to the making of a particular decision. The Plaintiffs also submit that Mr Conway accepted that the taking of losses would have affected when CCC would first be able to pay a dividend and the amount of that dividend, but once again, on examination, this was a hypothetical answer, given in the context of his having just said that

> *"Nobody was thinking about a dividend at this time. There was an occasional discussion about it. But there was – dividend was not really under discussion because we had to put the company in survival mode. Taking and paying a dividend out to shareholders now was not, certainly, in my mind. I don't necessarily talk for other people, but it was not a very high priority. That was for some future date."*

I find that this statement accurately expresses the general state of mind of the Defendants, as at 23rd August and generally, subsequently as well.

1476. The Defendants also point out that, the evidence does not even ground the proposition that taking realised capital losses into CCC's accounts would have prevented the payment of a dividend out of current *income*. This would be a mistaken assumption as shown by the evidence of accounting practice. That may be correct, but it is also, in my judgment, irrelevant. The issue is whether the Defendants were improperly preferring Carlyle's interests to CCC's, not whether they had a correct understanding of relevant accounting practice. The material point is the Defendants' subjective belief. Mr Conway is not an accountant and I took him in any event to be talking only in terms of commercial policy. The point made by Advocate Swan does, though, highlight the fact that if CCC's ability to pay a dividend at all had been a material consideration in the Defendants' thinking, then one would have expected to find some consideration of the question whether taking capital losses on to CCC's accounts would affect the position legally in the contemporaneous documents. I am unaware of any such evidence. That is not crucial to my finding, however.

1477. I make the above findings having taken into account my earlier recorded findings about the general underlying attitude of the Defendants towards their positions with regards to both Carlyle and CCC.

1478. In particular in relation to Mr Stomber, I do so whilst recognising that the evidence does show that on at least one occasion (in regard to the choice of timing for CCC's IPO) he apparently did place the interests of Carlyle to the fore, and actually above the independent interests of CCC, because of his concerns to please and impress the Founders. I have therefore considered the evidence relating to his decision to recommend holding rather than selling RMBS critically, in this knowledge. However, having examined the evidence specifically regarding this point in time, the end of August 2007, I am quite satisfied that the specific interests of Carlyle were not uppermost in Mr Stomber's thinking at that time, and did not have (as they would need to have done in order to found liability) the effect of causing him to make any different recommendation to CCC's Board than if he had considered solely CCC's own best interests in any event.

1479. This is for several reasons amongst which are the following. First I am quite satisfied that Mr Stomber felt no tension between CCC's own best interests, which he saw as being survival and recovery, and Carlyle's best interests, which he also saw as being CCC's survival and recovery. His efforts were therefore directed at the possibilities for achieving this and no

conflict arose. Second, I am quite satisfied that Mr Stomber's natural cynicism and wariness of the wiles of others in the market, coupled with his deeply held (and perfectly logical) belief that the market value of CCC's Agency RMBS was bound to move back to par value in the end because the market would see sense about "flying to quality", were the most strongly held views in his arsenal. They were what actually drove his recommendation to hold on to RMBS if at all possible, and only to sell in reasonably "safe" circumstances. Third, if Mr Stomber had been motivated by a wish to curry favour with the Carlyle Founders, as a "team man" and this thought had influenced his decision, then I think there would have been some evidence of his seeking to take credit for this in the contemporaneous papers, as he had done before. There is no hint of this.

(ii) Fees for CIM

1480. The next suggested reason why the Defendants were acting in furtherance of Carlyle's interests at the expense of CCC's is that of not losing the opportunity to gain fees for CIM.

1481. The Defendants submit that there is simply no evidence to support a finding of any such motivation. They point out that it was not even raised with witnesses in cross-examination (and I certainly do not recollect its being.) They point out, with some force, that this motivation is inconsistent with the evidence of what actually happened as regards CIM's fees. Whilst CIM was indeed paid fees which, in the abstract appear to be very substantial, they were all properly earned under and calculated in accordance with the IMA. At and after the relevant time, starting with July 2007, CIM earned no incentive fees, (and indeed the basis on which CIM's incentive fee was to be calculated was reconsidered and modified in early 2008, to provide that it should not be paid an incentive fee in any quarter where no dividend was paid), and CIM in fact waived its incentive fees for the fourth quarter of 2007. Thus, no payment of any further fees ever took place.

1482. I can see absolutely no evidence suggesting that, in August 2007 or at any time, the objective of being able to "milk" CCC for the benefit of CIM, regardless of any resulting detriment to CCC, played any motivational part in the Defendants' decision to continue CCC's business without selling down RMBS. This allegation is nothing but assertion. It did not actually figure in the Plaintiffs' closing submissions. I reject it and need say no more about it.

(iii) Embarrassment of downsizing

1483. The third matter is a general allegation that selling RMBS would have produced an embarrassing downsizing of CCC so shortly after its IPO. In the Plaintiffs' closing submissions this appears to be prayed in aid in support of the third factor, namely the furtherance by Messrs Conway, Hance and Zupon of their own personal financial interests as Carlyle partners, rather than the interests of CCC. Insofar as there remains any assertion that the retention of RMBS was directly motivated by prioritising concerns about embarrassment to the Carlyle Group, I have difficulty seeing any connection between these revealed by actual evidence, as opposed to being just a theoretical construct. Any remarks in the evidence which might be argued to be capable of bearing such interpretation have come over to me as being just natural comment. I have not seen anything which I would regard as evidence of any positive motivation of avoiding supposed embarrassment for Carlyle playing any part, let alone a decisive part, in driving the decision not to sell RMBS.

1484. Mr Conway, plainly the most material Defendant in this regard as one of the Founders of Carlyle, denied that embarrassment was a factor which would have caused him to act otherwise than simply in what he thought was CCC's own best interests. The Plaintiffs suggest the contrary, citing an email of his on 17th August 2007 to his co-Carlyle Founders and Mr Gerstner, in which he refers to the capitulation to market conditions by one of CCC's cohort of competitor "comparators", KFN Financial, which had restructured the previous day, by announcing that it had sold $5.1Bn of its mortgage backed securities for a $40Mn loss. Mr Conway certainly expressed the view that *"we do not want to pull a KKR type meltdown*". However, the full quotation continues "*and will support CCC to avoid this. We should be successful if it costs us a little to protect our brand."* This does not read as an expression of intention to avoid embarrassment to Carlyle at the expense of CCC. I accept Mr Conway's evidence in this regard.

1485. In any event, it seems to me that this motivational argument is highly implausible. It is the Plaintiffs' case that holding on to CCC's RMBS irresponsibly risked – and the risk was such as to be a virtual certainty – the complete collapse of CCC. This would surely be far more embarrassing, ultimately, than merely downsizing CCC. I find it inconceivable that Mr Conway would balance out such risks and prefer the one which carried the greater embarrassment. I do not in fact think (and I so find) that embarrassment about the appearance of downsizing played any part in Mr Conway's thinking except by comparison with the potential costs of supporting CCC, as indicated in his email. The logical implications of Mr Conway's conduct are not that he irresponsibly voted for CCC to retain its RMBS to avoid the embarrassment of downsizing by selling part of the portfolio, but rather that he thought that retaining the RMBS, with financial support from Carlyle would be more likely to avoid such embarrassment.

1486. The Plaintiffs therefore fail to satisfy me of their generalised allegation that it is more likely than not that the Defendants, or any of them, were motivated by an impetus to prefer the interests of Carlyle as against those of CCC. However, and in any event, I am also satisfied (and so find) that the best interests of CCC and Carlyle were perceived as being aligned with each other in any event as regards what to do with CCC's portfolio, and in fact, that they were.

(iv) Personal financial interests

1487. The third separate matter which is suggested to provide an explanation for the supposedly inexplicable decision not to deleverage CCC by selling RMBS is the argued existence of a conflict of interest between CCC and individual Defendants. One allegation in this regard, contained in the original Cause, was that such a conflict arose because each of the material Defendants stood to have a small percentage of CIM's fee earnings rebated to him. I find this to be even more implausible and tenuous than the allegation of a supposedly conflicting interest of Carlyle in keeping CCC alive in order to earn further fees in CIM. This is especially so in view of the small size of any such rebate in the general order of things. This allegation was neither put to the Defendants nor persisted in in the Plaintiffs' closing submissions, and I therefore dismiss it.

1488. More serious and at first sight potentially pertinent is an allegation which <u>is</u> persisted in, that a conflict of interest, actual or perceived (although I cannot see how this latter can really have materiality as to a damages claim), existed between CCC on the one hand and Messrs Conway (in particular), Hance and Zupon on the other, arising out of their each being partners, to

varying degrees, in TCG. It is not this status as such which is alleged to give rise to a conflict - and, indeed, their status was well known to all the CCC Board - but the fact that it gave to each of these Defendants a potential personal financial interest in the most profitable achievement of three matters which the Plaintiffs insist on calling the "Carlyle Strategic Objectives", and which the Defendants say were accurately and less tendentiously, known within Carlyle as three of the Group's "Strategic Alternatives", and which were in contemplation at the time**.**

(a) The Mubadala sale

1489. The first point is that, during this period, negotiations were in hand for the potential sale of an ownership interest in TCG to Mubadala, from which Mr Conway, in particular, and Messrs Zupon and Hance to a lesser degree but still substantially, therefore stood to benefit. The second was the securing of a $1Bn credit facility for TCG from its bankers, intended to enable a dividend to be paid to Carlyle partners, to pay off some Founder Capital and to provide TCG with further working capital with which to expand its business. The third was the potential IPO of TCG itself, which was at the time being suggested, and which would again benefit each TCG partner, and indeed for which the IPO of CCC had been seen as a kind of dry run. Each of these would provide Carlyle partners with a direct or indirect financial gain of no mean sum.

1490. With regard to the Mubadala transaction, this was to be the second sale of a partial ownership interest in TCG and thus effectively in the highly successful Carlyle Group as a whole. The first such sale had been the sale of a 5.5% interest to the California Public Employees Retirement system ("CalPERS"). By August 2007, negotiations with Mubadala had begun, and a period of due diligence was underway. In the event, an agreement for the sale of a further 7.5% interest in TCG was signed on 17th September 2007 and completed on 10th October 2007.

1491. CCC's financial contribution to TCG appeared in the due diligence exercise, but the figures show that this was included as being $10Mn out of a total of $329Mn, and thus a very small fraction.

1492. The Defendants admit that the negative publicity about CCC at the time of the August crisis, already referred to, gave rise to particular concerns raised by Mubadala as part of their pre-contract enquiries. This came about particularly from an article which was highly critical of CCC, which appeared in the Washington Post of 5th September 2007. Mubadala's concern was unhappiness at the negative publicity associated with an enterprise in which they were about to invest, but their concerns were allayed, through meetings by Mr Conway and Mr Rubenstein, in particular, with Mubadala's negotiating intermediaries, by assurances that CCC was a very insignificant part of the TCG enterprise and had as yet contributed nothing to the Group's financial position. Mubadala went on to proceed with the transaction without seeking any reduction in the proposed purchase price.

1493. From the eventual deal, Mr Conway received about $280Mn, Mr Zupon around $7Mn and Mr Hance around $950,000.

1494. Mubadala apparently contemplated acquiring a further 2.5% of TCG, after this initial investment, and might have done so in about March 2008, but this never went ahead. The negative publicity from CCC's eventual demise are suggested as a possible reason for this, but so also is the suggestion that proceeding with the second investment at the lower relative price

which was then considered appropriate in value terms might have been seen as raising the question whether Mubadala had paid too much for their first investment.

1495. The Plaintiffs argue that the sale of RMBS would have created adverse publicity for CCC, and this prospect therefore created a conflict between, on the one hand, these three Defendants' duties to Carlyle and their personal financial interest in securing the conclusion of the sale to Mubadala at maximum value, with, on the other hand, their duty to CCC to pursue its standalone best interests which demanded (the Plaintiffs argue) the sale of RMBS or similar measures to raise liquidity and reduce leverage. The Plaintiffs argue that this conflict continued even after the conclusion of the first Mubadala sale on 10th October 2007 because of the prospects of a second sale, or a further sale to a third party.

1496. They invite me to find that this conflict of interest motivated these three Defendants to push through the decision not to sell RMBS, which decision the Plaintiffs characterise as so foolhardy for CCC as to be reckless and irrational. They also accuse the three directors of breaching their duty to CCC by failing to disclose the potential sale to Mubadala and their personal conflicts of interest to CCC's Board and recusing themselves from participation in the material decisions.

1497. Messrs Conway, Hance and Zupon each denied in evidence that he was motivated by the prospect of personal gain, and for what it is worth, Mr Nachtwey gave unchallenged written evidence that he had no perception of any prioritisation of the interests of Carlyle (and thus indirectly the interests of these three Defendants) in the progress or pursuit of the Mubadala sale and the obtaining of the highest purchase price.

1498. I reject the Plaintiffs' submissions. I can see no evidence of this consideration having had any actual effect on the actions of Messrs Conway, Hance or Zupon with regard to CCC. It is the case that these three Defendants all accepted that for CCC to be seen to sell substantial assets so soon after its IPO would probably generate negative publicity for Carlyle, but that admission of the obvious does not, in my judgment lead to the conclusion that this thought influenced, or still less determined, their advice or actions when it came to making the decision on behalf of CCC not to sell RMBS. Still less can I see that any of them actually thought that it was more in Carlyle's interests to avoid any such publicity, than to take the best decision for CCC notwithstanding potential negative publicity.

1499. Indeed, I have some difficulty in seeing any real substance, as opposed to theory, in the alleged conflict of interest itself. It seems to me, first, to be implausible. It depends on the dual perception that selling RMBS was both the best thing for CCC and something that would generate negative publicity. This seems to be something of a contradiction in itself, but even if it were the case, if selling RMBS were the best decision for CCC but did generate negative publicity, then the soundness of the decision (which the Plaintiffs are saying is so obvious that any other decision is inexplicable) could surely be explained in order to quell any concerns on the part of Mubadala or any other intelligent purchaser. In any event, the avoidance of adverse publicity by not selling RMBS, as a temporary expedient, would have to be weighed against the prospect of later even more serious adverse publicity either when RMBS was eventually sold or when CCC failed and the possibility of repercussions at this later time. I am therefore dubious about the logical likelihood of this suggested motivation for the (assumed) wrongful decision not to sell RMBS.

1500. As regards the further allegation of breach of duty by failing to disclose such alleged conflict of interest and wrongfully continuing to participate in the relevant decision-making, this fails in just about every aspect, but the most pertinent one is that it is not alleged to have caused any damage. There is no suggestion that if these Defendants had taken no part in the relevant decision it would have been different, and since Mr Stomber was advocating the challenged decisions, and Messrs Allardice and Sarles appear, from contemporaneous documents as well as their evidence in the case, to have agreed with his reasons, the overwhelming likelihood is that it would have been the same decision in any event. This is therefore yet another allegation of breach of duty without consequence.

(b) Obtaining a term loan for TCG and

(c) Carlyle's own prospective IPO

1501. The remaining two similar allegations as to conflict between a duty to Carlyle or to personal interest and a director's duty to CCC are levelled principally at Mr Conway.

1502. The second of the "Strategic Objectives" was the obtaining by TCG of a Credit Facility from a number of the lending banks who were also repo lenders to CCC. This was being negotiated during the period from March 2007. It was originally intended to be a $1.8Bn facility, but became reduced to $1Bn when market conditions became less robust. It was intended, the Plaintiffs suggest, for the purpose of funding a special dividend to Carlyle Partners of $750Mn, replacing the Founders as a source of Carlyle funding and providing further working capital. It was due for first tranche drawdown on 3rd August 2007.

1503. The increasingly worrying financial market conditions rendered the negotiation of this facility more difficult, although in fact its first payment was accelerated so as to enable TCG to make the $100Mn loan to CCC in August 2007. The Plaintiffs say that this shows how important the obtaining of the facility was to Carlyle, as it did not have the funds to make the loan to CCC without it. The Defendants say that the making of the CCC loan by using this facility shows that Carlyle and Mr Conway were certainly not putting Carlyle's interests ahead of CCC's.

1504. The Plaintiffs' eventual submission was that Mr Conway became placed in a position of conflict of interest because he was simultaneously negotiating with the same set of banks on behalf of both Carlyle, and CCC. As to the former, his obligation was to negotiate for the best terms for the Credit Facility (and his own personal interest) whilst as to the latter, CCC's interest lay in his not negotiating too hard with those banks in case this might alienate them and deter them from offering favourable repo terms to CCC. The allegation of failure to disclose this supposed conflict of interest to CCC's Board (etc) is then added.

1505. Before dealing with this I will describe the third material "Strategic Objective" said to generate a conflict of interest, again principally for Mr Conway. This was the intention to take Carlyle itself public. Although this did not happen in the event until 2012, it had been in contemplation since 2005 and by early 2007 was seen as attractive because of the premium valuation which could be placed on TCG at that time. Preparations (such as modifying accounting compliance practices and drafting documents) began in June 2007 and continued in some form until going public was put on hold in March 2008. It is submitted that Mr Conway's personal interest in, and indeed his duty to Carlyle to maximise the prospects of, a successful IPO for Carlyle was an incentive to avoid taking steps in relation to CCC which

would jeopardise this by embarrassing Carlyle or generating adverse publicity, and that this motivation was the reason for his proposing the retention of CCC's RMBS rather than resolving to reduce leverage by selling a significant quantity of it. There is then the familiar addition of the accusation of failure to disclose this supposed conflict of interest to CCC's Board and wrongfully continuing to act in CCC's decision making processes.

1506. I dismiss all of these allegations with regard to Mr Conway's supposed conflicts of interest. They are even more convoluted and tenuous than those regarding the Mubadala transaction. I find no evidence to support the contention that such considerations played any part in Mr Conway's (or, for the avoidance of doubt, Mr Hance's or Mr Zupon's) thinking with regard to CCC's interests and strategic business decisions, let alone one which affected and produced the actual decision of which the Plaintiffs complain.

1507. The Defendants suggest that these arguments are lawyers' constructs rather than submissions, without any foundation in the real world of actual fact. I agree.

Conclusions as regards August 2007

1508. I therefore conclude that there was no breach of duty to CCC, fiduciary or otherwise, by any individual Defendant during this period.

1509. I emphasise that this conclusion is based firstly on the grounds that, on any basis, I find that the decisions actually taken by the individual Defendants as directors of CCC during this period were well within the range of decisions which reasonable directors, endowed with the particular skills and knowledge of the actual Defendants respectively, could reasonably have reached in all the circumstances. This is enough to dispose of the Plaintiffs' claims with regard to August 2007.

1510. However, I also find that those decisions were in fact made with due and appropriate skill and care by the Defendants, and that they were, in fact, made by each Defendant in what he bona fide believed to be in the best interests of CCC, exercising actual independent judgement as appropriate, and without any taint of conflict of interest.

(c) Contractual/tortious claims against CIM

1511. With regard to the claims framed in breach of contract or tort against CIM, once again, I have held that the decisions made and advice given by Mr Stomber, whether as a director of CCC or as the manifestation of CIM, and also by Mr Zupon insofar as he retained involvement as part of the investment management team provided by CIM, were within the range of properly loyal and competent such decisions or advice, and were not negligent.

1512. On the basis that the standards owed by CIM were no more stringent than those owed by these two Defendants as Directors of CCC with particular expertise in the management of CCC's type of investments, I conclude that there was no breach of contract or tortious negligence committed by CIM either.

(d) Wrongful trading

1513. This allegation is first made in respect of August 2007. With regard to it, I expressly find that the situation was not such that the Defendants as directors of CCC either did or ought to have

concluded at this time that CCC stood no reasonable prospect of avoiding insolvent liquidation in the absence of setting about deleveraging by selling a large quantity of RMBS. This is principally for the reasons given by the Defendants.

1514. I make this finding on the basis of my previously expressed view of the correct interpretation of the applicable 1994 Law, namely that "insolvent" would mean "being unable to pay the company's actual debts". However, I cannot see that if the insolvency test were that of "being unable to pay its debts as they fell due" that would make any practical difference as there was equally no reason why the Defendants ought to have concluded that CCC stood no reasonable prospect of avoiding getting into a situation in the reasonably near future where it would be unable to continue paying its debts. The two tests seem to me to give rise to no practical difference. In laymen's terms the first involves the question "Do we foresee that there is no reasonable prospect of our avoiding becoming unable to pay our debts?" and the second would be "Do we foresee that there is no reasonable prospect of our avoiding becoming unable to keep paying our debts?" The difference is extremely subtle.

1515. I see no reason why the Defendants ought to have concluded either of the above. The important point is that the test is always that of "standing no reasonable chance of avoiding" the pertinent financial collapse.

1516. The business which CCC was conducting at and after August 2007 involved holding investments on a pattern of re-financing these on a 30 day cycle, staggered as regards about half of the total. The potential debts for CCC were three-fold: its obligation to pay interest on its current round of financings, its obligation to repay those financings at the end of their term and its obligation to meet margin calls made in the interim.

1517. The first was self-funded from the higher income derived from the investments and there has been no suggestion that this differential ever failed, or should have been anticipated to do so. It was, albeit slowly, bringing in funds. The second would be met by refinancing, and so the question becomes whether it should have been concluded that there was no reasonable prospect of avoiding failing to obtain repeat finance. As I have already indicated, I am satisfied that there was no reason to place the prospects of obtaining repeat financing so low. As to margin calls, the question becomes whether it should have been concluded that there was no reasonable prospect of avoiding being unable to meet margin calls. But margin calls were not even inevitable. They were contingent on several matters, being first a further (it is to be remembered) decline in the prices of CCCs' assets below where they were currently being marked, and also this happening at a point where CCC had neither enough liquidity of its own, nor enough recourse to Carlyle for assistance, to be able to meet such calls.

1518. Put positively, CCCs Directors only had to believe that there was a reasonable chance that CCC would manage, when it came to it, be able to meet these obligations, and I cannot see that this was an unreasonable view to take. The qualifying condition for a finding of wrongful trading is therefore not made out, whichever is the appropriate test of insolvency. I therefore reject the claim of wrongful trading at this time against all the Defendants.

11. <u>The Claims: SEPTEMBER 2007</u>

Did the Defendants culpably fail to review and change their strategy during September 2007?

General overview

1519. In the week or so after the 23rd August Board meeting, market conditions had improved slightly. CCC went into September having survived the 9th August liquidity crisis and having resolved on and taken steps to increase liquidity by selling credit assets to raise liquidity, and taking the supporting loan of $100Mn from TCG.

1520. At the beginning of September 2007, CCC's liquidity cushion stood at $66Mn (9.9%) according to the agreed extracted figures from CCC's daily "Capital with Cash and liquidity cushion management" files (as mentioned), although the Defendants suggest that the figure could be regarded as $146Mn if the projected future proceeds of bank loan sales are included. Its net asset value as at 31st August 2007 (and excluding the credit assets just disposed of) was recorded as $642,104,242. Over the first two weeks of September, liquidity increased as proceeds of the sale of credit assets came in, peaking at $105Mn (16.8%) on 10th September, before falling to $21.9Mn (and thus only 3.8%) immediately after the 15th September roll, when the last of the haircut changes agreed in August came into effect. By 30th September, liquidity had recovered to $48.5Mn (7.2%) and CCC's net asset value was recorded as $691,843,000. The Carlyle loan of $100Mn was fully utilised during this period.

1521. However, on the financing front, CCC's soft line repo capacity was recorded as having fallen from about $37.5Bn to just over $25Bn in mid-September, as against a usage of around $22Bn, and CCC was therefore operating, by the end of the month, with only around 10-12% excess available repo capacity, as against its most recently formulated guideline of 25%. Although it had never been obliged to accept any individual repo haircut in excess of 3%, its weighted average haircuts on finance in use had risen from 2.3% at the end of August, to 2.62% at the end of September.

1522. During September, though, market conditions had calmed somewhat from the turbulence of August, although the aftermath of the August liquidity crisis was showing up in an avalanche of ABCP securities coming on to the market. There was, even so, the opportunity to draw breath and take stock in less panic-laced conditions.

1523. There were, I think, three significant aspects to CCC's activity in September. The first was trying to work out an appropriate business model for which to aim. The second, and linked to this, was preparing for and making presentations at the Carlyle Investor Conference in Washington DC on 11th September. The third, and the most consuming of effort was the general ongoing activity of sustaining CCC's business, monitoring market events, monitoring prices (collecting and analysing information and data about pricing, and processing this to keep a close eye on prices and values for CCC's RMBS), monitoring the reactions of CCC's repo lenders with a view to anticipating and possibly contesting margin calls, and otherwise "working" the relations with CCC's repo funders in order to maintain the flow of CCC's financing.

1524. In setting out the story of September 2007, I again recount facts which I consider material, either directly or evidentially, to what I have dubbed the allegations of "effectual" breach of duty in the case, ie those which are alleged to have caused loss to CCC, and I set out my reasons for some of my findings where it is convenient to do so in the narrative. I also deal with facts relating to some allegations which are not claimed to have caused loss, because of the prominence which they have been given in the trial despite their lack of causative weight. Where I do not refer to an allegation or fact, this does not mean that I have ignored it but only

that I do not consider it of sufficient significance for my conclusions to merit separate mention. Also, in the interests of trying to keep down the length of this judgment, I do not record all of the detailed materials contained in the ALCO pack briefings and similar records which were widely examined at the trial, although I do make some references by way of example, or illustration of their scope and general flavour. I do not refer to all the evidence regarding day to day matters of only faint materiality, such as, for example all Mr Stomber's email updates, and email exchanges as part of market negotiations, press articles about CCC, and reactions to these, but I note and record that many of these were meticulously dealt with in the parties' submissions.

Early September 2007

1525. I have already recorded, in completing my account of August, the course of Mr Conway's efforts to arrange beneficial repo financing for CCC from Citigroup which continued into September and during the first half of that month in particular. I do not repeat it here.

1526. At the beginning of September it is clear from documents that Mr Stomber was giving consideration to a possible future business model for CCC, based on the potential for assets being obtainable at higher spreads (lower prices) than previously. They would consequently produce a greater yield, meaning that a greater return could be achieved with lower leverage. This, he considered, showed that CCC still had a viable future. However, such remodelling could only be put into practice once markets had become sufficiently stable - at whatever parameters they might then settle at - and when he and CCC's other directors were confident that this was the case.

1527. Mr Stomber's view, expressed in an "Update" email of 3rd September 2007 to CCC's directors, and copied also to Management and the Carlyle Founders and senior personnel, was that there was a business model for CCC which could work at a lower return relative to the current "risk free" rate but which would still be attractive. He stated that CCC "*and others*" had previously reached for too high a return and that CCC would be bankrupt without TCG support, observing also that many of CCC's comparator entities had gone out of business or had highly diluted their shareholders in order to survive.

1528. Of course CCC was not out of the woods, though. On 4th September, Mr Stomber recorded in an email that PwC had raised the question whether CCC would qualify as a "going concern" for the purpose of PwC's 30th September audit review, and also that Deutsche Bank was currently insisting on a 4% haircut in the future. The following day in a further general email he emphasised that CCC simply could not afford to go to a 4% haircut, because repo dealers were enquiring whether any of CCC's counterparties were at a rate higher than 3%, and they would plainly follow suit if they believed they were. 4% haircuts across the board would be simply unaffordable.

1529. In the end, first Mr Rubenstein and then Mr Conway used their good offices to persuade Deutsche Bank to remain at 3%. Mr Conway says that he felt confident of being able to persuade them back to this figure, even at the outset. I accept this; it fits with my general perception of how such negotiations often proceeded. Calyon, Goldman Sachs and Lehman Brothers had all held a 2% haircut. Negotiations with Citi, for a fairly large facility, were in train as I have mentioned above. I think it is very fair to say, though, that repo negotiations, now for the upcoming roll on 17th September, continued to be difficult and tense.

1530. On 4th September, Mr Stomber sent another "Update" email to CCC's Directors and also Messrs Rubenstein and D'Aniello, attaching PowerPoint slides recently created by his team and presaged in his 3rd September email, showing illustrations of possible business models for CCC. These were a first draft of slides which would eventually be used at the September Investor conference.

1531. They showed scenarios for comparison. The first was that if CCC's business had been launched using its original business model, but reducing the targeted return on equity to 11% instead of 13%, it would have been operating with a 38% liquidity cushion (instead of 20%). The second was that if CCC's business were relaunched at the current level of prices but with a targeted return of 11%, it could operate with a 63% liquidity cushion. These comparisons therefore suggested that a viable business model for CCC could be devised if targets for returns were reduced.

1532. Mr Stomber recorded that other entities which had aimed for a 13-14% return, as CCC had done, had not survived. Two (Caliber and Queenswalk) had already gone out of business; KFN and Thornburg were in extreme difficulty. Annaly, a long-established and very big player in the market, had raised additional equity capital to meet unrealised losses, with the effect of diluting shareholders - a course which, it is apparent, from the evidence, Mr Stomber fundamentally disliked. He also listed some matters which he called "mistakes", such as using too fast a ramp for purchases, and not tying in funders such as Bank of America to continue to finance securities purchased from or through them.

1533. The Plaintiffs characterise the statements in the emails of 3rd and 4th September as "concessions" that the Defendants had made a number of mistakes in their management of CCC. This is true as regards objective observable fact and its consequence, but I do not read these as being a concession of fault. I read these emails as a frank analysis of past events in order to learn lessons for the future. In any event, none of the allegedly conceded mistakes is within the ambit of the claims pleaded in this action.

1534. The Plaintiffs make much of the placing of a figure of around 40% on the level of liquidity cushion shown in the slides produced by Mr Stomber. They submit, and it was put in particular to Mr Stomber and Mr Conway, that this was a contemporaneous admission by CCC that CCC needed a 40% liquidity cushion to operate viably, an admission which was not implemented at the time, and an admission which the Defendants, in particular Mr Stomber and Mr Conway, were now trying to row back from. I do not accept that this is a fair interpretation of the documents, either. The slides were, and were obviously (it seems to me) illustrations of business models upon certain assumptions, which could be operated comfortably (as one would wish and expect to operate in stable times) in the postulated circumstances, and they were there to provide material for discussion. They were not an actual plan for CCC, nor a decision as to anything. It was as yet too soon after the crisis of August to make definitive plans.

1535. For the avoidance of doubt, I accept Mr Stomber's evidence that in his eyes the liquidity cushion was a guard against margin calls and not increased haircuts, this latter being a feature which would be inputted into the business model elsewhere. I also accept his evidence that whilst he saw Mr Hance's reference in their exchange of emails to a "liquidity" of 40% as being potentially confusing - because he (Mr Hance) was referring to liquidity in terms of cash needs, which was not the same thing as a liquidity cushion - he did not see the need to correct

Mr Hance, and he did not calculate a 40% liquidity cushion as being a target which CCC ought to achieve imminently. I am satisfied that his illustration of a business model incorporating a 40% liquidity cushion in late August 2007, was, as he said, a quick reaction to the shock of the sudden and recent credit/liquidity crisis, intended to show that CCC was not necessarily fatally wounded, and that it preceded a more measured assessment of the situation once some idea had been gained of how market conditions were going to develop, either with a return to the "normal" of before, or with a settlement into a new "normal".

1536. In cross-examination, and some time after a change of subject, Mr Stomber was shown his email of 7th September 2007, within which he said "*I am not debating a reduction in RMBS - a liquidity cushion of 40 per cent does that and we will do more"* and it was put to him that his recent explanations were contrived and that even at the time he had recognised that CCC needed a 40% liquidity cushion. The Plaintiffs rely on his enigmatic response of being "*trapped within my own language"* as virtually an admission of this, and evidence of his unreliability in evidence. I did not, however, perceive it as such at the trial, and having gone back over the transcripts I still do not see it as such. I saw it as a recognition of the language he had used in his contemporaneous email, and an ironic simultaneous recognition of how he feared it might therefore look in his oral evidence. I did not see it as an admission that he had been somehow caught out in his oral evidence, nor as being an implicit withdrawal of the distinctions which he had been making in earlier cross-examination between liquidity and liquidity cushion, and between an illustrative business model and an actual proposed business model. I actually found it quite difficult to see any necessary inconsistency between Mr Stomber's current explanation of what had been behind his thinking and the language he had used in the to and fro of email correspondence at the time. Insofar as there was any, it did not strike me as being of any great weight in the end, either as regards the main issues in this case or the reliance I could place on what Mr Stomber now tells me was his thinking at the time.

1537. There is a minor issue about whether the further developments of these slides, which were in preparation for use at the 11th September Carlyle Washington Investors' Conference, were really Mr Stomber's work (aided by his team) or were in fact prepared for him by Mr Conway. This proposition was advanced, as I understand it, as evidence of Mr Conway's dominance and control over CCC in general and Mr Stomber in particular. I am satisfied that Mr Stomber was the author of the CCC slides in substance; input from Mr Conway not being significant and being simply in the nature of a sounding board and making constructive comments. Mr Conway in fact produced his own slides.

Possible sale of $1Bn RMBS to UBS

1538. A possibility of CCC's selling $1Bn of RMBS to UBS emerged in early September 2007. In the early morning of 5th September 2007, Mr Glascott of UBS, made an enquiry on the Bloomberg messaging system looking for seasoned strip floaters. Later that day Mr Greenwood sent him a list of three securities, not quite corresponding with the descriptive details which Mr Glascott had posted, with an original face value of approximately $785Mn.

1539. The Plaintiffs relied strongly, in their opening, on the failure to show bonds directly corresponding to the description put forward by UBS, when in fact CCC had some such bonds, as evidence that CCC was not genuinely trying to sell RMBS at all, thus supporting their allegation that the Directors had made a culpable decision not to do so, for obstinately wrong or improper reasons. Later, the Plaintiffs appeared to modify this charge in the alternative to

one of incompetence. I examine this incident and how it played out in more detail below, in considering generally the evidence about whether the Defendants were genuinely amenable to selling RMBS or not.

6th September 2007 - ALCO Meeting

1540. The ALCO Meeting minutes of 6th September 2007, which Mr Sarles and Mr Allardice also attended, show Management concentrating on maintaining and working repo lines. There was no prepared pack of papers for this meeting, because of the rapidly changing events of the market. The Minutes indicate, as also appears from emails, that from about this time Mr Stomber started using the Carlyle connection aggressively, pressuring and playing the Carlyle card, in order to try to obtain the financing terms which CCC needed. Mr Stomber acknowledged here, and in an email update on 6th September, that the risks to CCC were now the linked risks of increasing haircuts and reducing repo availability. Effective haircuts were noted then as being about 2.3%-2.4% on average.

1541. The possibility of raising more equity capital was raised internally at around the time of the ALCO meeting of 6th September 2007. CCC's failure to do so in order to increase liquidity is a recurrent theme of the Plaintiffs' complaints.

Changes in market behaviour

1542. Changes in the behaviour of the financial markets are illustrated by a pair of emails circulated by Mr Stomber on 7th September 2007, which were headed "CCC Slides for DC (conference version)", but which in fact recorded Mr Stomber's bitter view of the way in which the repo banks were now behaving. He recorded that FT (IDP) prices for certain of CCC's bonds had risen by $58Mn, which meant that CCC should recover $5Mn of margin. However Credit Suisse, who owed CCC $3Mn in returnable margin had simply repriced the bonds which they held as collateral to their own, lower, marks, and retained the $3Mn. They had, moreover, done this after themselves providing to CCC the prices which had formed the basis of the return margin calls; they had thus challenged their own prices, after the event - a course of action which was against the conventional "rules" of the market. Similarly, Mr Stomber later reported a conversation by Mr Trozzo with the US head of credit risk at UBS, to the effect that whilst a 2% haircut well covered their risk, they had demanded 3% because they "could", and because their mandate was that there should be "*no losses, full stop no losses*".

1543. These were examples of changes in the way lenders in the market were now behaving, but Mr Stomber recorded, nonetheless, that his basic intuition was still that CCC's policy of selling credit risk securities, and protecting their RMBS with its minimal "*govt risk*" would ultimately be rewarded.

1544. At the same time as the above, the problems with CCC came to the attention of Mubadala, and had to be explained. A matter which I have already touched on elsewhere, but I mention it hear to put it into time context.

1545. On 5th September 2007 the Washington Post published an article by Steve Pearlstein, in popular financial journalism style (and, interestingly, raising many of the matters of criticism and complaint made in this action) criticising Carlyle's embarking on a venture such as CCC in the first place, and publicising with an appearance of glee and also some exaggeration, the steps which Carlyle had had to take to support CCC. The criticisms of Carlyle's business

acumen annoyed those in the top ranks of Carlyle, and particularly, I think, Mr Rubenstein. The article was picked up by Mubadala's negotiating representatives, who on the following day cited it as underlying their valuation concerns.

1546. To reassure them, on 7th September at a meeting between Carlyle and the Mubadala professional team, Mr Conway "walked them through" Carlyle, to explain the position and put the difficulties with CCC into perspective as regards the Carlyle Group as a whole. Any immediate effects of this are not recorded, but ultimately Mubadala's concerns were clearly allayed, because, as previously noted, on 20th September, their acquisition of a 7.5% interest in the Carlyle Group was publicly announced, with completion fixed for 10th October 2007.

11th September - Carlyle Investors' Conference in Washington DC

1547. Mr. Hance and Mr. Stomber gave a presentation at Carlyle's September 2007 Investor Conference. Whilst CCC was of course a significant topic at this conference, the perspective needs to be retained that it was not the only one.

1548. All members of CCC's Board, save Mr. Sarles, attended. The presentation about CCC made by Mr Hance and Mr Stomber was in three sections: "*A market overview; What happened and where we are today*", "*Near term strategy: Preserve investor capital and bolster liquidity cushion*" and lastly the "*Long-term strategy and outlook: Achieve stable returns.*" Various slides were presented under these heads, containing facts which indicated, first what CCC's original business model had been and why it had not been entirely resilient to the recent market disruption, second what CCC had done in the interim to meet its problems and what its business now comprised, and third, some illustrations as to how CCC's business might be remodelled in the future, at different spreads, parameters, and returns.

1549. A good deal of time and argument has been devoted to examining the CCC presentation by Messrs Hance and Stomber and the slides supporting them, even though this is again of no direct relevance to any of the claims which are made in the action, and, on analysis, hardly any indirect relevance either. This presentation did not affect CCC's financial position, and its materiality to events which are pleaded to have done so is slight.

1550. The Plaintiffs' reliance on this conference presentation has two strands and apparent purposes. First, at the conference it was publicly announced that the CCC presentation would be viewable by webcast and that the video would be available for 30 days on the CCC website. In fact what happened was that in the course of the CCC presentation, Mr Hance made an unscripted remark, that the book value of CCC's shares was currently around $16. A few days later Ms Cosiol became aware of a Dow Jones article reporting this figure, and could not understand how it had been arrived at. Mr Hance could not recreate his thinking, and it was not at all clear from looking at CCC's published figures how the $16 figure could be supported as accurate, on any basis. Ms Cosiol therefore sought external legal advice as to whether it was permissible to take the video of the presentation down from the website, and on receiving advice that it was, she had this done on 28th September, and thus somewhat earlier than the promised 30 days.

1551. Mr Hance's remark is pleaded by the Plaintiffs to have been inaccurate and misleading of the market, with the innuendo that there was something sinister and culpable about the whole sequence of events. They note specifically that it has not been possible to find the record of the presentation, and suggest that it was therefore presumably destroyed.

1552. I cannot see anything sinister in this course of events. I am satisfied that this was just the kind of mistake that can occur in live presentations - and which lawyers are kept on hand to be vigilant about, so as to deflect any untoward consequences. I do not find that it was anything more than that. The allegation also has no materiality that I can either see or construct to the claims actually made in the action, as there is no plea of any resulting damage to CCC. At the most, therefore, it could only go to credit, and I find it to have no significance on this aspect either. I therefore dismiss it.

1553. The Plaintiffs' second point about the conference presentation concerns the draft slides and what they are said to have conveyed, in particular with regard to the business models which were shown. This point was argued, and put to the relevant Defendants (Messrs Stomber, Hance and Conway) in two ways. The first was that these business models represented to investors that, at this time, CCC had *already* deleveraged so as to be operating with a 40% liquidity cushion, and they were therefore a culpable misrepresentation of fact, misleading investors. The second was, alternatively, that the slides either were, or gave the impression of being, actual plans or actual models representing that CCC was *going* to operate in the future with a 40% liquidity cushion - in which case they again culpably misled investors and were either a misrepresentation of intention, or of fact (if the Defendants claimed that no business model had then yet been decided on).

1554. I unhesitatingly reject the former. I can see nothing in the slide material which would promote the belief that CCC had already transitioned to having a 40% liquidity cushion. The Defendants have referred to evidence which they have collated, and which they submit suggests that no-one who actually attended the conference interpreted the slides in that way either, and this appears to be the case. (The unreliable Mr Shah seemingly did so rely, but he was not there.)

1555. As to the alternative criticism, that of a representation of intention, I also reject the suggestion that, on a fair interpretation, these slides made any clear representation that this was what CCC "would" be doing so as to amount to a warranty of intention (which is in effect what the Plaintiffs' submission means), still less a warranty with some sort of timescale attached to it. I find that the second section of the slide presentation about CCC which I described above, sufficiently explained the "capital preservation strategy" which was to be CCC's immediate approach and, by very clear implication, it revealed the intention to hold CCC's RMBS and aim to ride out the disrupted markets; the belief that CCC was in a position to "weather" the current turbulent market situation was expressly stated. These slides are found in the third section of the slide presentation. I find that the highest reasonable interpretation is that the presentation slides implied that changes designed to move towards some such new business model as was illustrated were intended to be implemented as soon as CCC's Management deemed this practicable. That, though, is consistent with the truth.

1556. In context, and even independently, I find that these slides were nothing more than an illustration of what CCC might look like, or aspire to look like, in the future, as and when steps to shape a new business model in a more stable market environment could be taken. I cannot see that any reasonably intelligent and informed participator in the Investor Conference would or could have interpreted these slides in any other way.

1557. Once again, though, this allegation of "misrepresentation to the market" simply misses the point. It has no relevance to the claims made in the action, which are charges of a culpable

failure *in actual fact* to institute an immediate or progressive disposal of RMBS. These slides could only have materiality to that allegation if they could be argued to show that CCC's directors were aware of the necessity to sell RMBS as the Plaintiffs postulate they should have been. Not only is this assertion not actually made, but it would be an impossible interpretation of the slides in any event, not least because the intention not to sell RMBS was clearly revealed in the slides themselves.

1558. Mr Conway also included several slides relating to CCC in his broader presentation regarding Carlyle generally. They set out, in an elegant sequence and style, where the CCC model had gone "wrong" in the circumstances, once more indicating what changes it was intended that CCC would be making, "moving forward". The slides proclaimed as one point "*We thought we could pay a reasonably certain 10% plus dividend, but we can't*", thus (incidentally) scarcely leaving any investor in doubt about reduced dividend prospects.

1559. Again, these slides clearly convey, I find, a vision for the future, rather than a representation as to CCC's current business model, or one that is about to be introduced – and with no promises about timing except the obvious suggestion that changes would be implemented as soon as feasible. Once again, moreover, their supposed relevance is, in any event and at best, merely as to credit rather than as to the substance of the Plaintiffs' claims.

17th September - repo roll and support from Carlyle

1560. As 15th September was a Saturday, the crucial repo roll for Freddie Mac securities would take place on 17th September. On the afternoon of 14th September Mr Stomber provided an email report to the Board noting that CCC had $116Mn in liquidity but was expecting to use about $50Mn of that to meet collateral demands at the 17th September repo roll. He reported that repo availability had been negotiated, although with some increase in haircuts taking place, either nominally or through the backdoor method of lowered price marks. In fact, the repo line with Deutsche Bank had been frozen at $1.8Bn on the alternative of higher amounts being subject to a 4% haircut. (CCC was in fact never able to return to 30 day repo with Deutsche Bank, although it did succeed in obtaining a 2 week rather than a 7 day facility over the year end.)

1561. At about 6.30 pm Mr Allardice exchanged an email with Mr Stomber to the effect that "*if everyone stays at 3% and we don't have further price erosion we should be ok. It feels like we are near the bottom*". Mr Stomber agreed but said that CCC might need another $50Mn for safety. That evening he emailed Mr Conway to say that he thought that CCC had a 65-75 % chance (in their submissions, the Plaintiffs, inaccurately and tendentiously, report this as "*only"* a 65%-75% chance*)* of meeting all new haircuts without drawing on the $100Mn bridge loan which Carlyle had advanced in August, although there was a possibility that it might later need an additional $50Mn owing to potential new haircuts being imposed. He said that the alternative to the further $50Mn would then be to *"fire sale assets and raise liquidity"* but that "*This is more of a Carlyle decision than mine…"* . Mr Conway replied, saying, "*If we need it and things are roughly as they are now you will have it. Without fireselling assets.*"

1562. The Plaintiffs rely on this exchange as evidence of Carlyle's "control" of CCC, and of Mr Stomber's being subservient to Carlyle and having regard to the interests of TCG rather than those of CCC, in breach of his duty. I reject this and agree with the Defendants' more measured interpretation. As explained by both Mr Stomber and Mr Conway, this was simply an acknowledgment of fact, namely that Carlyle could decide whether or not to provide any

further financial support for CCC and was not obliged to do so, but that if it did not, a fire sale would likely be the only option. Moreover, the response is consistent with what I find to have been a general pattern of willing support for CCC from Carlyle - albeit, I am sure, support which Carlyle regarded as being in its own interests just as much as CCC's, and not necessarily being unlimited. There is nothing extraordinary, or wrong, or sinister in that.

1563. The Plaintiffs point out in their review of CCC's repo arrangements at the time, that at this roll CCC only obtained repo with a tenor (term) of one week from BNP Paribas, UBS, Citi and Deutsche Bank. They cite this to invite the inference that CCC's repo financing was ultra-precarious and obviously so. However, I am far from satisfied that this is the explanation. From the evidence, it appears to me to be more likely (except in the case of Deutsche Bank, who, with Lehman, turned out to be CCC's most consistently "difficult" counterparties) that this had to do with the expectation that the Fed was about to lower interest rates on 18th September. For CCC this would be good for the likelihood of raising RMBS pricing, but bad for paying repo interest at rates fixed at the old level. Adjusting repo terms immediately following this would give CCC the advantage of potentially gaining the effect of beneficial pricing adjustments earlier than the next repo roll date. In any event, I do not see this as a point of great significance, especially as most if not quite all (ie not Deutsche Bank) the material repo finance subsequently returned to its 30 day norm.

1564. CCC continued to monitor prices, events and trends in the market. On the evening of 18th September, Mr Stomber sent his habitual update email to the Board. There were a few encouraging points such as that CCC had received back $15Mn of margin as RMBS prices had improved, and that liquidity was up to $82Mn. He noted that there was prospectively a forced sale auction of up to $1.5Bn in AAA floaters coming within the next 10 days, and that the results of this would be a "*test for the market*". The importance of this is easy to see, and Mr Stomber would no doubt follow it with interest. It has emerged that this was in fact one of the "Westways" fund auctions which have assumed some importance in the expert evidence about markets, price trends, and the question of what prices CCC could and should have obtained if it had sold RMBS from this time, as the Plaintiffs argue it should have done. I will revert to this below.

1565. Mr Stomber also reported that Deutsche Bank had claimed to *"sell $700Mn of 7% caps at 57 over* [ie 57 basis points over LIBOR] *last week"*. This was seen as an encouraging sign of improved demand in the secondary market. It was also no doubt of assistance regarding price levels, but Mr Stomber also said that the transaction was not of a size to suggest that a party such as CCC could expect safely to transact greater volumes. I also note that whilst 7% caps were held by CCC, this was only about one third of its total holding, the remainder being 6.5% or 6.75% caps, which all the evidence suggests were intrinsically less attractive and less valuable than 7% caps.

1566. On 18th September, the Federal Reserve announced an unexpectedly large cut in the Federal Funds Target rate by 50 bps to 4.75% to improve liquidity conditions generally, so as to "*forestall some of the adverse effects on the broader economy*" of the current liquidity squeeze. This immediately caused a fall in LIBOR. It was generally received as an encouraging sign with regard to Fed intervention.

20th September - ALCO Meeting

1567. Mr Stomber did not attend the 20th September ALCO meeting, which was therefore chaired by Mr Trozzo. Mr Allardice did attend by telephone, and he actively participated, suggesting some additional information columns which could usefully be included in the routine ALCO pack information templates with regard to haircut levels and repo rolls. I have previously commented that the evidence shows that Mr Allardice took significant active involvement in his role as a director of CCC.

1568. Apart from the usual reviews of markets trends, metrics and so forth, the meeting's discussions centred on the course which had been decided by the 23rd August Board Meeting. It was noted that there were several "fails" recorded in CCC's investment guideline compliance indicators which were collected for inclusion in the ALCO pack materials for review, with the repeated explanation that these were because of the extraordinary events of August and a note of the measures taken in consequence. It was in order to remedy these "fails" and to reflect the reality of CCC's current situation that it was discussed and resolved (Mr Stomber having previously requested this discussion) that CCC's Investment Guidelines ought to be amended, especially as to their minimum liquidity cushion and asset allocation requirements, and that the proposal should be circulated to the Board with a request for the Independent Directors' approval. The justification was that this was "*necessary due to the activity in August and the impact on CCC's portfolio"*. This discussion was to culminate in the request to the Independent Directors, made on 1st October 2007 and referred to below, to approve the suspension of the liquidity cushion guideline, the minimum borrowing capacity guideline and the asset allocation guideline, until the end of the year.

1569. The prospective Westways auction was also brought to ALCO's attention as a transaction to be watched. A pronounced decline in new CMO issuance by Fannie Mae and Freddie Mac in August was noted and explained, by Mr Greenwood, as being attributable to the "*high inventories of secondary paper that dealers were looking to sell*…." causing reduced demand for new issue. This would suggest that there was plenty of supply of similar existing bonds in the market, although of course bonds are individual and the precise characteristics of existing bonds are fixed, whereas new issuance bonds can be tailor-made.

1570. Later that same day, Mr Stomber reported the results of what was apparently this auction, as "*not being a fun day"*. This was because the $1.4Bn of Agency capped floaters which had reportedly been sold, at about 67 bps over LIBOR, was in his view an influx of supply into the market which had caused a price decline in the value of such securities, which were also held by CCC, and resulted in a $5Mn margin call. A $13Mn call from Lehman Bros came the following day. Mr Stomber said, in evidence, that this event served to reinforce his view about the difficulties of selling a large volume of Agency capped floaters into the market, and the likelihood that it would depress prices.

Repo line negotiations continue to be fraught

1571. From around mid-September CCC's recorded negotiated available repo capacity fell significantly, from a previous level of around $35Bn or above, to around $25Bn.

1572. I have already referred to the gradual introduction of a higher rate haircut by Citi, on its very substantial line, and also the prospect of Deutsche Bank insisting on a 4% haircut in early September, and the difficulties that this would cause to CCC. When Deutsche Bank eventually did agree to drop back to 3% (CCC was never, in actual fact, required to meet a nominal haircut higher than 3% before the ultimate cataclysmic events of March 2008), the papers

show that one of the reasons for Deutsche Bank wanting a higher haircut for a larger line was because it was perceived that "*a liquidity premium on the portfolio"* was needed *"when we repo such large positions (in case we ever have to liquidate)".* This obviously recognises that a fire sale or a distressed sale of assets is likely to realise a lower price than a sale between unpressured parties. It also recognises, it seems to me, that the large size of a block similarly tends to lead to lower prices.

1573. From about 19th September, CCC had had a difficult negotiation with Credit Suisse, who were providing repo at 3%, but asked CCC to roll away over the quarter end (which meant the 25th September repo roll) for its own balance sheet reasons. When CCC said it would prefer not to do so, Credit Suisse quoted a haircut of 5%, effectively, therefore, compelling CCC to roll away. They did, though, immediately promise to restore the line for the following roll at the same 3% haircut as before, and they honoured that promise.

1574. Mr Stomber interpreted this as part of the dance of negotiation which I have mentioned in general terms, and which is widespread in this business. He read it as occasioned by short term internal pressures on the bank, a *"balance sheet issue"* about which his counterpart, Mr Aikenhead, *"can't tell me in an email, or he'll get fired"*. I find this view to be confirmed by the immediate reinstatement subsequently of the soft line availability, on reasonable terms, with a view to maintaining good business relations in the longer term. It is also supported by internal documents obtained from Credit Suisse, from which it is clear that Credit Suisse's credit officer had already been asked to confirm, (and had done so) that a 3% haircut on CCC's repo was approved.

1575. Mr Stomber had been pressuring Bank of America to reinstate its repo line. The need to roll away from Credit Suisse for the 25th September repo roll put pressure on CCC's promised availability of soft repo lines, as recorded by Mr Stomber in an email of 21st September, in which he reviewed where funding for this roll needed to come from. In fact, Bank of America (Mr Duffy) confirmed that they would make a $2Bn line available in October, thereby relieving the pressure.

1576. However, during the Credit Suisse conversations, Mr Aikenhead of Credit Suisse had stated, in an email to Mr Stomber on 24th September 2007, that 5% was currently the market standard haircut. The Plaintiffs put forward this statement as a major reason why CCC's Management should or would have expected to see haircuts increasing above the 3 % level. For the reasons given above, I am satisfied that it was not. I am not sure how closely Mr Stomber actually read the detailed position at the time, but I do accept his evidence that he did not regard the statement that 5% was "currently market standard" as being true, or that Mr Aikenhead genuinely believed it to be, and I find his beliefs to have been reasonably held. This is an example - and this time from outside CCC - of the kind of statements which get made for the purposes of negotiation but which are not solemn representations of truth by the parties at the time, and are neither expected nor believed to be such. This incident is also an example of the need for reading between the lines when interpreting what is really going on in communications in these markets, and the dangers (of which I am satisfied) of jumping to superficial conclusions. It also shows that Credit Suisse, for one, was anxious to provide facilities for CCC because of the pull of further potential Carlyle Group business, and that the reality was that this was an advantage which CCC could exploit.

1577. The Plaintiffs have suggested forcefully that at this time CCC was "running out of room" with regard to repo availability, and that this fact was not given proper significance by the Defendants. I accept that the recorded reduction in available soft line resources in mid September, apparent from ALCO pack materials, was significant and it also made the negotiation of repo more fraught. I also accept that there was something of a "take one day at a time" approach to the operation over this period, but this had, I think, been anticipated by Mr Stomber, and the situation was reported to the Defendants generally. It was part of the plan considered at the 23rd August Board Meeting that the repo lenders would no doubt have to be "worked", and the fact is that CCC did succeed in obtaining repo funding which was adequate to meet its actual needs during this period.

1578. Mr Stomber also noted in this email that CCC's portfolio was gradually reducing owing to natural amortisations, and that by the second of the October rolls, this would have reduced by about $400Mn which would slightly reduce requirements. This was, of course, one of the underlying planks of CCC's strategy. The Plaintiffs point out though, and with justification, that the rate of reduction relative to the size of CCC's portfolio was very small. Without more, it would in fact take very many years to achieve the kind of reduced exposure which (they submit) was plainly required.

25th September – repo roll

1579. Having been able to move the Credit Suisse financing to other banks over the 25th September roll, Mr Stomber reported back to the Board in his update email that evening that CCC had rolled its repo and recovered $9Mn of margin, taking liquidity to $88Mn. The weighted average haircut even fell slightly from 2.62 % to 2.6 %. Mr Stomber also noted that CCC would start using the new Bank of America repo line in early October to bring down the amount outstanding on Citi's line, so as to encourage Citi to be willing to assist CCC for a longer period. Thus, the repo lenders continued to be "worked".

1580. Citi, Deutsche, Lehman and UBS were CCC's main repo providers at this time. Nominal haircuts were at 2%, 2.5% (Citi) or 3%, although conservative pricing raised the effective haircut, as mentioned above. Bear Stearns, BNP Paribas, Calyon, ING and Merrill Lynch were providing lesser lines of around $1Bn of which only Calyon remained at 2%. However, the overall position was that CCC was proving able to cope with this pressure on loan to value ratio.

1581. CCC had recognised its vulnerability to "funding risk", as is clearly stated by Mr Stomber at the ALCO meeting of 6th September 2007. Consistently with statements made at the Investor Conference of 11th September, from mid-September, Mr. Stomber, Mr. Hance and Management were in negotiations with Wachovia, one of Carlyle's main banks, to obtain a 364-day term repo line, which would obviously provide more stability. Negotiations initiated through Mr Hance appeared to be positive, although it was noted that Wachovia was not a seasoned repo lender.

1582. On 26th September, Mr. Burlingame of Wachovia emailed Mr Stomber and Mr. Hance, stating that the move towards concluding such an agreement had received final approval within Wachovia subject to final documentation. The facility was to be for a $2Bn line, with resettable interest rates based on 1 month LIBOR and a fixed maximum 3% haircut. Mr Stomber and Mr Trozzo regarded this as a major breakthrough.

1583. At the end of the month (30th September was a Sunday) the position was that Wachovia had agreed to work from CCC's documentation and would do their best to turn matters around quickly. Attempts to negotiate longer term repo with Sumitomo and another lender, though, had not been successful.

Prospective going concern analysis

1584. Towards the end of September – 26th September to be precise – the question of PwC's prospective third quarter financial audit of CCC, and in particular the evaluation which they would then be undertaking of CCC's ability to continue as a "going concern" emerged in a telephone conference call between Mr Reville and CCC's accounting team, consisting of Mr Green, Mr Rella and Mr Allardice. Mr Green sent an alerting note about this to Mr Stomber, Mr Hance, and the in-house Carlyle accountants (Mr Nachtwey and Mr Buser), pointing out what PwC would be looking at. This would include a budget or cash flow forecast, and a sensitivity analysis with regard to future events such as possible changes in market prices and the "advance rate" (apparently meaning the haircut).

1585. This produced a flurry of email responses. On the same day, Mr Nachtwey responded with a summary of the requirements of US GAAS (Generally Accepted Auditing Standards) which PwC would use, noting in particular that this would be likely to mean looking forward for a period of one year beyond the next opinion date, and if it appeared necessary, would include reviewing management plans regarding disposal of assets, borrowing money or restructuring debt, delaying expenditure or increasing equity ownership, and so on, and the feasibility of such matters.

1586. Mr Buser's simple summary of the position was that *"The audit issue is a judgement call as to whether the entity has sufficient resources to fund its obligations for at least 12 months"* and he voiced concerns that TCG would need to be very careful about commitments or guarantees of CCC, or waiver of fees, as this might be interpreted in accountancy terms as rendering TCG a "primary beneficiary" of CCC and requiring consolidation of accounts.

1587. I have noted this, and am satisfied that the concern about consolidation of accounts would be a reasonable one in general terms, that is regardless of whether CCC were in any financial difficulties or not, simply because of the complications which this would have entailed, and which practical considerations would therefore make it preferable to avoid if possible. For present purposes, though, I find that its interest lies in the fact that this immediate reaction shows a general understanding that TCG would be likely to be willing to support CCC.

1588. Mr. Stomber responded to everyone including Mr Conway, Mr Hance and Mr Alladice on 27th September, in an email headed "Natural cash generation – going concern" explaining, for transmission to PwC, that the portfolio would generate $150Mn in cash over the next twelve months, and the current position was that:

> "*[A]ll dealers who were to change margins have done so – that was a one time cash draw.*
>
> *The volatility of our margin calls on price is low and has been cash positive for the past 4 weeks.*
>
> *We have $87 MM of liquidity today.*

We have $5 billion of new repo lines… of which $2Bn is locked for 364 days.

We are profitable for the first nine months [of 2007] despite the one time loss associated with selling bank loans.

Our portfolio has no credit risk – it is quasi-US government [securities] that repays at par.

Our portfolio self-generates a large amount of cash and a reasonable level of income.

$4bil of 7% caps have traded in the past two weeks at about 60 over – if [CCC] had to sell to raise cash, there is a market in September that has transacted size.

In summary – every day in September has been better than any one day in August…".

1589. The Plaintiffs dispute the accuracy of some of these points. As to the fourth point, this is on the grounds that some of the allegedly "new" repo lines were actually returns of old repo lines, and the final point is, of course, an unfortunately premature assumption about Wachovia, although I find it was understandable at that point in the negotiations. The eighth point may, I think, be a generous interpretation of volume when the figures are examined, and it of course says nothing about prices. I accept, therefore, that Mr Stomber was putting forward all the positive points that he could think of in this email. I am still satisfied, however, that it gives a reasonable bird's eye view of the position at the end of the month and is also accurate in the final sentence, which I have no doubt also accurately recounted Mr Stomber's feelings at the time.

1590. This positivism is corroborated by the fact that when copied in on Mr Green's original email, Mr Trozzo responded in very upbeat terms, although it is clear that this was especially because of the hugely welcome prospects of the Wachovia finance. But of interest here is the fact that he recorded that if CCC ran into more liquidity pressure, CCC could sell RMBS, because "*we do not plan or hope to right now but it is an option available".* This is, I find, consistent with the strategy of holding on to RMBS but not being averse to selling, if it were worthwhile or appropriate. If the policy decision had simply been not to sell at all, then this would not have been natural wording.

1591. This is as far as this "going concern" issue progressed during September. My overall clear impression from this early correspondence is that the question was regarded as one which it was only natural for the auditors to be raising, because of CCC's obvious liquidity issues, but that the fact that it was being raised was in itself no indication that PwC had made a decision that there was real doubt about CCC's viability. Demonstrating this positively, though, was a matter that would have to be addressed. Mr Stomber – not an accountant but with a passionate belief that CCC could survive and ought to survive - was simply anxious to know what was needed to achieve this, and to ensure that all the positive indications available were drawn to PwC's attention. I defer further consideration of this matter to October/November 2007, which is the timescale to which it is most material.

1592. However, there is one document which I do need to mention at this point, which has played a large part in the Plaintiffs' criticism, spearheaded by their accountancy expert, Dr Holstrum, of the reliability of the PwC going concern review and its endorsement of the view that CCC qualified as a going concern at the end of September 2007. This is an "RMBS Repo Status

Report" in a version dated 26th September 2007. It is a table listing all (then 14) of CCCs' repo counterparties, giving the quantity of repo lines available and actually in use, divided as regards Freddie Mac and Fannie Mae securities, next repo roll dates, current and original levels of haircut, totals, and other information with regard to repo lines obtained or potentially available in the future. It also contains a column for comments. Although it is not clear exactly when this document was prepared, it seems reasonable to expect, and I therefore assume, that it had been prepared by the end of the month - it certainly lists "next repo roll dates" as potentially 1st October 2007 in many instances. It was a document apparently prepared for internal use by CCC's Management.

1593. The reason why this document is controversial is that there are at least two further versions of it, although these are both dated 30th September 2007, and were clearly prepared later. The first was prepared for presentation to PwC in connection with its review of CCC's 2007 Third Quarter financial statements, and there is a further copy of this with a few handwritten notes made on it by members of the PwC review team. The other, which is almost but not quite identical to the version just referred to, was presented to CCC's 13th November Board Meeting. There are differences between these versions and the 26th September document, in that not only have some figures been amended (which one might well expect owing to the date difference, or a need for correction) but certain negative remarks or explanations contained in the comments column have either been removed, amended or truncated to present the position in either a neutral or seemingly more positive light than did the 26th September 2007 version.

1594. I will leave my findings about the importance of the fact of these amendments to consideration in relation to CCC's position in October/November. The important matter for present purposes is the state of knowledge of the Defendants as directors of CCC, or of CIM (effectively Mr Stomber and his management team) as regards CCC's financial position, its risks and its prospects. In considering, the Plaintiffs' complaints against the Defendants focusing on 30th September/1st October 2007, I make it clear that I have measured these complaints treating the content of the 26th September 2007 version of this RMBS Repo Status Report as giving the full and true state of play in this regard at that time.

1st October 2007

1595. The Plaintiffs include this date in this section of their claim because it brings within it the upshot of the request, foreshadowed from the 20th September 2007 ALCO Meeting, that the Independent Directors should approve a three month suspension of the liquidity cushion, minimum borrowing capacity and asset allocation guidelines of CCC. They say that this was, therefore, the obvious point at which the Defendants, in particular the Independent Directors, would have had brought to their attention the question of then diligently reviewing the whole question of the purported "capital preservation strategy". The request was in fact circulated to the whole Board although only requiring approval of the Independent Directors. This was, Mr Stomber said, because it was a major decision. It was presented, however, in a short email as "*A clean-up for corporate governance*". The Plaintiffs criticise this as a shockingly superficial and casual approach to such a serious matter.

1596. Within an hour Mr Conway had replied with approval as did Mr Allardice shortly thereafter. Mr Loveridge and Mr Hance both responded that evening, and Mr Sarles the following day. Mr Zupon did not respond; he said that this was because he was a non-voting director, although he was in fact in agreement. His given reason seems to me to be plausible, but I also

think that his reticence owed something to his strained relationship with Mr Stomber and the fact that by this time he regarded himself as an outsider as far as CCC's operations were concerned.

1597. The Plaintiffs criticise this event as a serious breach of duty by the Independent Directors. In itself it has no causal connection to the damage claimed to have been suffered by CCC – it is the failure to sell RMBS which is the nub of the complaint and suspension of mere investment guidelines has nothing to do with this. It was, though, part of general corporate governance processes relating to CCC's business, and it was also a natural consequence of adopting the capital preservation strategy complained of. It has figured very large in the Plaintiffs' arguments.

The claims - September 2007 and 1st October 2007 – summary of arguments

1598. At the Board Meeting of 23rd August 2007 the Defendants had made or approved a decision not to sell RMBS but rather to liquidate credit assets, withdraw from commitments to purchase other assets, take a loan from TCG, and not to sell RMBS unless a favourable opportunity arose. I have found that, at that time and in the circumstances, those decisions were no breach of duty by the Defendants, being neither improperly motivated or made for improper purposes, nor being negligent. They were a reasonable reaction to current circumstance, as a matter of proper and responsible business judgement.

1599. This last aspect - failure to sell RMBS - is the core allegation of breach of duty made by the Plaintiffs, and their ensuing arguments are therefore that to continue subsequently with that policy was conduct which itself became a breach of duty. Their next argument is that it did so in and from September 2007. With the opportunity to consider the position, with market conditions having calmed down somewhat in September although still remaining extremely difficult for CCC, they say (in effect) that the Defendants ought at least to have revisited and reviewed the August decision and then decided to take the "required action". In carrying on as before whilst only holding the highly leveraged RMBS assets, CCC was operating at a leverage ratio of an extraordinary, unprecedented, and hugely dangerous 37x. After August, in September 2007 therefore, CCC still required to deleverage urgently, and in the absence of obtaining further capital, that meant selling RMBS.

1600. The Defendants' essential response to this remains that the balance of risk and benefit of the two courses of setting about selling RMBS or holding on to them continued to favour the latter course. The Defendants say that this is in fact the case on an objective view, but they also submit that it was certainly a view which a duly diligent, loyal and competent director of CCC could reasonably have held.

Plaintiffs' case

1601. As to particular matters showing that the Defendants were, or ought to have been well aware of the pressing need for such action, and therefore supporting their key allegation, the Plaintiffs make submissions, greatly summarised, as to the following.

1602. They submit that Mr Stomber's emails of 3rd and 4th September show that he believed (and conveyed to the other Defendants) that CCC required a liquidity cushion of 40% to operate viably. They further submit that the similar presentation slides at the Investor Conference on 11th September effectively made the same representation by CCC's directors to investors, to

the repo lending banks and to the world at large. They submit that this carried the implicit representation that this requirement was therefore the model that CCC was transitioning to, and within this was the equally implicit recognition that substantial deleveraging from the previous position was required. All this showed that CCC needed, and the Defendants knew that it needed, to sell RMBS.

1603. I have already rejected the Plaintiffs' submissions that the slides amounted to representations or warranties, but the Plaintiffs are of course entitled to rely on the contents of the slides as evidence of the Defendants' knowledge or thinking. That is what I am concerned with here, and since it has formed such a large part of the Plaintiffs' cross-examination, I will also say here that I am satisfied, and I find, that Mr Stomber's thinking at the time (early September 2007) was that CCC's business ought to operate with a liquidity cushion of approximately 40% liquidity in the future. This is because there seems little point in his including such figure in his illustration otherwise. However, I equally find that that figure was, at the time, a target at best. It therefore may disclose Mr Stomber's thoughts at the time, but it has no more significance or evidential materiality than that. It was a useful aspiration, but in itself it says nothing about how to achieve the transition from the then current state of the business to the target state, and it is only this latter consideration (ie what to do) which could be in point, because I am here concerned with the supportability (or otherwise) of the immediate operating decisions which were being made about CCC's business, in the state in which it then was.

1604. The Plaintiffs then point to various financial metrics noted in the ALCO Pack papers for 20th September 2007, which all the Directors had had circulated to them. They point to the new high of the RMBS price volatility index, measured at 1.20% by 17th September, and the liquidity cushion ratio to capital of 3.8% at 17th September and 7.2% at 28th September, thus way below the 20% fundamental requirement of CCC's original business model, let alone the 40% now recognised - they say - to be required. They point to the "*perilously low*" liquidity cushion to VaR ratio shown as being only 0.2% in September, and the fact that in absolute terms CCC's RMBS had shown a loss in value of $239Mn (that is, in practice, just over 1% or 100 bps) up to the end of September 2007. This sum was the approximate total of margin calls suffered by CCC. All these points, they submit, showed the continued urgency of substantial deleveraging in order to increase liquidity and alleviate the position, ie the urgency of selling RMBS.

1605. The Plaintiffs stress the difficulties which CCC was experiencing in obtaining repo finance on affordable terms, indicated by the lengths to which Mr Stomber had had to go and the precipitous reduction in its recorded repo line availability. As an example of the former, they argue that he only procured Bank of America to agree to provide a vitally necessary $2Bn repo line by "threats" that Carlyle would withdraw lucrative investment banking business from Bank of America if it did not step up and assist CCC. They submit that a correct evaluation of this evidence and the negotiations which took place with other repo lenders shows that there was increasing difficulty for CCC in maintaining its necessary repo finance, and that this was indicative of a company on the verge of collapse.

1606. They submit that CCC needed at least $10Bn of excess soft repo lines at this time to secure its position - which figure I take to reflect CCC's original investment guideline of maintaining a minimum borrowing capacity of 150% of actual requirement - when, in reality, it had none. Its repo capacity had reduced to 113% of requirements in September, but the precariousness of even this was demonstrated by the difficult negotiations taking place in all directions. They

submit that this was, or should have been obvious to the Defendants, Mr Conway having admitted in evidence that CCC was "*in a tight spot*" with regard to its repo funding. They submit that proper evaluation of the evidence shows, similarly, that CCC was facing a real risk of haircuts rising to 4% or 5%, which was seen as unaffordable.

1607. Lastly, in general terms, they submit that the suspension of the Investment Guidelines on 1st October 2007 was a knowing and reckless breach of duty by the Defendants in that what was being agreed was the suspension of a vital aspect of CCC's structure, which had been acknowledged to be "*fundamental*" and "*critical*" in its PPMs and OM. Yet this was proposed and agreed to as a mere formality – without any briefing paper being prepared or required, without convening any meeting, without any discussion or deliberations taking place, without seeking information about or considering any alternatives (ie selling RMBS or raising capital) and, lastly, without any thought being given to requiring any steps to be taken to restore the guidelines, thus leaving CCC operating without any risk controls at all. They submit that this action totally ignored that it was essential to restore the liquidity cushion forthwith.

1608. The Plaintiffs also roundly criticise the fact that the suspension of the guidelines was not publicly disclosed until 13th November, when CCC published its quarterly report for 30th September 2007. This criticism, though, seems to me once again to be wide of any material mark. No financial damage to CCC is alleged to have resulted from any such delayed disclosure, and the only allegation of any form of damage caused to CCC is a submission of its "jeopardising CCC's reputation". This scarcely has any weight in financial terms, and none is suggested. Even assuming this allegation of delay is factually true and that there is no satisfactory explanation or excuse, the whole episode is in my judgment, simply irrelevant. Further examination would be entirely disproportionate and I will not embark upon it.

1609. Looking at the material matters among the above should, say the Plaintiffs, have caused the Defendants, at least by the end of September 2007 and in the circumstances then pertaining, to review the position with realism and care with regard to selling CCC's RMBS. Had this been done, then, the Plaintiffs submit that the only and inevitable reasonable conclusion was that at least a major part of CCC's RMBS portfolio had to be sold. Whilst not formally withdrawing their previous submission that there should have been an immediate sale of about half ($10Bn) of the portfolio, the Plaintiffs have, in the event, concentrated on the submission that CCC could and should have embarked on a planned programme of sales to achieve a sale rate of around (it later becomes "at least") $2.5Bn - $3Bn per month (that is $500Mn - $750Mn a week) from at least September through to December 2007, and even beyond, thereby achieving at least the $10Bn reduction in the portfolio size which is urged.

1610. As to price, the Plaintiffs initially submitted merely that this could, and therefore should, have been accomplished at "only a modest discount" from CCC's own repo marks, which were effectively FT/IDP prices. They suggested various approaches, such as that repo marks, or secondary market pricings could be taken as a "lower bound" for achievable prices, or that a "hybrid" price - which I understood to be the mid-point between IDP prices and secondary market prices, would be a reasonable assessment of what could have been expected to be achieved. When pressed on what they said this meant in terms of actual figures, they ultimately, towards the end of the hearing, rested their case on the argument that it would have been possible to sell RMBS at a discount from CCC's own repo marks (and thus IDP prices) of no more than 11 bps (effectively 0.11%). I was told that this figure had been arrived at for being the half way point of the average difference between IDP prices and secondary market

prices during the period from September 2007 to January 2008, which the Plaintiffs (Dr Carron) had calculated as 22 bps; the proposition is therefore that CCC could have achieved sales at better than half this average discount. This, say the Plaintiffs, would have been acceptable and certainly should have been acceptable for being a modest loss which would be a worthwhile price for extricating CCC from the position to which it had sunk, and from which a collapse such as actually occurred in March 2008 was really inevitable.

1611. The Plaintiffs submit that the evidence, mainly the expert evidence but supported by inferences from the factual evidence, suggests that such sales could have been achieved, and that it was a breach of duty by the Defendants (and they would say an egregious breach of duty) to fail to perceive or even investigate this possibility and then - since they would have been then bound to conclude that doing so was the right course of action - to implement such a plan. The Plaintiffs argue that the Citigroup repo financing arrangements, even treating these as proper, were obviously an attempt to buy time, but this advantage was wasted because CCC then did not go on to use the respite to make any sales, as it should have done.

1612. The Plaintiffs invite me to find, first, that the risks of selling being advanced by the Defendants, which I have referred to briefly above but examine in more detail here, are a contrived *ex post facto* justification for not selling. They submit that the contemporaneous evidence does not show such risks being actively considered and found to exist at the time, as one would expect if they were real and were actually perceived. Based on the expert evidence, they submit that these risks did not really exist at all, and are now being blown up and exaggerated. They further submit that even if those risks did exist in theory, there was no serious prospect of their eventuating if CCC sold RMBS assets on a voluntary basis in a disciplined and orderly manner. They suggest that the real consideration in the Defendants' minds was that of not taking losses, and this was afforded undue and improper weight. They submit that the evidence which I ought to prefer shows that controlled deleveraging in this way was the obvious and only responsible course for CCC to take. The supposed risks of adverse consequences such as "liquidity spirals" were not real and have been seized upon and exaggerated after the event, but also, there were, in any event, recognised trading techniques which would have protected CCC.

1613. In further support of their argument that it was culpable not to sell, they submit that the evidence shows that to do so would have been in CCC's best interests from a reputational point of view as well, because visible deleveraging by CCC would have been welcomed by CCC's repo counterparties as evidence of a responsible attitude. It would have earned respect for CCC and have thus helped to make it easier to obtain further financing at a then more appropriate level of business. They point to evidence that CCC's self-acknowledged peer group did carry out deleveraging activities as evidence that this was obviously regarded as the most sensible thing to do.

1614. They also submit that the evidence undermines the Defendants' submission that they in fact had a capital preservation strategy as they now describe, because it shows that CCC failed to investigate or take advantage of enquiries or approaches from dealers which actually presented themselves as to possible sales by CCC of RMBS. The UBS enquiry referred to above is one example. This is relied on as evidence of at least the intransigent - and therefore culpable - resolve not to sell RMBS at all, which the Plaintiffs submit was what was really motivating the Defendants.

Defendants' case

1615. The Defendants have said in their written and oral evidence that their views at the end of August were that CCC had survived a very severe market crisis, and that its finances were stable albeit without much room for error or manoeuvre. If market conditions remained the same, it could survive. Indeed it could also survive even if they worsened slightly; I am referred to the summary given by Mr Trozzo, CCC's risk manager, in his email of 26th September 2007. CCC's assets were cash-flow/funding matched and paid monthly. Haircut charges were at an average 2.6%. Even a change to 3% was manageable and a change to 4 % was highly unlikely. Support from TCG had shown itself to be there when required. Funding arrangements (repo finance), although hard fought for, had been kept alive and were adequate.

1616. With the return of Credit Suisse and Bank of America to the general panel of repo lenders, and the prospect, by the end of September, of a long term $2Bn repo facility from Wachovia (whilst this did not materialise in the end, I am here concerned with a reasonable view of the apparent position up to 1st October 2007), CCC's prospects of being able to continue, slowly but steadily, on its current course towards gradual natural deleveraging whilst preserving its capital assets in the meantime in consequence, were, say the Defendants, perfectly rational and reasonable. That was even without an improvement in market conditions (prices, liquidity etc). But they also say that, viewed at the time, price improvements were a reasonable expectation, and that suggesting otherwise is being influenced by the effects of hindsight. Price improvements were a reasonable expectation in general terms, but in particular because, first, the price of CCC's RMBS must inevitably revert to par in time because they would pay out in full on maturity, and second because Agency capped floaters were a high quality asset (owing to the absence of credit risk) and previous experience showed that in difficult times investors migrated their investments to such solid assets in a flight to quality.

1617. The Defendants say that there was therefore no immediate need to sell RMBS, and the reasons given previously for not doing so still applied. It was a decision which required balancing the risks of selling and the risks of holding. The Defendants had previously made a considered decision that that balance favoured holding the assets, although this was not an utterly rigid rule and the opportunity of a worthwhile sale (ie worthwhile in quantity and acceptable in price) would, if it arose, be taken up on its merits. Nothing in the circumstances during this September period had changed materially from August, and certainly not sufficiently to suggest that this policy was no longer viable or, indeed, no longer offered the best option. In any event, perceiving and acting on the basis that it remained so was well within the range of possible decisions and actions of the hypothetical reasonable and competent director of CCC.

1618. With regard to Mr Stomber's illustrative slides, both internal at 4th September 2007 and at the Investor Conference a week later, the Defendants submit that they were all quite obviously illustrations of a business model which might be appropriately adopted in the future, ie after CCC had ceased being in "capital preservation mode". Not only could no one have reasonably thought that they were representations that CCC had already assumed such a model or was warranting that it would do so in the immediate future, (as I have agreed) but they cannot be fairly interpreted as an admission that CCC could only currently operate viably with a 40% liquidity cushion; the context made CCC's present strategy quite clear.

1619. With regard to matters such as the metrics appearing in the ALCO papers, the significance attached to these as frightening figures is superficial and misguided. The Defendants submit that it is always necessary, in considering these tools of analysis, to keep them in perspective and to bear in mind what they actually are measuring. Where they provide indices based on historic data, the figures will inevitably appear outlandishly high (or low) as long as any extreme event falls within the time frame of the data capture.

1620. As regards the liquidity cushion figures, the reduction in these was the inevitable and obvious result of having just used the original liquidity cushion for its intended purpose; it would not immediately return to its previous ratio, and the issue was what steps it was appropriate or prudent to take to operate in the interim and/or to bring this return about. Comparisons with the original liquidity cushion figure were of no assistance when the conditions for its intended application had radically changed.

1621. The figure given for the ratio of the liquidity cushion to VaR, they say, illustrates this. Not only was the liquidity cushion obviously depleted, but the VaR figure calculated statistically the liquidity now needed to withstand, for 20 business days (ie one month) with 99% certainty, the worst degree of market turbulence recorded within the last three months, with no corrective measures being taken as regards the portfolio. This therefore included volatility figures for the August market disruption, which had been extreme in itself, but the effect of applying this metric was to posit the possibility of a similar level of such disruption from the present circumstances of the market - which made that possibility even more unlikely. It was therefore superficial simply to take the 0.2% ratio figure thrown up as an absolute; one had to consider its practical implication in the context of real conditions. Thus, when the Plaintiffs made the dramatic submission that CCC's liquidity cushion resources showed, in September, that it could not withstand a fall of as little as 0.25% in the price of RMBS, even assuming this was mathematically correct, the real question was just how likely a further fall in price of such magnitude might ever be, bearing in mind also that, statistically, the possibility that a price rise would take place was no less likely.

1622. Lastly and importantly, the figures given for the accumulated losses on RMBS were not actual losses but paper losses only. They were not realised, and never would be if the assets themselves could be held to maturity, or at least until prices rose. Not only that, but any such rise in prices would result in an actual return of cash to CCC; the cash handed out to repo lenders on margin had not been lost, but remained CCC's. Thus, taking into account the fact that sales would bring losses onto CCC's balance sheet was not an illegitimate concern, but one of the features which could be and was reasonably taken into account in making what was, in essence a business judgment.

1623. The Defendants also argue that the Plaintiffs draw attention only to features which are, or could be construed as, negative to CCC, and because they focus entirely on these, they therefore fail to take account of positive features such as, first, that assistance from Carlyle had hitherto been forthcoming when required and there was no reason to think that this would cease to be the case so long as it appeared likely that it would enable CCC to return to health. Second they ignore the fact that CCC was actually solvent and even profitable on a day to day basis; its income from RMBS exceeded the interest costs of its repo financing. Of course the continual wrestling with haircut negotiations and the changed attitude of the banks made matters difficult, but so long as that aspect could be managed (and with hard work there was no reason to think it could not) there was no threat to CCC's continued existence. Third, the

Plaintiffs overlook (or belittle) that CCC did have an actual plan for improvement of its position, even if a slow one, in that repayments received on its RMBS would be bound, ultimately, to restore the position because the securities would repay at par at least on maturity. This prospect was a truism which, they point out, all the experts actually agreed upon.

1624. As to the proposal to suspend the Investment Guidelines, the Defendants say that it was perfectly fair to describe these as a clean up for corporate governance. It was obvious that CCC's current operation did not and could not comply with Investment Guidelines which were devised in a completely different market situation and actually for different purposes, ie the raising of income for a high yield dividend, rather than the present objective of business survival and the preservation of capital as far as possible. It was therefore absurd to maintain these guidelines in place, as this performed no practical purpose.

1625. The Defendants reject the Plaintiffs' accusation that the suspension of the guidelines was treated as a mere formality. They submit that the Plaintiffs' pejorative description of how it was effected - without any meetings, or preparation of position papers, or discussions etc - is a mischaracterisation of what really happened and, boils down to having a greater regard for form than substance. They point out that the suspension was discussed fully at the ALCO meeting at which Mr Allardice was present by telephone and joined in, and that Mr Stomber lunched with Mr Sarles on the same day that the request for approval of the suspension of the guidelines later went out, and that it is overwhelmingly likely that the matter was discussed between them, even if this now cannot be expressly remembered. In addition, the members of the Board were all aware of the lost relationship between the guidelines and the current factual position, from previous discussions, decisions, and papers sent to them. To suggest that it was a dereliction of duty not to hold a formal meeting or to demand the production of formal discussion materials or suchlike is simply unrealistic.

1626. As to the central allegation of breach of duty the Defendants repeat their previous arguments as mentioned above. The question whether CCC <u>should</u> have sold all or part of its Agency RMBS portfolio raises the questions not merely whether CCC <u>could</u> have sold all or part of its Agency RMBS portfolio, but what <u>prices</u> it could anticipate achieving if it had done so, and what other consequences might have flowed from selling. They submit that for the Plaintiffs to succeed, they need to satisfy the court that the Defendants should have done something different (that is, sell RMBS) from what they actually did, the consequences of which would, in that counterfactual world, have left CCC ultimately better off as at March 2008 than it actually became in the factual world. This means not only satisfying the court as to what prices would probably have been achieved – and the Defendants point out that this is not simply a question of selling a quantity of RMBS as fungible items, because CCC in fact owned tranches of 150 specific bonds each with different characteristics which potentially affected the price they could command – but also that any other effects of such sales would still have left CCC better off.

Plaintiffs' reply

1627. The Plaintiffs riposte is that the Defendants' own evidence shows that they did not, and never did, really expect "normalisation" of the market conditions; they were in no way optimistic, still less reasonably so, about Federal Reserve action having any worthwhile beneficial effect, and they never saw any evidence of the "flight to quality" they now claim to have expected and relied upon in anticipation. The reality is that they continued blindly and obstinately to

fail to appreciate the underlying seriousness of the situation, and pursued a failed business model, which could not survive and in which there was, recklessly, no protection from another market crisis of the type which had occurred in August 2007.

Discussion and conclusions – September/1st October 2007

1628. For practicality, I here examine the situation up to roughly the end of September with 1st October being taken as a convenient date. Again, it is appropriate to turn first to what is pleaded by way of breaches of duty etc in respect of this time.

Breaches of directors' duties

1629. The breaches of duty actually alleged in the Cause against the individual Defendants in respect of this period of 1st September to 1st October 2007 (again dealing with the contractual allegations against CIM and the position of the Entity Defendants separately) are, against the Carlyle Directors, the matters listed in Paragraphs 339B.1 - 12 and 339C of the Cause, and against the Independent Directors, the same matters in the same words, *mutatis mutandis*, in Paragraphs 339D.1-12 and 339, all as further particularised by Paragraphs 418A-N and 424A-G incorporated here by Paragraph 340. Among these, the effectual breaches of duty are the allegations at Paragraphs 339B.7 and 339D.7, again framed as

> *"failing to insist that CCC either (i) sell down its RMBS assets to generate liquidity and reduce leverage, and/or (ii) raise additional equity capital to reduce leverage and/or (iii) conduct a restructuring or orderly wind down".*

1630. Since the last would also involve selling RMBS, it is really an extension of the first as I have previously remarked. It would be applicable only if the Defendants ought of their own volition to have concluded that CCC could not be navigated to a viable future but this slightly different way of putting the matter has not been argued separately from the simple general allegation that CCC ought to have sold its RMBS assets.

(a) Breach of fiduciary duty

1631. Paragraphs 339C and 339E contain allegations of breach of fiduciary duty by preferring the interests of Carlyle or individual Defendants over those of CCC. As such, they list reputational embarrassment, pursuit of dividend payments, furtherance of the alleged "Strategic Objectives", and payment of fees to CIM and rebate of such fees, as a benefit conferred on the Independent Directors, as before. They are based on the factual allegations and submissions which I have previously considered and dismissed above when reviewing the position in respect of August, and examining whether any effectual breach of duty there could have been a breach of fiduciary duty as alleged, as opposed to a breach of the duty of skill and care. I do not repeat that analysis. It does not appear to me that there are any further or other circumstances applying or relating to September 2007 in that regard which I have not already considered. I therefore dismiss the allegations of breach of fiduciary duty for the same reasons as previously given and need not refer to them further.

(b) Breach of duty of care

1632. Most of the other sub-paragraphs of Paragraphs 339B and 339D are in the nature of particulars of negligence; in other words, they are aspects of the core breach alleged and are at best

elements going to establishing it, rather than being separate causes of action in themselves. They are framed in terms of, for example, failing to make a "viable business plan" for CCC or to require one to be made, or failing to make "analyses", such as of how CCC could "*achieve the "Business Model" presented* [sic] *to investors*" at the Washington DC Investor conference or "*achieve the levels of liquidity and leverage recognized as necessary*". (This latter is predicated on a factual assumption which as I have indicated, I find to be an overstatement of the effects of the presentation to the Washington DC Investor conference in any event, but it shows the structure of the pleaded claims). There is an allegation in Paragraphs 339B.12 and 339D.12 of breach of duty by failing to convene another Board Meeting of CCC in all the circumstances, but there is no allegation that this in fact made any difference to what happened or itself caused any loss. In the end, therefore, the practical effects of these allegations all reduce back to the general allegation of breach of duty by failing to sell RMBS, or otherwise raise additional equity capital, etc, quoted above. Only two particular allegations justify separate mention.

(1) Failure to take insolvency advice

1633. The first is the allegation in Paragraphs 339B.10 and 339D.10 of breach of duty by failure to obtain insolvency advice despite the alleged insolvency or near insolvency of CCC. This goes to two possible points. The first is the more obvious one of the wrongful trading claim, although it only becomes directly material if accompanied by the implied allegation that if such insolvency advice had been obtained, the Defendants would inevitably have received advice either that CCC was insolvent, or on the verge of insolvency, or that to avoid insolvency the only possible course was to deleverage by starting to sell RMBS forthwith. This allegation is not expressly made, but I will take it as implied.

1634. For the avoidance of doubt, I again find on the evidence with regard to September 2007, as in August, that CCC was not insolvent at this time, certainly not within the meaning of the 1994 Law as I hold it to be correctly interpreted, but also not, in my judgment, even if the appropriate test of insolvency were the ability to pay its debts "as they fall due". This is based on what, in my judgment, would be the effects of the latter test properly applied to the particular business circumstances of CCC. CCC was able to pay its debts as they fell due. Any inability to do so would depend entirely on its being, at some point in the future, (a) unable to raise "affordable" repo finance in respect of a subsequent repo roll, or possibly (b) unable to obtain any financial support from Carlyle if it needed to do so in respect of potential margin calls. However, CCC had thus far succeeded in obtaining repo finance on terms which it could manage, and had succeeded in meeting margin calls with financial support from Carlyle being provided, and there was no actual fact, as contrasted with doom-laden speculation, which could be pointed to to show that it could not continue to do so. Therefore, to posit that CCC was not able to "meet its debts as they fell due" was entirely speculative; it did not fall within the ambit of cash flow insolvency even on this more stringent test.

1635. The facts which might give rise to any perception that CCC was "on the verge of insolvency" – which is a different point because it throws the perception one stage further back from the state of actual "insolvency" on whichever test is applied - were sufficiently obvious matters that it was scarcely necessary to seek the advice of an investment or insolvency practitioner to discern them, and the evidence, even of Mr Wallace, but certainly having regard to that of Mr Shaw, simply does not satisfy me that if insolvency advice had been sought and obtained, CCC

would have been advised that its only possible and responsible course was to start selling RMBS forthwith.

1636. The second point to which the criticism of failing to take insolvency advice might go is perhaps an argument that if such advice had been received, it would have brought home to the Defendants the need to have regard to the interests of the company's unsecured creditors as part of the interests of the company. This is a legal topic which I have discussed above. However, it is an argument which really adds nothing to the essential consideration, whether the Defendants did have proper regard to the interests of such creditors, or, if not, whether their decisions were objectively within the range of what would have been proper and reasonable if they had done so.

1637. I therefore conclude, in relation to the plea that the Defendants culpably failed to take investment or insolvency advice, not only that it was no breach of duty not to do so, but that even if it had been, CCC suffered no identifiable loss in consequence, as it is not proved that it would have made any factual difference. There is no other identifiable complaint arising from such advice not having been sought. Nothing can therefore be built on this allegation and I do not consider it further.

(2) Causing or implementing suspension of Investment Guidelines

1638. The second notable separate allegation which I feel obliged to mention specifically is that of breach of duty in recommending, causing or implementing (as applicable) the suspension of CCC's investment guideline parameters on 1st October, either at all or without any plan for restoration, (see Paragraphs 339B.11 and 339D.11). This has more connection with the main issue, even though it is not alleged to have caused damage in itself, nor is it even pleaded as a *causa sine qua non* (or "but for" factor) bringing about the effectual breach of duty alleged. However, as it has been extremely prominent in the Plaintiffs' arguments, I should make separate findings in this regard, and it is convenient to do so here.

1639. Having considered the evidence and arguments, I find that there was no breach of duty in the decision to suspend the formal Investment Guidelines for three months, either intrinsic to the decision itself, or because of any supposed shortcomings in the process by which the decision was made.

1640. First, unguided by any expert evidence, I can see nothing wrong with the decision to suspend the Investment Guidelines as a matter of common sense. In the factual situation which CCC was now in, they were simply redundant. They could not be adhered to, and retaining them begged the whole question as to whether their immediate restoration was the right thing to aim for at the moment, when it had been decided, in effect, that it was not. The suspension was indeed, it seems to me, a "clean up" of corporate governance and I do not find use of that term to be a criticism where it is (as here) an expression of the realities of a situation brought about by external factors, rather than the removal of some constraint intended to promote disciplined decision-making, simply because it is turning out to be inconvenient.

1641. The only argument for not making a formal suspension appears to be that keeping the guidelines in force, and consistently failing to comply with them, would be a discipline, reminding the Defendants and management of the need to give reasons for the guideline breaches and the (supposed) need to restore compliance with these risk management tools, which had, it is of course accepted, been thoughtfully and deliberately constructed. This does

not seem to me to be at all a strong point, first, because the Defendants and Management would be all too conscious of those points already and second, and more importantly, because that approach would imply that giving immediate priority to the restoration of those management tools was the right objective when that was not necessarily the case.

1642. Whilst Professor Das appears to advocate this latter approach, Dr Webster does not, and I strongly prefer her evidence and expert opinion on this topic. She explained, and, I find, from a position of significant experience rather than academic research and theory, that the suspension of guidelines in the case of a "passive" breach of them (ie one that had been occasioned by circumstances outside the control of the entity, rather than by its own controllable internal actions) which meant that they could not currently be complied with, was appropriate. It was also industry standard practice even in 2007, (although that goes more to whether it was reasonable to think it appropriate than to whether it was so in absolute terms). It was a recognition that in such circumstances, previously devised guidelines were no longer applicable, whether temporarily or even perhaps for a longer term. Dr Webster emphasised, with regard to written guidelines, that far from declining to suspend them and striving to restore them or operate them, in a crisis

> *"… in circumstances that are abnormal, the idea of operating with a guideline as if market conditions were clear, sufficiently clear to alter the guideline and replace it with something else, - a crisis of this magnitude - I believe would be imprudent. Not just unreasonable, imprudent."*

and

> *"…so, whilst I certainly think there is more to guidelines than administrative statements and indeed I think they inform the conduct of an organisation or of a fund, I also think that the guidelines themselves are something prudently suspended, because one simply cannot identify what the emerging conditions are in order to say anything sensible at all, at that point, in terms of a written guideline."*

1643. Professor Das advocated that investment guidelines should be treated as a set of rules which, having been devised, required to be operated strictly, as a matter of disciplined management. His approach was, to my mind, far too rigid in its outlook. Dr Webster regarded guidelines as a tool to be employed usefully and intelligently in context, and not a straitjacket. I find this view more convincing.

1644. Since I regard the suspension itself as a reasonable decision in the circumstances, it follows that the Plaintiffs' other complaints about how the decision was made (ie, either lack of individual care by the Independent Directors in giving their approval, or deficiencies in the process by which that approval was obtained) fall away as irrelevant. However, for the avoidance of doubt, and treating this as an independent matter of alleged breach of duty, I would not find either allegation to be substantiated.

1645. To start from the issue of process, I am satisfied that this was perfectly reasonable in all the circumstances, such as CCC's structure, the size of its Board, and the way in which its operations were habitually managed. There was in fact no formal requirement in its Articles for a meeting or other discussion between the Independent Directors in order to make a decision. All that was required was that a majority of them should approve the material

decision. It was therefore a matter for each of them individually to decide whether he had sufficient information to be able to make a properly considered decision.

1646. I am satisfied that as at 1st October 2007, each of them could reasonably come to the conclusion that he did. The background was that matters pertinent to this point were well known to the directors. The recommendation to suspend the guidelines came from CCC's CEO (and effectively its Investment Manager, CIM) following an ALCO meeting at which it had been discussed and deliberated on by those with closest connection to the day to day management of CCC's business – including CCC's Chief Risk Officer, Mr Trozzo. (I do not find any significance in the fact that Mr Trozzo had apparently initially recommended suspension for two months only, but the eventual recommendation was for a period of three months; this is trivial.) One of the Independent Directors, Mr Allardice, had participated in the ALCO meeting and he was therefore certainly fully informed of the position. I am also satisfied that Mr Sarles must have discussed the matter, at the time, with Mr Stomber – it was such an obvious thing to do - and I have no reason to believe that this discussion was inadequate. Mr Loveridge says that, in considering whether the request was reasonable, he relied on his knowledge of relevant considerations gleaned from the 23rd August Board meeting, and logic. In all the circumstances I find that too to have been reasonable.

1647. I conclude, therefore, that the suspension of the Investment Guidelines was a decision which was in itself properly obtained and properly made. I turn now, therefore, to the essential core breach of duty complained of by the Plaintiffs, which is that of failing to sell RMBS, or raise additional equity capital, dealing first with the latter.

(3) Failure to raise additional equity capital

1648. I have already dismissed this briefly as an unrealistic proposition in August 2007, but the situation had by now moved on somewhat from the immediate aftermath of the mid-August liquidity crisis, and the Plaintiffs' case on this point therefore requires closer examination.

1649. As mentioned, the possibility of raising new equity capital for CCC was raised at around the ALCO meeting of 6th September 2007, and the failure to pursue this possibility is a matter of specific and vehement complaint by the Plaintiffs. The essence of their criticism is that the Defendants identified the need to raise new capital, and (they suggest) avenues for doing so, but made no attempt, at least not of any substance, to pursue these. In particular, they did not raise the possibility of obtaining additional capital from Carlyle, from CCC's existing shareholders, or via a back-up line of credit from Carlyle's or CCC's investment banking relationships. They suggest that the Defendants' explanation that this was because it was not seen as a viable possibility is an *ex post facto* justification for an inexcusable failure to pursue this option.

1650. Without doubt, the Defendants were aware of the theoretical possibility of raising extra capital as a step that would assist the situation, if it were achievable. Unsurprisingly though (it seems to me) it was regarded as a non-starter in September 2007, even if it were legally possible - and in fact no new shares could be issued by CCC within 180 days of the original IPO (ie before the end of the year) without the consent of Citigroup.

1651. The obvious reasons for this course being impractical in any event are that it was only two months since the original IPO, which had itself found more difficulty in generating full subscription than had originally been anticipated, that CCC had no established track record of

success in the interim short period to attract more investment, and that it was in fact in the aftermath, if not the throes, of a storm. Independent capital would hardly find CCC an attractive investment at the time, and a rights issue would scarcely be popular. It would be difficult to find underwriting banks with the cash to support any further offering of shares on any basis, and it was beginning to become apparent that banks were becoming more tight and less relaxed about dispensing their cash. Simply subscribing equity to support a liquidity cushion (which is what such further investment would amount to) would not be an appealing proposition to anyone, outside, perhaps Carlyle itself.

1652. In support of their proposition that these arguments are all rationalisation after the event, the Plaintiffs point out that although Mr Stomber informed the Board, on 6th September 2007, that Mr Green was starting work on what CCC would have to do if it decided to raise capital, nothing ever came of this and no-one could explain why or exactly what happened. As Mr Green had not been called to give evidence they invite the court to infer that Mr Green's evidence would not have assisted the Defendants and that no meaningful investigations were carried out.

1653. I would decline this invitation, even if it went anywhere, which in my judgment it does not. I have already stated that I do not find circumstances sufficient to justify the drawing of any adverse inferences arising from the absence of particular witnesses in this case. The evidence is what it is. On balance of probabilities, it certainly shows that any investigations were sufficiently tentative or low key that they came to nothing, to the extent that they did not even generate any records. I do not, however, find that remotely surprising, because the other factors which suggest that pursuing them was a waste of effort seem to me to be overwhelmingly obvious. They include both the restriction on the issue of new shares, and the general unpromising circumstances referred to above.

1654. However, (and the reason why the Plaintiffs' invited inference really goes nowhere in any event) the Plaintiffs' criticism of lack of investigation could only have any substance if they can also show that investigations would have proved fruitful, ie that if supposedly "meaningful" investigations had taken place the probability is that CCC would have been able to raise additional equity capital. But the evidence goes nowhere near supporting any such proposition; nothing even approaching that is demonstrated. The Plaintiffs' assertion that they have

> "*amassed a body of evidence which … clearly demonstrates that …. raising further capital may well have been feasible*…..".

(which itself falls somewhat short of probability) turns out, on examination, to consist principally of mere repetition of the assertion itself, and a submission that because the Defendants did not actively pursue investigations of the possibilities of raising capital, the absence of evidence that they could have done so should be attributed to this failure, which thus justifies an inference that they could have done so. This submission entirely begs the question, and I reject it. It amounts again to an invitation to draw an unjustified adverse inference so as to relieve the Plaintiffs of the need to prove a case on this point.

1655. The only concrete matters of fact which the Plaintiffs cite in support of their claim that CCC could have raised equity capital if it had tried appear with regard to criticism of not investigating raising capital from Carlyle or from Carlyle's "established relationships". As regards Carlyle, this is absurd. Carlyle was ever-present in the background as a possible

source of financial assistance (I accept not guaranteed, but that is simply a matter of realism), and it had already shown itself willing to step up and assist with a loan when this was required. I cannot see why it should be a criticism of the Defendants' care in the conduct of CCC's affairs that they did not set about attempting to embody such assistance in the formality of equity capital, which would hardly be likely to have happened and would have been a diversion of both attention and efforts.

1656. As regards Carlyle's "established relationships", the Plaintiffs present no coherent grounds for believing that capital could have been raised from Carlyle's bankers, and their only other suggested sources of capital producing relationships at this time are Mubadala, and Bank of Angola. That possibility is nothing but the thinnest speculation, and the unreality of it is illustrated by the fact that the latter is included on the basis that Bank of Angola had expressed interest in a further investment of $500Mn in CCC in May 2006. In fact, it is quite possible that they were approached in September 2007 and declined to subscribe, because Mr Hance had a vague and unsupported recollection of this, and early lack of success would have been the most plausible likely outcome.

1657. Both Mr Shaw and Mr Wallace agreed that it would have been unlikely that CCC could have raised further capital. I think that is an understatement. I am therefore quite satisfied that giving this option no further consideration in September 2007 was a reasonable and rational decision at this time. The Plaintiffs' closing submissions to the contrary simply fly in the face of realism, and amount to little more than criticism for its own sake.

1658. It was, I therefore find, no breach of duty by the Defendants at this time to fail to investigate or pursue any more than they may tentatively have done, the possibility of raising further equity capital. It was quite reasonably viewed as a waste of time.

Later position on raising capital

1659. It is convenient to mention here that I am also satisfied that CCC's position never subsequently changed sufficiently to make raising additional equity capital a remotely practical option and therefore worthy of pursuit, before it was in fact raised again at the end of February 2008 shortly before CCC's eventual collapse and, in the event, sufficiently shortly to be too late to have had any potential effect.

1660. I will give my reasons later as regards each of the times when the Plaintiffs make this criticism. I make the point here, though that I make this finding on an objective view, quite apart from any consideration of whether, subjectively, the Defendants gave such an option proper consideration at any later time. With regard to this latter point, I also regard criticisms of the Defendants for apparently not having given this matter further consideration at later times to be unjustified. Businessmen work practically, and do not record repetition of their earlier decisions continually for the purposes of later scrutiny. I do not regard it as any criticism of the Defendants that the possibility of raising more capital was not repeatedly referred to, and its impracticability confirmed, when there was no change of circumstance to give this any point.

(4) Pursuit of the "capital preservation strategy"/failure to resolve to sell substantial (or any) amounts of RMBS

1661. I turn, therefore, to the central issue as regards the end of September 2007, and indeed, I think, as regards the whole case, namely whether the continuation of the capital preservation strategy as broadly formulated at the 23rd August 2007 Board Meeting, from (for choice of a convenient date) 30th September 2007 going forward, was a breach of any of the Defendants' duties of care and skill towards CCC. Put another way, this allegation is in effect that, in the circumstances then pertaining, it was a breach of such duty not to reconsider this strategy and not to conclude that it should be replaced by a strategy of actively selling off CCC's RMBS.

1662. In essence, as I mention rather later, the crux of this point is the balance between the gravity of CCC's financing risk – principally the risk that it would not be able to continue to obtain enough repo financing on affordable terms to be able to continue to hold its RMBS – as against the risks of trying to alleviate that financing risk by selling off the relevant assets, or some part of them. The degree of financing risk is therefore, perhaps, logically more appropriate to consider first before looking at the degree of the countervailing risks. However, since far more attention was focused on the question of selling RMBS in the evidence at the trial it has felt more natural to consider that first.

1663. The Plaintiffs' initial contention in its Cause was that it was a breach of duty not to sell the whole of CCC's RMBS portfolio immediately in July or August, or at least in about September 2007, but this rapidly became reduced to an allegation that the breach lay in not selling half of it - say $10Bn worth of it as proposed by Dr Carron, who opined rather vaguely that such sales could have been effected in two or three months. Even this broad brush contention, though, was largely discarded by the time of trial in favour of a more sophisticated contention that the breach lay in not embarking on a programme of selling RMBS over several months.

1664. This has been variously and imprecisely expressed, at different times, as being to sell "*about*", or "*at least*" … *"$2.5Bn - $3Bn*", or just *"$3Bn*", of CCC's RMBS assets per month *"on average*", and that the period of such selling should have commenced from July 2007 through to December 2007, or, in some places, February 2008. I will refer to this variable allegation as "selling RMBS as submitted" or, where I need to refer to it more quantitatively, then for brevity as "selling RMBS at a rate of $2½ -$3Bn a month". Since I have already held that the earliest date upon which I think it even arguable that CCC should have commenced such a programme of selling is September 2007, and that I reject the allegation with regard to July or August 2007, future reference is also to selling starting in September 2007.

1665. I have also recorded that, in the end, the Plaintiffs' case has become that CCC could have sold RMBS under such a programme at a price discount of no more than about 0.11 percentage points from IDP prices, and therefore that this is what it should have done.

1666. The importance of a precise price, or a precise formula for ascertaining one, becomes of most relevance at the later stage of quantification of loss to CCC. The question at this stage is the anterior one of whether CCC's directors (or CIM) ought to have reviewed the situation and resolved to attempt to sell RMBS at all, and the issue of achievable price is material to this at the more general level of what perception of achievable price it was reasonable for those parties to factor into their decisions about the desirability of selling. The 11 bps discount figure therefore here provides a contextual benchmark in the Plaintiffs' argument that failing to embark on a programmed process of selling RMBS was culpable.

1667. I record at this point that during the trial two particular aspects of the Plaintiffs' arguments about CCC's failure to sell RMBS seemed to me to have some force, and to demand close

scrutiny, which I have therefore given to them. They both stem from the obvious fact that despite the Defendants' evidence that there was always a willingness on their part to sell RMBS in appropriate circumstances, no such sale was ever in fact made. The question is whether this was because the circumstances were monitored and suitably investigated but were reasonably never viewed as constituting a suitable sales opportunity (as the Defendants say), or whether this explanation is, rather, an *ex post facto* attempt to justify what was really either an inexcusable rigidity of approach, or a culpable failure to keep reviewing the position and appreciate that circumstances now demanded a change (as the Plaintiffs contend).

1668. My first particular concern on this score arose, first, from my broad impression that once the Defendants had taken the decision at the 23rd August Board Meeting not to sell RMBS except in sufficiently discreet and beneficial circumstances, it did not appear to me that that decision was consciously and deliberately re-evaluated subsequently, at any rate before the end of February 2008, as opposed to simply being treated as a given from then on. I can accept (and this was reinforced by Dr Webster's evidence) that once a strategy to deal with a crisis or an otherwise difficult situation has been thoughtfully decided upon, it would be bad practice to be readily deflected off course, ie to change that strategy, without confidence that circumstances now justified this. That is not, however, a reason for not keeping the strategy under review, so as to confirm whether relevant circumstances have changed, and if so, whether the original policy is still the best course.

1669. My second particular misgiving was what seemed to me to be some force in the Plaintiffs' criticism that the Defendants – most particularly Mr Stomber as the Defendant with the greatest expertise and responsibility in this area, and as, in effect, the personification of CIM – were at fault in failing adequately to appreciate, and therefore to investigate more closely and possibly adopt, the techniques for safely achieving advantageous sales of RMBS, in the market of late 2007, which the Plaintiffs' expert, Dr Maini, said were readily available, and indeed even standard practice.

1670. The Defendants' position has always been, in broad terms, that deleveraging was not necessarily the obvious and only desirable course for CCC, and that even if deleveraging were accepted as a good idea in theory, the practical problems were <u>how</u> to do it. Given that CCC's assets were currently priced below par, but would ultimately pay out at par (a financial attribute apparently as inevitable as night following day), selling them in the third quarter of 2007, as on the Plaintiffs' case, would create a locked in loss of around $250Mn which would be avoided if CCC could manage to finance its holdings until their necessary return to par value, or approaching it. Couple that point with the fact that selling would not only crystallise capital losses potentially unnecessarily, but would risk making the immediate financial situation worse (as explained below), and the decision not to sell was certainly not unreasonable. The problem for CCC was that the balance of risk against benefit, and in particular the risks of being seen to attempt, or even just prepare, to deleverage by selling RMBS were just too great, or too imponderable, to make it sensible to take any active steps in that direction at any material time.

1671. The Plaintiffs' retort is that these risks are being exaggerated. They submit that the evidence suggests that these risks were simply not part of the Defendants' thinking at the time - which they rely on as itself showing that they were not great - and that they are now being given prominence so as to provide an excuse for the irresponsible, negligent, or inept (I have already

dismissed "improperly motivated") decision not to make positive efforts to make at least some sales, and to reduce the recklessly high leverage ratio upon which CCC was operating.

1672. Whilst this case is a dispute about the care or propriety of the Defendants' actions, I have been presented with much external expert evidence (Dr Carron, Dr Maini, Mr Welles and Professor Das for the Plaintiffs and Professor Hubbard, Dr Niculescu and Dr Webster for the Defendants) going to these propositions. The usefulness of this expert evidence lies generally in providing me with context (events of the time, perceptions of the time, nature of relevant transactions, contemporary industry practice, customary habits, folklore and ethos of the relevant markets and so forth) to enable me properly to evaluate these criticisms of the Defendants' conduct against the legal principles which I have held to apply.

1673. It is convenient to review the material expert evidence generally at this point, although I am here examining the reasonableness of the Defendants' continuing with the capital preservation strategy, rather than then changing it in favour of selling, only at and from September 2007. The immediately material circumstances are therefore only those which pertained, and were known or available to the Defendants, at that time. The expert evidence has of course been directed more widely than simply up to September 2007. Because it deals with all the periodic allegations of breaches of duty by the Defendants and also with the issue of what would have been the potential financial results if CCC had in fact decided to sell RMBS as it is said it should have done, from July 2007 onwards, the experts have looked at events and circumstances through the whole of the following period, and in some respects right up to CCC's actual collapse. They have also looked at material which would not necessarily have been known to a market participant, or to the Defendants, in September 2007.

1674. Later matters, if not known or knowable to the Defendants, cannot influence my view of what it was reasonable for them to do or decide at that time, although the Defendants' own later behaviour may, of course, provide material evidence from which their state of mind earlier can be inferred. Where it becomes necessary to make any such findings, I will therefore mention and take this into account.

1675. I remind myself, therefore, that I am here specifically concerned with what the experts' evidence tells me about the circumstances which applied, or which could or should have been perceived, at the end of September 2007 without the benefit of hindsight, even though it is convenient to refer to some wider or later aspects of their evidence generally.

Factors affecting the continuation of the capital preservation strategy in and from 30th September 2007.

(i) Risk management considerations

1676. The decision not to sell RMBS was an investment management decision, but one in which risk management plays a very significant part, and I look first at the risk management evidence, which is principally that of Professor Das and Dr Webster.

1677. Before noting their material disagreements, I repeat one general point which is underlined by their evidence and which I found particularly helpful to bear in mind. This was their very useful comments about the place of risk in the field of investment management. It arises from the accepted proposition that, in business, risk and return are correlated, and the implications of this.

1678. An investor understands and expects (or should expect) that the gaining of a higher return means the assumption of a greater degree of risk. Although I think this came first from Professor Hubbard's more generalised evidence about the financial markets, it was agreed between the experts (I understand) that the returns targeted by CCC's original business model were similar to the then (in 2006/7) expected returns to be made in the equities market by investment in relatively large companies. I found this helpful for giving me a comprehensible general sense of the relevant level of anticipated risk in this case.

1679. Second, both Professor Das and Dr Webster were in agreement, that the risks disclosed in CCC's PPMs and OM were material to a consideration of appropriate risk management practices for CCC. From this I derive that risk management standards and practices are not absolute, and that appropriate conduct is influenced by the degree of risk implied in the relevant business model. This is because risk management is not the same as risk avoidance - another point which I gained from their evidence and have registered as important. Risk is intrinsic in any business where the purpose is to generate return, and it cannot be avoided, only managed.

1680. The central place of risk in the thinking of businessmen, and perhaps starkly in the financial markets sector, seems to me to be illustrated by the fact that much of Dr Maini's evidence was phrased in terms of the proposition, which sounds extraordinary when taken out of context, that market participants "found risk attractive". This was in fact shorthand for the less controversial proposition that they found the lower prices (wider spreads) which are commanded by investments with greater perceived risk, and their consequently higher yields, attractive. The point, though, clearly illustrates how intrinsically entwined the effects of risk and return are automatically felt to be.

1681. Turning to the particular issue, namely CCC's risk management after the August 2007 crisis, Professor Das's view, expressed very firmly, was that it was irresponsible, indeed I think he would go so far as to say grossly irresponsible, to continue operating CCC's business at its then current level of leverage. His favourite metaphor was that this was like proceeding down the motorway with the accelerator (the high leverage ratio) pushed down, but with no brakes (the liquidity cushion) to provide safety because they were burnt out. What you needed to do was "*get off the freeway and fix those brakes*" before coming back on. His firm view was therefore that, as a matter of risk management, having used up the liquidity cushion (being ultimately bailed out by the Carlyle loan), the only appropriate course for CCC to take was to replenish it, forthwith.

1682. This was all the more so because the risk which CCC was running was, "asymmetric". By this Professor Das meant, as I understood him, that the financial disadvantage of selling RMBS, which was locking into the portfolio the losses caused by sale prices being below acquisition costs, was small in amount, whereas the potential financial disadvantage which was being courted by not selling RMBS was vast; it was the potential loss of the value of the entire portfolio.

1683. However, when asked about his views on how, practically, deleveraging should be achieved, ie in any greater degree of practical detail than the simple injunction to "sell half of the RMBS portfolio", Professor Das immediately said, (quite properly) that this was not his field of expertise and he could not give evidence about this. Indeed he said this with such notable

alacrity, that I had the impression that he was rather aware of this weakness about his evidence, and was anxious to avoid getting involved in that topic.

1684. And, in my judgment, it is a significant weakness. To take Professor Das's metaphor of hurtling down the motorway with no brakes, he was advising that one should get off the motorway to fix the problem, but without considering whether there were any risks in steering towards the exit slip road to do so. Whilst graphically attention-catching, his metaphor strikes me as too simplistic. If I were to extend it, then it seems to me that the comparison is that of imagining that the road surface is icy, but the road ahead is straight with a gradual uphill gradient into the distance. In such a case, the analogous decision would be whether it was safer to steer off for the exit slip road, or simply to keep steering straight ahead and rely on gravity. The answer then might not be as obvious, nor the apparent risks so asymmetric, as Professor Das suggests.

1685. Dr Webster's evidence was far less rigid in its approach. She did not see the matter as being as black and white as Professor Das did. Her opinion was that risk management practices in times of crisis or abnormal market conditions are very different from risk management practices during normal times. During the latter, observing predetermined rules or principles is likely to be appropriate as good discipline and safety play, but as regards the former, the primary objectives are to assess the impact, or potential impact, of emerging external factors, to conduct tactical management of these on a short term day to day basis, and to work out an appropriate longer term strategy to aim for. In this situation, she said, risk management became more of an art than a science, and without a necessarily right or wrong answer. This is because risk management is about predicting the future, and in crisis times, the future is, by definition, less predictable, as "*history becomes a less reliable indicator of what will happen next*".

1686. Her view was that the decisions and steps taken by CCC's management after the crisis of August 2007, and in particular the decision to retain rather than attempt to sell RMBS, were supportable decisions from a risk management perspective, especially having regard to the standards of the time. Professor Das appeared to opine that they were irresponsible to the point of being unsupportable.

1687. I accept that Dr Webster did here express her own opinion that the decision not to seek to sell RMBS was an appropriately careful and responsible decision at the time it was made, which is really the very decision for the court. I have criticised other experts for straying and overstepping the mark in this way. However, I do not regard this as usurping the function of the court in this particular instance, because what Dr Webster was actually saying was that what she observed from the evidence provided to her was consistent with what she recalled and observed at the time as being within accepted appropriate risk management practice (although practice in those days was quite varied). That is a perfectly proper form of expert opinion evidence, and I treat it as such.

1688. I have no doubt that Professor Das is an excellent academic, but I unhesitatingly prefer Dr Webster's evidence to Professor Das's evidence in the context of this case, partly because that was the very difference between them, and partly because I found Dr Webster's disagreements with Professor Das's views to be both measured and persuasive. Professor Das's evidence was academic and theoretical. He seemed to me to be expressing an opinion at the totally high level of what one would ideally seek to do to manage future risk after surviving a crisis but

being wounded in the process. His evidence really said nothing about managing any immediate consequences of the wound.

1689. Dr Webster's evidence was redolent of practicality and common sense. She was an academic who had moved out into the financial world in order to apply her subject knowledge and expertise in practice. I preferred her evidence to Professor Das's, where they disagreed, for being, it seemed to me, that much more practically orientated. I afford considerable weight to her opinion that CCC's management's approach to the issue of whether or not to sell had been consistent with good risk management practice of the time.

1690. Both these experts expressed opinions on matters other than those which I have expressly mentioned for being (in my view) the key points. Although I have read and noted the remainder of their evidence, it is not necessary to record and comment on all their points of agreement and disagreement. As examples, they disagreed on matters such as the appropriateness of regarding SIVs as vehicles comparable to CCC, and the usefulness of continuing to apply VaR metrics in times of crisis. On these topics, as with others, I found myself preferring Dr Webster to Professor Das.

1691. They also disagreed as to the state of industry practice with regard to the sizing of an appropriate liquidity cushion for an investment management business of the general type which CCC was operating when it was launched, and how conservative this was, they disagreed about the usefulness of VaR metrics in this regard as well, and they disagreed about the degree of caution which would have been seen as appropriate at the time as regards the funding risk inherent in using 30 day repo to finance long term asset holding. None of these points is of great direct materiality because they mostly concern CCC's original business model, which is not the subject of criticism in the action. Such disagreements do, though, tell me something about their respective approaches, and this has in turn informed my assessment of their evidence on directly material matters.

1692. In each case, Professor Das's view was that practice before 2007 was more conservative and was more driven by regard for measurements and statistics than was Dr Webster's view. I was more persuaded by Dr Webster. I noted Dr Webster's view that risk management practices and standards in the finance industry today had been heavily influenced by the events of 2007-8, whilst Professor Das considered that the standards which he described in his report had been widely accepted and operative prior to that time. I again found Dr Webster more persuasive, and I noted that she had herself been active in practice in this area both before and after that crisis period. I suspect that the difference between the two experts in this regard may well lie in their respective perceptions of how standards were actually operating in practice at the relevant times up to and during the crises of 2007-8, and the extent to which theory and practice really did coincide before lessons were learned in reaction to the events of 2007-8.

1693. In the end, though, it is necessary for the Plaintiffs to show that the decisions and actions which the Defendants took after July 2007 with regard to CCC's business were outside the possible range of reasonably careful and skilful such decisions and actions in the circumstances. I find that Dr Webster's evidence is strong support for the fact that, from a risk management perspective, they were not.

(ii) Investment management considerations

1694. The investment management considerations are the practical matters which would be material to a decision by the Defendants that CCC should sell RMBS as submitted, ie through a sales programme devised to reduce CCC's holdings of RMBS by an average of $2 ½ - $3Bn per month from September to December 2007 or even February 2008. That translates to about $500Mn per week or (the Defendants suggested albeit I think only for effect) $91Mn a working day. The Defendants also point out that as these figures are proposed as an average, less frequent sales in practice would have to be in greater quantities. The question is therefore how feasible should the devising and following of such a plan have appeared to the Defendants at this time, and in my judgment this means, in particular, although not exclusively, to Mr Stomber.

1695. I will therefore look first at the various factors which it is either common ground or common sense, would be material to making such a decision (and I am here concerned solely with the feasibility and the commercial implications of sales in themselves, and not with other factors affecting whether selling was desirable). I will first review the expert evidence on each topic before relating this to the Defendants' own decisions, for which the expert evidence provides material background context.

1. Size of the market

1696. The size of the market refers to the quantity of relevant RMBS securities which were in issue and outstanding in the market. The experts have taken mid-2007 as a convenient appropriate time to focus on this.

1697. The Defendants in fact question the relevance of this measurement at all, on the grounds that when considering the prospects of selling something, (eg selling a car in Guernsey) it is of little assistance to know how many such items there are in the market, (ie cars currently in Guernsey). I have some sympathy with this. Unless there is some other evidence showing a logical link between the size of the market in this sense and the volume of transactions in the particular item, the market size is of very limited assistance. It shows at best that, in the past, the number of parties observed in the data capture has thought it attractive to acquire the item in question at some time, but little more than an impressionistic conclusion can be drawn from this.

1698. In this case, the helpfulness of such a factor is even more diminished by the two facts, first, that it is agreed that there is little or no readily available and reliable published data as to such size and, second, that the experts disagree as to what sectors of the broader financial securities market are appropriately regarded as part of the "market" for CCC's particular assets. However, as I have found this material of some assistance at a very high level, I will deal with the evidence briefly.

1699. The material evidence is really that of Dr Carron and Dr Niculescu, Dr Maini having merely, it appears, relied on Dr Carron's figures. Dr Carron initially put the figure of outstanding Agency floater RMBS, as at 31st July 2007 at $537Bn. He arrived at this figure by taking the total value of <u>all</u> Agency CMOs outstanding at that time ($1,342 Bn) and applying 40% as the reasonable approximation of the quantity being issued as CMO Agency floaters during 2006-2008.

1700. Dr Niculescu did not contest the reasonableness of taking 40% as the fraction of Agency CMOs issued as floaters in 2006-8, but said that this was not a reliable figure to use in the way

Dr Carron did, because the figure fluctuated significantly over time based on investor demand and did not take account of the different life expectancy of certain CMO structures. He initially put his own figure at $105 Bn, using a different methodology, which was to aggregate the published data figures for certain segments of the Agency CMO market.

1701. During the expert conferral process, Dr Carron accepted that Dr Niculescu's methodology was more reliable. He reduced his figure, consequently, to $336 Bn. Dr Niculescu accepted that a relatively minor adjustment to add $1.8 Bn of WAC ("Weighted Average Coupon") securities to his original estimate was appropriate, making his figure $107Bn. The remaining difference was accounted for by disagreement between the experts as to the segments of the market which it was appropriate to include in the aggregation.

1702. As an aside, this is an episode which illustrates the kind of general misgiving I have had, in places, about the thoroughness and reliability of Dr Carron's evidence and opinions. The reduction in his figure is very significant, at about 38% of the figure which he gave initially. That original figure gave an impression that CCC's holdings of RMBS (about $22Bn) would have been being disposed of in a market ($537 Bn) into which they could easily have been absorbed because such assets were generally very widely held in a large quantity. Whilst Dr Carron's eventual figure is still much greater than Dr Niculescu's, it is very different from his first figure, and very much diminishes that impression. I found it disconcerting that Dr Carron should have originally presented a simplistically derived figure, which he seems to have been quite easily constrained to accept was too crude to be accurate, when other data was apparently reasonably readily available which could have been used to check it. At best, his original approach was scarcely rigorous. Alternatively, it relied too much on material assembled by a team with less critical experience than he himself would be expected to possess.

1703. The outstanding dispute between the experts goes to what segments of the market can be regarded as relevant, a point which assumes more significance with regard to "depth" of market, which is considered later. The key point here is how far it is reasonable to regard types of Agency RMBS other than those actually held by CCC as part of the relevant "market".

1704. CCC's portfolio was of simple composition. It included no Ginnie Mae securities. Its floaters were distributed more or less evenly (one third) between 6.5%, 6.75% and 7% caps. Less than 15% of the portfolio comprised structured floaters, the remainder being standard strip floaters (where the income from the trust pool of underlying mortgages is simply divided into the floating rate tranche, as held by CCC, and the inverse floating rate tranche, and is paid through without any further redirection of the income or other structured cash-flow feature.)

1705. Dr Carron's figure includes all floating rate CMOs issued by Agencies, including Ginnie Mae floaters, structured floaters, PACs ("Protected Amortisation Class") and "exchangeables" (securities with an added option to exchange a fixed rate coupon for a floating rate at some time, or vice versa). Dr Niculescu says that the relevant market is really only that of conventional strip floaters, because that was the vast bulk of CCC's portfolio.

1706. This disagreement arises from the principle described as "substitutability", which is the extent to which it is reasonable to assume that buyers of one narrow class of security would regard securities of another class as sufficiently similar to their ideal (and therefore sufficiently attractive) to be willing to buy them as an alternative. If the two classes appear to be similarly attractive to the same buyer(s), then transactions in one class of securities may be some

evidence of the likelihood of transactions in the other, and could arguably be seen as part of the market for that other.

1707. The experts agree, though, that substitution would doubtless also entail an appropriate adjustment in price to make a transaction in the less-than-ideal security sufficiently attractive to secure it. They differ as to the significance they each accord to this. Dr Niculescu's reason for ruling out other classes of security is that he considers that demand from persons who preferred those other classes of security to the ones which CCC held would only emerge at a significant discount from the price which was (or would be) paid by those who were actively transacting in CCC's classes of security.

1708. Ultimately, the evidence shows, in my judgment,that the key consideration about "substitutability" does come down to price. Price is determined by the point at which the willing seller drops his price requirement for a particular commodity sufficiently to meet a buyer who is willing to raise his offer to that same level. In fact, when someone says that he "cannot sell" an item, what he usually means is that he cannot get anyone to buy it at a price which he is willing to accept. This actually only means that its true market value is less than he would like it to be.

1709. A buyer will pay more for what he ideally wants than he will pay for something less ideal. However, "more" is relative rather than absolute, because his willingness to pay "more" may still not rise to the price which buyers who actually prefer the commodity will pay. Whether any such adjustment amounts to a "discount" from a "market" price, or itself fixes a "market" price therefore depends on the data point from which one starts and how one views the balance of supply and demand. Whilst, therefore, I understand and fully accept the principle which Dr Niculescu's evidence says would operate, I do not think that describing it as a discount from a market price is very helpful, as it begs the question.

1710. However, this is a digression for present purposes. I have said that I do not regard the theoretical size of the outstanding market for CCC's securities as of any great assistance in assessing the quality of its directors' decisions not to sell RMBS in September 2007; this is because the only aspect on which it is of any assistance is what I might infer from this evidence with regard to likely demand for CCC's RMBS assets, or market interest in them. Since this can only be at a highly generalised and rather impressionistic level, I do not need to resolve the experts' disagreement by making any finding as to a "right" figure for the size of the relevant market. Having compared and contrasted the evidence, I prefer Dr Niculescu's evidence, as being more persuasive in its reasoning, although I do feel that his exclusions may well be somewhat over-stringent. If I had to make a finding as to the size of the relevant market, theoretical though this would be on any basis, I would come to a figure which was nearer to Dr Niculescu's figure than even Dr Carron's revised figure. I find that a figure of around $150 - $200 Bn probably gives an appropriate impression.

1711. However, the only significance of this evidence for present purposes is that I can and do derive from it that CCC's portfolio was, on any basis, a large fraction of the total pool of comparable securities outstanding in existence. Even on Dr Carron's figures CCC held about 7% of the comparable market pool. On Dr Niculescu's assessment it was in excess of 20%. I am satisfied that it was certainly fairly regarded as being over, and probably well over, 10% on any basis. I am also satisfied that this was a very significant fraction, from the point of view of market perceptions.

1712. I am also satisfied that even if this figure or perception were never expressly analysed or articulated by the Defendants, they will, to a greater or lesser degree according to their experience, have naturally gained the basic understanding that CCC's RMBS portfolio was large in the relevant market, and that this would affect market reactions to CCC's activities. This would naturally and reasonably have some influence on CCC's own choices.

2. Depth of the market

1713. This aspect of the expert evidence goes to the volume of sales transactions in securities comparable to CCC's which took place in the relevant period, illustrating the liquidity of the relevant market. Plainly, the more transactions which are taking place, the more confident a seller can probably be that it too will be able to sell on a similar basis.

1714. The expert evidence here, however, consists of the experts' views, with hindsight and over a period of time, as to what volume of activity there actually was in the relevant market. Whilst this may be of help in determining, as the experts then go on to opine about, what sales CCC could itself have effected during that period and at what prices, it is of little direct help with regard to the anterior question with which I am concerned here, namely whether it was negligent of the Defendants not to have embarked on a course of selling at all in the light of what they could perceive at the time. Only the level of activity up to the time of the relevant decision, here taken to be the end of September 2007, would be in point.

1715. Once again, I have had much detailed evidence on this topic, and a great deal of dispute. Since some of the evidence throws up general points which I do find of some broad assistance for present purposes, I refer to them here, whilst also noting the wider aspects of the expert evidence.

1716. The first point is that the experts' disagreement referred to above, about what securities really comprise the relevant "market", obviously affects their consequent views of the volume of relevant market activity. However, they also disagree in their assessment of what market activity there was at the time, and which is material to forming a view of the depth (ie liquidity) of the then market in CCC's assets.

1717. There is a lack of generally available data about secondary market transactions in RMBS such as CCC held. The secondary market is the onward sale of existing bonds which have been previously created and sold as new issuance (by the relevant Agency or created by a broker/dealer) as I have previously described. CCC's sales would have been in this secondary market. The absence of available data is because such transactions are individual OTC ("over the counter") transactions, rather than transactions conducted on an exchange. Even though generally conducted through dealers or brokers, they can therefore often go unrecorded in public information, and they are not necessarily widely noted. There are researchers and data vendors, such as Thompson and MBSource, who research into such matters and can supply their findings, but they are not necessarily comprehensive. All the experts agree that market information is incomplete and even scarce.

1718. The experts have therefore used their expertise and experience to estimate the volume of material transactions. The importance for present purposes is that apparent robustness and activity in the market would be material to CCC's Directors, or CIM, assessing the prospects of being able to make suitable sales. However, whilst assessing the volume of actual transactions in the market may be some guide as to what would be reasonable perceptions of

activity in the market, I do remind myself that CCC would have only had the impression which it obtained, or could infer, from its daily monitoring of market activity and from its communications with traders or others involved in the markets. Its own sources of information were therefore probably more limited than the totality of the evidence in this case, and that available through the researches of the experts, particularly after the event.

1719. Dr Carron's evidence on this topic rather fell by the wayside. He agreed that his original calculations, based on extrapolating from transactions in 11 unique securities reported by five banks in the period from 1st June to 31st December 2007, and treating these as an average across the whole of the market which he had calculated, led to no reliable conclusions. In the end, he did not really give any opinion of the quantum of relevant market activity on which the Plaintiffs place reliance, and this fell to Dr Maini.

1720. Dr Maini was of the view that the relevant market was healthy and active during the second half of 2007, although he accepted (indeed as all the experts agreed) that the level of activity was lower than in the first half of the year. He estimated a total of $71.35 Bn of transaction volume between August 2007 and February 2008, inclusive. This comprised $11.35 Bn of sales evidenced by inference from information in both BWIC data and emails and messages ("market chatter") disclosed in the materials in this action. He later identified $6.6 Bn of this activity as taking place from September to December 2007. (This seemingly replaced his original reliance on MBSource data - a data vendor, specialising in mortgage backed security data – which showed the quantum of dealer inventory strip floater offerings declining by $5Bn between July and December 2007, from which Dr Maini had deduced that around $5Bn of such securities had been sold.) Dr Maini had added $10Bn as an estimate of other, undiscovered, privately negotiated sales in the secondary market, and $50Bn of new issuance. He included the latter because he argued that these bonds had sold, and that this therefore indicated demand for bonds of these types being sold as new issue, but which demand could have been satisfied (although with appropriate, modest price adjustment) by existing bonds, such as CCC's, in the secondary market.

1721. Dr Niculescu, in contrast, took September to December 2007 and estimated $7.5 Bn of transactions derived from analysis of emails and Bloomberg message information and from BWICs. His figure for transactions of which there is actual evidence is therefore comparable with Dr Maini's $6.6Bn. However, he did not add figures for any further privately negotiated sales, being of the view that for such sales to have taken place without being reflected at all in any of the email data or market chatter material which had been scrutinised in arriving at his first figure, was highly unlikely and certainly would not justify doubling the quantum of the evidenced transactions. He included some allowance as regards new issuance, but this was because this included "exchangeables", and it was consequently only a small one; he was of the view that new issuance activity generally was not material because dealers had more incentive, for various reasons, to create new issue than to attempt to buy and re-sell existing bonds, and also because new issuance would tend to be bespoke, and would not be comparable with, or substitutable for, the fixed characteristics of extant conventional strip floaters.

1722. Dr Niculescu also considered that the creation of apparent demand for new issuance of Agency floaters could well have been driven by demand for inverse floaters, although I cannot quite see why that detracts from the point that the ordinary floater which was created seems, from Dr Maini's data, to have sold.

1723. Dr Niculescu pointed out that Dr Maini's reliance on this data did not take account of the fact that new issuance of conventional agency strip floaters, already down in quantum, became confined almost exclusively to 7% capped floaters from at least September 2007. This would be a likely reflection of demand, and it was to be noted that two thirds of CCC's RMBS bore lower caps, those having been the norm when they had been purchased originally. By common consent (ie including Dr Maini) floaters with 6.5% caps, at least, were much less liquid than those with 7%, or even higher, caps.

1724. Whilst acknowledging that there was less market activity for lower caps, Dr Maini's retort was (in effect) that lower caps were attractive because they were cheaper, their spreads increasing relative to 7% caps in the latter half of 2007. This seems to me, however, rather to illustrate the point that they could only be shifted by reducing prices. That must also, it seems to me, throw the focus on to questions as to the worth of the whole exercise for CCC, with its mixed portfolio.

1725. On considering the totality of the evidence of Dr Niculescu and Dr Maini on this topic of depth of market, I find Dr Niculescu's opinion generally more persuasive than that of Dr Maini, because I find it more measured and more soundly reasoned. Some of Dr Maini's evidence seemed to me to be highly generalised. His assumption as to the quantum of additional privately negotiated secondary market transactions appears to be little but a guess, and his approach to new issuance does not seem to me to take any account of matters of detail which I am satisfied would have been material to purchasers, and as to which I prefer Dr Niculescu's views. In places Dr Maini's opinions appeared to be driven by his natural reaction always to find a rebuttal for challenges to views which he had earlier expressed, and sometimes to do so without regard as to whether his rebuttal comments were even consistent with those earlier views.

1726. Once again also, however, there is no need for me to make a finding of the actual level of such market activity, and given the differences between the characteristics of bonds, and the lack of precise data, I think it would be largely meaningless for me to do so. The materiality of this evidence for present purposes is again only at a general level. It simply helps to suggest what broad level and focus of market activity might reasonably have been perceived by Mr Stomber and his team, conducting CCC's day to day business, and would therefore reasonably have influenced their views as to the feasibility of CCC's embarking successfully on a course of selling a substantial quantity of its RMBS. Dr Niculescu's view was that the market was much less liquid than previously (ie previous to August 2007). Dr Maini's view was that it was less liquid but still "relatively liquid" although he acknowledged a close link between liquidity and price. As I have said, I prefer Dr Niculescu's somewhat more conservative view with regard to market activity.

1727. I have pointed out that, for the purpose of examining the impact of market liquidity on the question whether it would be feasible to devise and to commence a sales strategy to divest CCC of $2½ - $3Bn per month of its conventional strip floaters, the evidence of market activity available to CCC was only that up to September 2007. It is therefore material here to note one particularly pertinent item of transactional data at this time which is included within the experts' total for September to December 2007, and which seems to have been quite major but which really only came to the fore in the expert evidence at the trial itself.

1728. This was the first six "Westways" liquidation auctions, the first of which took place on 10th September 2007, with three more on 20th – 25th September and two on 4th October 2007. They included a total of about $3.4Bn worth of Agency floaters, and thus a large part of the total specifically identified market activity over the relevant four month period. The auctions were the compulsory liquidations of these six investment funds, brought about mandatorily under the terms of their constitution under which the funds had to be liquidated if the asset value fell below a specified level. These were, therefore, forced sales. On the evidence, I am satisfied that the prospect of these sales was a known fact in the market, significantly in advance of their actually taking place.

1729. The details of these auction results, insofar as known by CCC, were noted and recorded as part of CCC's day to day process of checking secondary market price information to monitor asset values and anticipate margin calls or repayments, although they were not there identified by name. CCC had already been recording daily IDP and repo lenders' pricings for its securities, but certainly from just before the end of September, it also started periodically recording price information on secondary market transactions, indications from dealers as to their views of prices, new issuance prices and suchlike, systematically analysing the data received into a spreadsheet entitled "RMBS Collateral Pricing Analysis" from which could be calculated secondary market prices for CCC's own individual bonds. Dr Carron, who had reviewed this process agreed that much work was done by CCC's management in this regard.

1730. That Mr Stomber knew of these auctions is shown clearly by emails of his of 4th October 2007 to Mr Buser and others in which he referred to an *"auction that was the result of a liquidation of an ABCP portfolio*", and questioned whether the prices there would be considered to be "distressed" prices or "fair value" prices. His concern about this point arose with regard to the material which PwC would take into account in forming a view of whether CCC was a going concern for the purposes of their end of September audit. It seems to have been in this connection that CCC began its increased data collection with regard to actual secondary market prices and comparison with IDP prices and repo prices.

1731. This specific information is therefore important with regard to assessment of achievable price levels, but what I take for present purposes from this general evidence about the volume of comparable secondary market activity is that even over the last four months of 2007 and even including these liquidations, the whole of the broadly relevant market activity – ie activity in fairly comparable assets - was of a similar order to the whole quantity of RMBS - around $10 Bn - which the Plaintiffs say CCC ought to have commenced disposing of in (at least) September 2007 and continuing during this period. Much of it, also, was noted as being with regard to Agency floaters with 7% caps (as Mr Stomber noted in his emails of 27th September and 4th October 2007) which were, it is agreed, more attractive and readily saleable or better priced than lower caps, which comprised two thirds of CCC's portfolio.

1732. The evidence of such activity which was available to CCC also shows the perception in the market, which the experts do not disagree with, that there was an increase in the supply of securities owing to the sales occasioned by the "broken" ABCP programmes which had had to liquidate in the aftermath of the August crisis. The Westways auctions were an obvious example of that in the RMBS field. This would tend to keep prices down. Dr Carron acknowledged that around this time "*Because of these ABCP liquidations, other holders of RMBS avoided selling if they had the means to forbear*".

1733. Apart from the Westways auctions, it also appears to me, looking at the evidence of actually recorded transactions, that these were generally small, by which I mean below $250Mn. In all the circumstances, I find that the apparent volume of activity in the relevant market, its nature, and the sizes of individual transactions, were factors which were not encouraging to the idea that the market could and would absorb sales of larger quantities of RMBS, at any rate without negative implications for the price. I conclude that the evidence of market activity which was or ought to have been available to CIM and CCC and which would have informed a decision whether or not to embark on a plan to sell RMBS, showed that whilst there were sales being transacted, except as regards forced sales, the volume was not great, certainly in comparison with the amounts which would constitute a worthwhile and meaningful disposal for CCC's purposes. These were inauspicious circumstances for any prospect of making substantial sales at good prices.

1734. In short the quantum of observed market activity over the four month period from September to December 2007 does not seem to me to support a conclusion, even with hindsight, that CCC could have readily disposed of half its own portfolio into the market, even on similar terms to those disclosed in actual transactions. As to the particular immediate question, whether the volume of activity reasonably observed by CCC up to this time - say 1st October 2007 – should have produced the conclusion that CCC could embark on a sales programme to attempt to divest itself of a significant amount of RMBS at reasonable prices with confidence that doing so would meet ready demand, it seems to me that this is even less plausible.

3. Price

1735. The price which CCC might reasonably expect to realise from selling its RMBS is obviously of central importance to the question of the reasonableness of deciding not to sell. It would affect both the extent of any capital losses which would be crystallised by a sale, and it would also provide hard available evidence to third parties of the current market value of the relevant securities.

1736. The first point with regard to the evidence on prices, which the Defendants rightly invite me to note, is that CCC originally purchased these assets at their par value, or (I was invited to assume) as near thereto as made no significant difference. The importance of this is that by the time with which I am now concerned, the end of September 2007, prices had already fallen from this level.

1737. A graph compiled by Professor Hubbard from the ABX Home Equity Indices charts the decline in general RMBS values from the start of 2007 onwards, taking mortgage backed securities of four grades, from BBB to AAA. The poorer quality began to decline first, from January 2007, but AA and AAA ratings remained at around par until June 2007, when they too began to decline. AAA rated securities fared better, declining less and later than AA rated securities, but both Professor Hubbard's chart of these indices and a chart of CCC's own average pricings over the period show a slight decline beginning from around July 2007, becoming small but significant, and gradually increasing, from then on. In fact, CCC's own assets, being Agency backed AAA rated RMBS initially fared better than the AAAs of the Home Equity Index during July 2007, but by the end of September 2007, the compilation list of CCC's own records of the "Average Final Price" of its RMBS assets, which was effectively IDP pricing, shows this now at the $99.00 level.

1738. This figure, a weighted average across all CCC's RMBS, had started the month at $98.82, about its lowest following the August upheavals. It had risen waveringly to a high of $99.26 on 24th September, but then dropped sharply back to $99.00 on 27th September. The price figures for the three different classes of CCC's RMBS by cap levels over the period July 2007 – December 2007 were individually calculated by Dr Maini in his report, and vary around this figure, with 7% caps being consistently higher than the others. In September 2007, these were $98.90 (6.5% caps), $98.83 (6.75% caps) and $99.29 (7% caps).

1739. A 1% fall in value on a $23Bn portfolio meant a capital loss of $230Mn. Thus, the Defendants point out, selling at prices below CCC's own marks would be realising losses not merely measured by that difference, but with the added loss already suffered through the decline in market prices since purchase, a not insubstantial sum. They add, of course, that this was also a loss that could ultimately be avoided as the asset value rose back to par, as it must do by the time of maturity.

1740. Turning to evidence of current prices, CCC's "Average Final Price" was effectively IDP prices, since this was the yardstick which CCC used to mark the value of its portfolio to market daily, although at times making adjustments to factor in its own perceptions of values shown by observed actual market activity. This adjustment tended to result in a downward mark. I have already referred to an instance in June where CCC did this and consequently anticipated margin calls which did not materialise, as its repo counterparties continued to use IDP prices. It became apparent then, if not before, that IDP prices tended to lag behind transactional market prices. Indeed, when CCC started collecting actual secondary market prices and tracking them more closely from just before the end of September 2007, this became (it seems to me) even more clear, as is shown by a chart prepared by Dr Carron (his exhibit CCC-4) of the weighted average prices of CCC's portfolio comparing IDP, repo, and secondary market, and also new issuance prices. From this time, the situation shown is that IDP prices were in general notably higher, generally between about 10 and 50 or more bps higher, (to judge impressionistically from Dr Carron's chart) than prices calculated from secondary market information. They did later converge briefly at three points: the end of October 2007, the beginning of December 2007 and the end of January 2008, but this was still in the future at the time I am looking at.

1741. With the scarcity of market transaction evidence and the individuality of bonds, IDP pricing was always going to be in the nature of telling its audience what prices "ought" (in a sense) to be rather than what they actually were in practice. In times of change, IDP prices were also always going to tend to lag behind actual market transaction prices. Looking at the evidence with the benefit of hindsight, it seems to have done so with a degree of optimism, but that may well not have been apparent at the time, based only on the information available then. It also seems to me that in difficult times, there is no party who would have had any interest in talking IDP prices down, such that this tendency would continue until the pricing agencies themselves decided on any adjustments. I have little doubt that Mr Stomber, avidly considering all current information, would have sensed this tendency.

1742. Repo prices as applied by CCC's counterparties had begun to diverge from IDP prices, downwards, from mid-July 2007. They did so quite significantly, generally by around 50 bps or more, from August 2007 onwards. The evidence suggests that this divergence represented the repo lenders' views of a margin necessary to protect themselves in the case of a mass liquidation of the relevant securities. Whilst the level of repo prices is obviously too vague,

potentially the result of other unknown pressures, and generally too unscientific to be any kind of reliable indicator of likely transaction prices, it seems to be a tolerably clear indication that other players in the market - repo lenders - would expect significantly lower prices than current IDP prices in respect of realisations of such assets, especially in large quantities or stressed situations. In the latter case, there would be the added fear of realisations possibly being in competition with other security holders. On any basis, it seems to me that this displayed price divergence is a factor which would suggest caution about assuming that prices near IDP level could readily be obtained.

1743. This leaves any evidence of prices available from secondary market activity itself.

1744. As regards the evidence of reported transaction prices, there is an evidential difficulty where these are in the shape of market chatter, or emails. This is that quite frequently this information is not conveyed in dollar prices but by reference to the relevant discount margin or "DM". This is a metric used in the valuation of Agency floaters. As I understand it, (and I trust sufficiently accurately for present purposes, although nothing turns on this) "DM" relates the price or value of the security to the current value of the future income stream which it is expected to produce, expressing this in terms of the spread (difference) between that and a benchmark such as, typically, LIBOR. It thus provides an expression of value in the form "[x] bps over" LIBOR, or a "DM of [x]". This is the "spread" which I referred to earlier as the way in which bond market participants choose to look at prices. This enables ready comparison of underlying asset values shown by different transactions, or the translation of a known transaction to the equivalent theoretical price for another security, but it does not itself reveal the actual unit price of the security in question, and the relationship of this to the DM is neither simple nor immediately obvious. The method, or formula, for converting values expressed in DM terms to the dollar price for the security does not readily emerge from the materials in the case, although it is present in what Advocate Wessels described as "punishing detail" in Dr Carron's evidence. The conversion of DMs to an actual price therefore requires expert understanding of how the metric works, and some mathematical skill. On my own, I therefore cannot draw any conclusions, let alone any safe ones, from the expressions of DM which I find in the evidence beyond the fact that, as I have already said, the higher the DM, the wider the "spread" and therefore the lower the price. (This follows, in basic logic, from the point that the same dollar return on a lower capital outlay is a higher yield and therefore a (relatively) more valuable asset, all else being equal.)

1745. I am therefore very much dependent, in my appraisal of the evidence of apparent prices for RMBS, on the expert analysis and calculations which have been given to me in places. This brings me back to the expert evidence and also specifically to the Westways data, which became an important focus of the evidence about price in the market place at this time.

1746. Dr Carron's opinion as to the price at which CCC could have realised its portfolio, was expressed in his initial report as being that "*the range between secondary market levels and IDP prices [was] a reliable indicator of the prices CCC could have obtained in selling RMBS in an orderly sale of part or all its portfolio*." His secondary market prices were those derived from the evidence of secondary market transactions, including what were later identified as the Westways liquidations. By an "orderly sale" Dr Carron was apparently proposing a sale over a period of one or two months. He was thus contemplating sales of up to $23Bn RMBS in such a time period.

1747. Dr Carron had also compared IDP and secondary market prices with the prices for the recorded bank trade transactions referred to above. This information was derived from informational data supplied to the liquidators on their demand by five of CCC's repo lending counterparties (Credit Suisse, Citigroup, JP Morgan, Deutsche Bank and Bank of America) after CCC's collapse. The liquidators asked for details of those banks' dealings in specifically identified bonds. Some of these were bonds of which CCC's portfolio contained parts of the same bond sequence. Having filtered the transaction data down to what he considered to be true sales transactions (although of small quantities and rather few in number) Dr Carron concluded that the prices shown by these transactions were sufficiently close to, and within, the range between IDP and secondary market price levels to support the conclusion that this latter range was what was achievable by CCC, and that the secondary market pricing, particularly as it included the Westways figures as admittedly forced sale prices, represented a "lower bound" of what would have been achievable. Ultimately, and apparently taking a position approximating to the average (I am not quite sure on what basis) mid-point between the tracked IDP prices and the recorded secondary market figures, the Plaintiffs have finalised their case as being that prices no worse than 11 bps below IDP pricing would have been achievable.

1748. Dr Maini although presenting some analysis of the prices actually achieved in the secondary market, especially the Westways figures (as mentioned later,) did not really give an outright opinion as to the actual prices which CCC could have obtained. His focus was more on refuting the proposition that sales in the market would have been likely to result in margin calls, which he disputed because of the even lower repo prices which lenders were using. He acknowledged that sales in the market were taking place below published IDP prices, and otherwise referred to Dr Carron's evidence of pricing, but talked only of a "modest discount" to IDP prices being achievable on "orderly" sales.

1749. Dr Niculescu disagreed forcefully with Dr Carron's opinion and with Dr Maini's support for it. Dr Maini had calculated that the prices achieved in the Westways sales of RMBS were on average 25 bps below IDP prices, (the latter being in effect the same as CCC's recorded marks). Dr Niculescu analysed Dr Maini's prices with corrections to the data set which he thought appropriate, and concluded that the price was more accurately represented as being about 48 bps below IDP prices. (I do not think Dr Maini disputed these corrections, but in any event they appeared to me to be credibly reasoned.)

1750. Dr Niculescu also rejected the proposition that these prices showed a "lower bound" to what CCC might expect to achieve. He pointed out that the Westways auctions were for an aggregate of only $3.4 Bn of RMBS similar to CCC's in total, but were nonetheless themselves regarded as pushing an excess of supply into the market in a situation where it was generally known that that would be the total of such assets coming on to the market. Were CCC to attempt to sell its own assets, the market would sooner or later perceive the prospect of anything up to $23Bn of such assets coming on the market. The only actual market data point which gave some idea as to likely prices for large tranches was the JP Morgan offer in respect of $4Bn, around 21st August 2007, which had been 165 bps below IDP prices (which prices had also been higher in August than in September) and equated to $97.68.

1751. Dr Maini objected that this was not a fair comparison as the proper course would have been to sell in smaller amounts, deploying the techniques which he advocated, and explained in greater detail, and which are considered below. I accept this point, and also Advocate Wessels' submission that therefore CCC could expect to obtain higher prices than those offered by JP

Morgan if it were selling smaller amounts, but the question is still how far that expectation could reasonab ly go.

1752. Dr Niculescu's conclusion, therefore, was that with secondary market activity being evidenced at between 44 bps and 48 bps below IDP prices, but with also the evidence of the JP Morgan offer at 165 bps below, it could not be inferred that current secondary market prices were what could be achieved by CCC's selling under a sales programme – still less the "lower bound" of this – and CCC was very likely to be faced with lower offer prices, and indeed potentially far lower offer prices, than current secondary market prices. At any rate, the risk of this being the case was very real.

1753. I do not see that Dr Carron's original conclusion that CCC could have reasonably expected to achieve prices somewhere between apparent secondary market prices and IDP prices has any convincing basis in logic. It is apparently based on the proposition that the secondary market prices being noted were "forced" sales, such that CCC could expect to achieve better prices because it would not be being "forced". That seems to me to owe more to theory than reality. Once CCC started selling, the market would perceive it had reasons to do so which, in that market climate, would have looked very similar to being forced. I see no reason why the proposition that CCC as a seller was not "forced" but was selling of its own free will should induce buyers to be willing to pay significantly more for its assets than the price of the relevant similar securities currently being achieved in the markets.

1754. The Plaintiffs say that the secondary market prices must be treated as "distressed" prices because they were collected by CCC and presented as such to PwC for the purposes of convincing PwC that the values of CCC's assets could fairly be regarded as higher than those prices for the purpose of PwC's "going concern" review, to which I refer later. I do not accept this, because the issue in the "going concern" report is not what the assets could currently be sold at but what they can fairly be taken to be worth on the basis that the entity is a going concern.

1755. I find that the Plaintiffs simply do not prove to my satisfaction the likelihood that CCC could have achieved any such figure as they propose. It seems to me to be superficial and to take no account of the influence of wider market factors, such as, in particular, the usual market phenomenon that prices will tend to be lower for greater quantities, and trading partners broadly look to achieve the most advantageous deal they think they can for themselves. Having considered and weighed the contrasting opinions of the experts, I very much prefer the evidence of Dr Niculescu in this regard, as it has, to my mind, far more of the ring of realism as against mere theory.

1756. I have referred above to elements of prices being noted by Mr Stomber during September. Through management, CIM/CCC was, I am satisfied, keeping abreast of this information as well as possible - it was on any basis important as regards monitoring the margin position, which was clearly done closely and continually. I find that on the evidence available it was reasonable to conclude that secondary market transactions were not proceeding, even for smallish quantities, at prices which approached current IDP prices. FT/IDP prices would, for obvious practical reasons and as had been previously identified by CCC when anticipating margin calls, lag behind the timing of actual transactions in the market.

1757. The evidence from the Westways auction which was noted and commented on by Mr Stomber on 4th October shows also that the prices of moderate and larger quantities of RMBS were relatively low and apparently gave rise to margin calls.

1758. I find that all the evidence points to it being a reasonable working prediction that on selling any significant quantity of RMBS, CCC could not expect to achieve better than current secondary market pricing levels, and at the end of September 2007, the time with which I am here concerned, this was at best about 45 bps below IDP prices. There was also a significant possibility that it might not, in the event, even be able to achieve that.

4. Risks of selling

1759. The benefits of selling a worthwhile amount of RMBS at a worthwhile price would be an increase in liquidity, and a reduction in repo capacity requirements. This would come at the cost of permanently crystallising capital losses, as prices were now lower than CCC had originally paid.

1760. However, these were not the only risks of selling, about which I have heard much. The further risks of selling I identify as being broadly twofold. They were the risk of moving the market, and the risk of being perceived to be a distressed seller.

1761. As to the former, CCC's business depended on the value of its RMBS as collateral – or more accurately in practice, its repo lenders' recognition of the value of its collateral – because on this value depended, first, the amount which CCC could borrow, and second, and on a day-to-day basis, whether margin calls would be made against it. The risk of selling was that in executing a transaction, even a small size transaction, CCC would provide evidence of price and thus apparent value. If this were below current prices, (whether IDP or other actual secondary market prices), this evidence could and obviously probably would be used by repo lenders to justify marking down the already marked down repo value of CCC's other similar securities still further, potentially producing an immediate margin call and subsequently producing an increased effective haircut as against CCC's own price marks, these broadly remaining at IDP prices. Eventually the evidence would percolate through to the pricing services and affect these as well.

1762. These knock-on consequences could have the effect, first, of wiping out the value of any increased liquidity generated by the sale, especially if the sale had been relatively small and had released only a small amount of liquidity (likely to be between 2% and 3% of the total sale price, approximating to the amount of the repo-lenders' haircut), but was then used as evidence to justify margin calls in respect of much greater amounts of RMBS which were still retained by CCC. Mathematical examples show that this effect could use up all the liquidity gained, leaving CCC no better off in liquidity terms than before, and worse off as to the financing terms which it would then be likely to obtain. If the margin call more than wiped out the gained liquidity so that even more cash was then required to meet margin calls, this would generate an urgent need to sell yet more RMBS, to generate further liquidity, and with the increasing risk of being seen as a distressed seller in a weak negotiating position. This cycle could continue and bring about actual insolvency. Indeed the expert evidence of Mr Welles was that this could happen very quickly, possibly as a result of a single repo cycle.

1763. This phenomenon has been generally called a "liquidity spiral" during this case, although there is some expert disagreement as to whether this is correct. Where the phenomenon relates to an

individual entity such as CCC, Dr Carron, and I think also Professor Das, say that it is more correctly termed a "repo feedback loop" with the term "liquidity spiral" being reserved for the same process on a systemic scale. The important point, though, is that all the material experts except for Dr Maini, but including Mr Welles, Mr Shaw and Mr Wallace, recognised the phenomenon, expressly.

1764. Dr Maini claimed not to recognise the term "liquidity spiral" and said that in his experience people on the trading floors did not know and were not concerned by it. However, the logic of his other evidence – in particular his recognition that selling for CCC, particularly selling bulk, was "risky", and which risk he associated with price declines – seems to me to be a tacit recognition of the potential for the phenomenon described. His denial of it was, I find, simply the product of his regrettably combative evidential style. However, his evidence was still that, in any event, such a risk could be eliminated, or substantially alleviated, by the use of the sales techniques which he advocated, and to which I refer further below.

1765. Dr Maini objects that the risks of moving the market were not confined to CCC's selling quantities of RMBS, but could on the face of it be triggered by any other party selling large quantities of RMBS into the market as well. This is not, however, a reason for rejecting the proposition that sales by CCC could have that effect. CCC had no control over the actions of other parties, but it could at least avoid self-inflicted damage.

1766. The upshot of all this is that I am satisfied that the overwhelming preponderance of the evidence is that the creation of a liquidity spiral, or repo feedback loop, by attempting to sell into an adverse market when dependent on slim liquidity, was a well-recognised and very major risk. This is not least because such consequences, once triggered, are entirely out of the control of the selling party, because they depend on the reactions of third parties, which are in themselves unpredictable, and which can very easily snowball adversely and gain enormous momentum. Embarking on a course which courted this risk would therefore be a very serious decision to make.

1767. The second, perhaps more subtle and insidious, risk was that of becoming perceived to be a distressed seller. It is associated with the first point, but has several other implications.

1768. First, there is the obvious point that a seller who is selling out of necessity rather than choice can be driven to accept a lower price because he cannot take a hard line in negotiations. Moreover, the financial markets are hard-nosed, and, especially in hard times, it must be expected that negotiating advantage will be fully driven home.

1769. Second, such a perception would have a reputational effect. It could and would (in this information sensitive marketplace) lead indirectly to more adverse terms of trade being demanded (higher haircuts; lower repo marks) by more cautious counterparties, who would play safe in dealing with a borrower about whom there were signs, or even just rumours, of instability.

1770. Third, but particularly applicable to CCC because of its large holdings of RMBS, was the risk that, if the market perceives that there is about to be an influx of supply of some particular commodity into the market because a particular entity looks as if it is going to be selling, which would, on the usual laws of supply and demand, tend to bring down prices for the commodity, then market reaction may well be to sell off their own similar assets in advance of the anticipated sales, so as, in their own interests, to get out whilst the price remains higher.

Such a reaction can gather pace as perception spreads and can itself move the market in the relevant assets down. This is no doubt particularly so in a market which includes traders as well as investors.

1771. Fourth, and a more extreme reaction than the third, is that it is suggested that there is a phenomenon known as "predatory trading", where the perception that there is about to be a major distressed sale of assets will cause dealers actively, and even in concert, to sell the same class of assets, even going so far as to sell short, so as to force down the market price and compel the distressed vendor to dispose of the assets at rock bottom prices, so that they can then all be bought up and traded on at a later profit.

1772. I fully accept that the first three aspects of this risk, mentioned above, exist, are potentially serious and would have been reasonably perceived as such for CCC. I am less convinced as to the fourth, which appears to me to be very extreme and artificial, and the evidence of which I find to be somewhat patchy. Research articles in the evidence suggest that it was instrumental in the downfall of Long Term Capital Management in the 1998 crisis which assumed an iconic identity in this case. Dr Niculescu also suggested that, on examination of the IDP pricing records, a sudden downward spike of prices for RMBS in August 2007 could have been an example of this phenomenon being applied to the anticipation of the Westways auctions, following the knowledge that their liquidation triggers had been reached.

1773. Whilst this evidence was interesting, I felt that it was speculative. I have certainly gained the impression that there is a good deal of tactical dealing and behaviour in the financial markets, and as an outsider I may not have a natural appreciation of its full extent, but predatory trading as described to me is an intricate and complex strategy, requiring ingenuity and nerve, and involving expense and risk for the predatory trader itself. It is virtually an attempt, even approaching a conspiracy, to bring down the entity in difficulty. The direct or indirect gains to be made would, it seems to me, have to be perceived to be very large to provoke such action. A technique described (by Dr Maini) of creating a "synthetic short" of an Agency floater anticipated to be coming on to the market was particularly elaborate.

1774. However, it is also to be noted that the risk of being perceived to be possibly a distressed seller can materialise even before any actual selling takes place. The market is alert to information which may need to be acted on to gain advantage or avoid possible disadvantage, and signs that a party is thinking of selling will be noted, evaluated, and possibly provoke early reaction, especially if the selling is perceived as abnormal activity for the relevant party. Again, such market reactions cannot be controlled and therefore, if the consequences of adverse reaction could be serious, that is all the more reason to take strong precautions to avoid possibly creating the dangerous impression. As such consequences could be triggered even by CCC being noticed to take steps which might be interpreted as anticipation of selling, such as making enquiries by listing bonds for sale, or responding eagerly to buying enquiries, I accept that "managing the message" to the market was, and was rightly seen to be, an important consideration with regard to CCC's ongoing strategy. It was all the more important because there would not be a second chance; once activity by CCC had attracted unwelcome attention that it might be a distressed seller, there would be little chance of quelling the perception, except perhaps by a show of conspicuously not selling, to send a message of strength and confidence. That, however, would be fire-fighting. All this underlines the dangers presented by the fact that one cannot control market reactions, and, however unreasonably or frustratingly, they can quickly work in an adverse fashion.

1775. I doubt if the anticipation of predatory trading as such really figured as a scenario in the thinking of CCC's directors at the material time, but it is only an extension of the first three risks (lack of negotiating clout, being offered less good terms and prompting a run on the relevant market) and I am quite satisfied that these did so figure, even if never recorded and articulated expressly as such. They are the kind of eventuality which players in the market observe, or gain experience of and simply "know" could happen.

1776. This, though, leads to the obvious consideration of how discreetly, in practice, CCC could have made or initiated any sales. The experts are agreed that selling by privately negotiated sales was the best course for CCC, precisely because of the need for discretion. Associated with this is the point that the greater the number of parties who became aware that CCC might be selling, the greater the risk of adverse reaction. But selling a large quantity discreetly in a single transaction to or through one buyer, at an acceptable price, was itself difficult, as CCC had already had direct experience of, with JP Morgan.

1777. As I have said, I do not think it is even contentious that the risks to which I have referred did exist. The difference between the parties is really as to how great they were (or were reasonably perceived to be), how much they weighed against the benefits of deleveraging, and whether they could have been satisfactorily mitigated by the use of certain sales techniques, which CCC – or CIM - ought to have known about, and which CCC could, and should, have successfully employed in order to mitigate such risks and achieve a successful sales programme, as submitted by the Plaintiffs.

1778. Dr Niculescu says that the risks of selling were particularly acute for CCC because of its reporting obligations as a public company, which made it difficult to sell discreetly, and meant that any information about its activities which was open to adverse interpretation was widely disseminated. He cites CCC's short operating history and the well-known facts of its recent purchases, its virtually unique position as a large market participant and its well-advertised buy-and-hold strategy, as factors which would increase the risk of markets interpreting signs of selling activity as signs of distress. He also cites the operational problem that CCC held almost equal quantities of 6.5%, 6.75% and 7% capped floaters, and that demand for the lower caps was notably reduced, as being indicators that CCC would have struggled to find buyers for this significant portion of its portfolio other than at distressed pricing.

1779. Dr Maini's opinion, expressed in his Addendum Report, was that the fear expressed that CCC, as a buy-and-hold enterprise, would be particularly vulnerable to the risk of being perceived to be a distressed seller if it embarked on selling activity, was incorrect and exaggerated after the August liquidity crisis, because market conditions had then changed. Responsible deleveraging was expected, and indeed respected, such that sales activity by CCC would be viewed with relief by its repo counterparties, rather than concern. CCC could and ought to have engaged proactively in the market and could and should openly and actively have gathered market information and "colour", with a view to being in a position to step in and respond positively and effectively to the market sales opportunities and in particular to dealer enquiries. His view, in a nutshell, was that this risk could have been averted by ensuring that CCC established a reputation as a "disciplined net seller".

1780. The Defendants submit, in effect, that this view is an opinion about the way in which the market would have reacted, which is no more than one opinion at best, and goes nowhere to

supporting the view that the only reasonable approach for CCC was to rely completely on the attitudes suggested by Dr Maini operating in practice.

1781. Having reviewed all the evidence, I am satisfied that it was both objectively the case, and a reasonable subjective perception for CCC, that the consequences of being perceived to be a distressed seller could be very damaging, and indeed potentially disastrous, both as to the terms of any sales achievable, and (and more importantly) as to consequential effects for them in the market. I find the points summarised by Dr Niculescu regarding the vulnerability of CCC to being perceived to be distressed to be significant and persuasive. Furthermore, fears of the effects of such risks would reasonably have been reinforced in the Defendants' thinking by the behaviour of CCC's repo counterparties up to that time, which suggested that they themselves were nervous and would react accordingly, and that safeguarding their own interests and internal pressures would make them hugely risk averse, and resistant to persuasion from CCC that they could safely continue lending as usual, even if that was apparently rational.

1782. Concern about highly unpredictable and disadvantageous consequences from selling RMBS in any quantity was thus, I find, not unreasonable. CCC had already had one discouraging experience in August, in the shape of being urged (and willing) to sell a large quantity of its RMBS and then finding that the discreet attempt to do so through JP Morgan had produced an offer price which all the experts agree was rightly viewed as unacceptable. Dr Maini is of the view that CCC was naïve in ever thinking that it could expect an offer for such a large block of RMBS at anything except a significant discount from the prices of more ordinary size transactions. That does not seem to me to detract from the point that the lessons of there being a discount for size then became all too vivid.

1783. Similarly, the news of Carlyle's support for CCC in the shape of the $100Mn loan of late August was a matter which Mr Conway had expected the market to receive favourably, and then to assist CCC by spreading the message that CCC was supported and was sound. Instead, the media reaction had been the opposite and had suggested that Carlyle support meant that CCC was in difficulties. Mr Conway having thus found market reaction to be disconcertingly adverse and unexpectedly unpredictable, I have no doubt that he would have become more wary about assuming and relying on a positive reaction to any noteworthy steps taken by CCC in the market. Since the consequences of a mistaken judgment about this could be so serious, it was not only reasonable but, in my judgment, prudent to be cautious in this regard.

1784. Mr Stomber had a low opinion of the degree of loyalty, or even dispassionate assessment, which might be expected from others in the market, especially in hard times, and I am satisfied that this cynicism was not an unjustifiable view, and the caution which it would engender was reasonably felt. The other Defendants, I am satisfied, reasonably held similar views, albeit with a greater or lesser degree of conviction depending on their own background, but otherwise (and reasonably) taken from and reinforced by the obvious views of their more experienced colleagues, whether implicit or directly articulated at the time.

5. Sales techniques

1785. However, much of the expert evidence at the trial was focused on the ways in which Dr Maini said that the perceived dangers to CCC of selling could be dealt with, namely by using appropriate sales techniques. I therefore now turn to these.

1786. I have said that a point of specific concern to me was whether Mr Stomber in particular, as the most expert amongst the Defendants, was as well acquainted with the possibility of using the techniques advocated by Dr Maini as he should have been, given the degree of skill to be expected of him, or, if he was so acquainted, whether he therefore gave their deployment sufficient consideration. It seemed to me during the trial that this was rather a significant point in the case, and my general impression was that it had been somewhat glossed over by the Defendants. However, having, as a result, looked in particular detail at the evidence on this topic, I have come to the conclusion that my initial impression was unjustified, and really arose because this matter barely figured in the oral evidence, which I review later.

1787. The issue of the availability of such skilful and expert sales techniques first emerged in the Expert Report of Dr Maini, in September 2015. The Plaintiffs' case had until then been based upon the general evidence of Dr Carron, suggesting that the whole - or at least half - of CCC's portfolio ought to have been sold off with an assumption that *"the range [of prices] between secondary market levels and IDP prices [w]as a reliable indicator of the prices CCC could have obtained in selling RMBS in an orderly sale of part or all of its portfolio*". This statement was thus seemingly in regard to straightforward sales, with no particularly special techniques or strategies being employed. For reasons which will already have become apparent I find (and this has been implicitly accepted by the Plaintiffs' modification of their case) that taken at face value that is far too broad, casual and simplistic a proposition.

1788. It was only with Dr Maini's evidence that it became suggested that more elaborate approaches to selling the RMBS assets might have been deployed. Both the experts in this field, Dr Maini and Dr Niculescu, are agreed that achieving sales of Agency floaters by CCC in late 2007 would have entailed risk, was not a trivial exercise, and would have required skill and effort. Dr Maini suggested that a combination of sales methods could have been employed which would have avoided, or at least hugely alleviated, the risks of selling mentioned above (which he considered to be being overstated in any event), and that this strategy would have produced a marked gradual reduction in CCC's RMBS holdings and increase in liquidity, would not have moved the market, and would have enabled CCC to divest itself of RMBS at the rate of "at least around $500Mn worth a week", on average and over a period of three or four months, thus achieving the reduction of about $10Bn proposed by Dr Carron. When this was challenged as impractical by Dr Niculescu, whose conclusion was that the best that CCC could have expected to achieve safely, in its circumstances, would have been the total sale of about $1Bn of RMBS during that whole period, Dr Maini then elaborated on his propositions in his Addendum Report.

1789. The sales techniques proposed by Dr Maini were to operate in combination (though he does not give any indication of suggested ratios) and were fourfold. They were:

a. two-way trading,

b. recombination,

c. auction sales/BWICs and

d. negotiated sales.

Although Dr Maini gave no further detail, he gave as his opinion that selling the whole portfolio by a combination of these methods would have achieved about $100Mn less than, for

comparison, selling the portfolio optimally in June or July 2007, reflecting a 0.5% change in prices since that time, and this he said would thus have limited losses to no more than about $100Mn. This comparison is, though, not really material. There is no suggestion that the portfolio ought to have been sold in June 2007, I have found that there was no justification for arguing that it should have been sold in July, and prices had changed by the time which I find central to this point, namely around the end of September 2007.

(a) Two way trading

1790. Two way trading is a technique which involves achieving the end result of selling by a combination of buying and selling in the market, but ultimately selling more than was bought. It is used to disguise one's motivations. Dr Maini expressly advanced this as a technique which would avoid the perception of being a forced seller and thus "*[avoid] putting unnecessary downward pressure on prices*."

1791. Dr Niculescu expressed scepticism that this method would actually avoid attracting attention to the fact that CCC was selling, especially as it would have to be repeated. Dr Maini's response was that he was not advocating stealth, but rather that CCC should establish a reputation as a "disciplined net seller".

1792. This contention seems to me to be departing from reality. It might fit the theory of avoiding the perception of being a *distressed* seller, but it does not meet the point and problem that CCC's reputational place in the market was that of not being a seller at all. Dr Maini's response that CCC's reputation would merely have been changed to that of being "prepared to sell at good prices", does not, in my judgment, meet this point, first because he never focused on what were "good prices" or the reality of CCC's being able to achieve these whilst using this selling strategy, and second because the notion that CCC would expect to have the time to establish itself with such a reputation seems to me to be a long way from practical reality. We are here looking at how the feasibility of deploying such a sales technique ought reasonably to have appeared to the relevant Defendants in September 2007.

1793. The Defendants submit that, in the end, Dr Maini accepted that this technique came down to avoiding the perception of being a distressed seller by demonstrating the ability to refuse to sell except at "good prices", and this was actually the fundamental plank of the strategy which CCC did adopt. This is rather superficial, though, as Dr Maini's point was that one established the reputation by participation in negotiations and transactions and thus getting the market used to the idea that one was prepared to be a seller, rather than by never transacting at all.

1794. However, the Defendants also point out other practical aspects of Dr Maini's technique which they submit he had not taken into account. On the purely financial front, there was first that the need to buy further assets as well as to sell them would itself have required more liquidity - which was the very thing which CCC was short of and trying to conserve. Next, the actual purchase of more assets so as to convince the market that CCC did not need to sell would itself entail the risk that, if sales then could not be achieved at sufficiently "good" prices - and there could be no guarantee of this - CCC risked being left with more securities, which by definition it could not sell at "good" prices, than it had started with. A third point was that by buying more securities in order to sell them again (as part of this strategy) CCC would incur the transactional losses inherent in the bid-ask spread on the securities, which Dr Maini himself estimated at about 0.5%. Dr Maini had also done no calculations to enable any comparison

between the putative outcome of his sales programme and CCC's actual financial position in March 2008.

1795. There were then the operational points that this activity would be time-consuming and effectively be turning CCC into a trading enterprise, and that CCC did not have the staff equipped for this; Dr Maini suggested that additional traders could have been hired in, but this would of course have further cost implications. The buying and selling strategy would also have been inconsistent with CCC's published investment strategies and this would risk betraying the underlying fact that this was an effort by a company under pressure to increase liquidity. Finally, the Defendants point out that this change of strategy would have brought into question CCC's accounting practices, which required that assets be held indefinitely and not used for trading in order to justify their "Available for Sale" accounting treatment.

1796. It did not seem to me that Dr Maini, or the Plaintiffs, really had any answers to these points beyond asserting that they were exaggerated. However, I do find them to be real disadvantages to using the technique of two way trading as a means of easily, or safely, improving CCC's liquidity in the latter part of 2007. The supposed achievable advantage also strikes me as more theoretical than real.

1797. It seems to me that this is somewhat betrayed by Dr Maini's pithy summary description that CCC could have set out to establish itself as a "disciplined net seller". This is because that is a market image which can only be applied to market participants on a temporary basis, because if it is a long term description, then it must amount to running down and winding up the business. This suggests that this is a description derived from the ever changing world of the market trader, suitable to describe a temporary attitude in the market, and thus that it would be unreal to expect that such an image could be productively cultivated for CCC. To my mind this exposes a major lack of practicality in Dr Maini's thesis.

(b) Recombination

1798. Recombination is a technique which relies on the fact that simple Agency pass-through securities are a better known, more widely traded and more attractive investment than are more elaborate structured securities. The concept of recombination is that of finding the exactly corresponding parts of the original pool of collateral out of which a structured security was created and purchasing these, so as to recreate the original simple pass-through security which can then be more easily traded.

1799. The most liquid market in this context is the TBA ("To Be Announced") market, under which standard contracts are made for the sale at a future date of a given amount of mortgage backed pass-through securities, which are as yet not specifically identified (hence "TBA") but which will comply with certain agreed criteria or characteristics.

1800. At its simplest level, with regard to an Agency floater, recombination would therefore involve acquiring the corresponding inverse floater (possibly, I think, further divided into IO (interest only) and PO (principal only) classes), so that one owned all parts of the original pass through and could trade them on compositely. However, to enable the complete recreation of the original collateral pool, and therefore to be tradable in the TBA market, it would also (Dr Niculescu pointed out, and I did not understand Dr Maini to disagree) involve acquiring something known as the "residual". This is a small value part of the structure created on securitisation which exists, as I understand sufficiently for present purposes, to take account of

the risk of tax liabilities arising from any mismatch in payments between the original collateral and the securitised coupon. In the case of a floater and inverse floater, it is of minimal value and may indeed even have a negative value at the outset. It is scarcely tradeable on its own, but it is necessary to buy it in to reconstitute the original collateral fully. There is an additional complication, according to Dr Niculescu, in that the residual would be likely to underly not only the particular bond in question but also others in the same sequence, such that one could not collapse the particular floater/inverse floater without collapsing these others as well.

1801. In this simple form, therefore, a true recombination involves acquiring these elements – floater, inverse floater and residual. Dr Maini said (and Dr Niculescu agreed) that there were many other forms of security as well, the product of more complex structuring. These could also be the subject of recombination, but Dr Maini accepted that anything more complex than a two or three part recombination at the most, would be far too elaborate to be feasible, certainly for CCC.

1802. The Defendants dismiss the "true" recombination possibility because, as Dr Maini actually accepted, this would only have applied in practice to about $200Mn of CCC's Agency floaters – those which he identified as "strip trusts" - which was hardly a worthwhile prospect as it was only about 1% of the portfolio.

1803. Dr Maini's main focus in relation to recombination was the class of CCC's securities which he described as "simple" floaters, with a total face value of about $9.46 Bn, and which he said had no more than one or two matching classes to be acquired so as to be tradable in practice. He noted that $2.57Bn of these were 6.5% cap floaters structured off 6.5% coupon collateral, which made them particularly amenable to recombination because (he said) it only required matching the inverse IO (interest only) to the relevant floater (rather, I take it, than other additional matching parts as well). This would produce, he said, a CMO with "pass-through like" qualities which could then be more readily and advantageously traded than the capped floater itself, although he accepted, not into the classic TBA market. As regards the remainder of CCC's portfolio, Dr Maini categorised these as "generic" and accepted that they were not amenable to recombination at all, because there were too many matching classes required.

1804. The general description of recombination was accepted by Dr Niculescu, who agreed that the mere matching of the floater and the corresponding inverse floater parts gives rise to an asset with the economic properties of a pass-through, but, as already mentioned, without the residual it cannot be traded in the TBA market, and is therefore (he said) less liquid. He explained that it is less liquid because its deficiency as against the familiar standard complete pass-through security means that the possibility of re-selling it is less reliable, and he pointed out that lack of liquidity reduces value. He suggested that the market for such recombinations was likely to be confined to the Agencies themselves, (although it is fair to say that, as his experience was very much within one such institution, this view might have been influenced by this background), and he pointed out that at the relevant time in 2007, as CCC had already discovered, the Agencies had balance sheet constraints which prevented them from acquiring assets. In addition, Dr Niculescu explained that there is the possibility of combining a floater and inverse floater which themselves do not quite match for not being from exactly the same original bond, and creating what is known as a re-REMIC, but that this is even less readily tradable. Dr Maini clarified that his general proposition about recombination was not intending to include this last kind.

1805. Dr Niculescu was challenged in evidence that the reason why he had not mentioned all these forms of recombination in his original report was because he was unaware of them, thus casting doubt on his expertise in this area. I do not accept this; I find, first, that he simply used different terminology when first describing recombination, and second that as he himself dismissed this as a viable option, it was only somewhat later in the course of the evidence that it appeared to assume any real significance and therefore to require more detailed explanations from him.

1806. Dr Niculescu's opinion was that, taking all considerations into account, this technique was simply not feasible for CCC, and I found his points persuasive. The Defendants submit that, apart from limited practicality, there are similar disadvantages in respect of recombination as in respect of two-way trading, referred to above. The process uses up liquidity to purchase additional assets, and incurs the financial costs of the actual trades and creating the new CMO. There are also considerable time and effort costs in tracing and purchasing the necessary parts of the securities. These, they submit, had not been given proper weight by Dr Maini.

1807. Dr Maini was dismissive of the costs involved, in particular, the likely need to pay any premium to the holders of the material inverse IO or PO, or the effort involved for CCC in positively pursuing any such strategy. Indeed his evidence rather moved from this to stressing the widespread use of such recombination activity, which he pointed out could be detected in the evidence, citing, as an example, an enquiry from Merrill Lynch to CCC in November 2007 with regard to a bond where they were apparently seeking to recombine a bond with the Bloomberg ID reference FHR 3262. Whilst accepting that he was not suggesting that CCC should have embarked on such activity on a mass scale, he disputed Mr Stomber's evidence that the balance sheet (ie resource) requirements for this technique would have been unworkable for CCC, on the basis that such financing requirements could be raised through the proceeds of CCC's other sales activities and previous recombinations - or even using leverage.

1808. Dr Maini's evidence is straying, at this point, from his expertise in the world of RMBS trading into the world of CCC's own investment management decisions. I find it unconvincing, owing a lot to theory and hypothesis and little to any conception of practicality for CCC in the situation in which it now found itself. Indeed, the very fact that Dr Maini advances his last proposition in apparent seriousness – that CCC could have <u>borrowed</u> in order to pursue his proposed techniques - illustrates my perception that he tends to focus on winning the theoretical argument, and in doing so loses sight of the point of the evidence at all. Again, therefore, I am persuaded by the more measured assessment of Dr Niculescu.

1809. As a final point, the Defendants ultimately submit that, in the complete absence of any evidence as to the quantities which Dr Maini suggests could have been recombined, or the economic consequences for CCC in terms of the costs of implementing the process and the cash which could have been generated, then even if recombination were a practicable technique it is impossible to assess whether it would have been worthwhile; it is for the Plaintiffs to satisfy the court that an actual opportunity was culpably missed which should have been taken and which would, on balance of probability, have secured a better financial outcome for CCC than in fact occurred, and in this respect, they conspicuously fail to do so. In the end, I agree with this submission too.

(c) Auction sales

1810. This includes the now familiar BWIC ("Bids Wanted In Competition") lists by which willing sellers solicit offers for their securities. It is not an esoteric sales technique, but it is, of course a sales method which, if adopted by CCC would have made it plain that it was in the market for selling. Thus it courted some of the risks previously referred to.

1811. Dr Maini cites the Westways liquidations in his Addendum Report, as examples of Agency floaters that traded by auction. I have already referred to his analysis of the price and Dr Niculescu's disagreement with this. The Westways evidence really goes no further than showing that RMBS could be sold, and the prices applicable in the particular conditions of those sales.

1812. The Defendants point out that whilst Dr Maini advocates that CCC could and should have approached several dealers with regard to a single bond at any time, apparently having no concern for the risks of CCC's intentions to sell becoming widely known and having adverse side effects, he is alone in his lack of concern about this. Dr Carron accepted, in his original report, that a concern about alerting the market to a large volume of securities being for sale, even if the identity of the seller were not disclosed, could be met by private arrangements whereby "*one or a small number of dealers (such as CCC's larger repo counterparties)*" would "*negotiate private sales (<u>not BWIC auctions</u>)"* with clients (emphasis mine).

1813. The Defendants submit that the preponderance of the evidence is that it was reasonable for CCC or CIM to perceive that resort to BWIC auctions would be too dangerous and risky as regards perceptions and reactions in the market place, and that this element of Dr Maini's suggested sales techniques should be discounted. On the balance of the evidence, I accept that this was a view which it was possible reasonably to hold.

(d) Privately negotiated sales

1814. There is agreement between both sides that one way (the Defendants say the only potential way) in which CCC could have hoped to make any sales which would have been sufficiently worthwhile but also sufficiently discreet was by seeking to achieve privately negotiated sales. The difference, with Dr Carron's rather "broad brush" approach having largely been discounted in the course of the trial, is that Dr Maini suggests that, as part of a concerted selling strategy using also the other techniques he has proposed, this could have been done openly and in negotiation with a reasonably broad range of counterparty brokers or dealers, such that his suggested level of deleveraging sales could have been achieved.

1815. The Defendants deny that there was any real mileage in this possibility in practice. They point to the lack of fruition of the JP Morgan offer, the unsuccessful attempts to sell back to Fannie and Freddie, and the ultimate coming to nothing of the UBS enquiry, all briefly mentioned above, but which I examine more closely below. They point out that this last resulted from a reverse enquiry anyway.

1816. This is really the essence of the point in the context of this general review of the factors which should have informed a decision whether or not to try to sell RMBS at the end of September 2007, because, on the evidence, it seems to me that private sales were really the central selling technique available to CCC. I just do not find it convincing that any of the other techniques advanced by Dr Maini were either feasible or practicable for CCC to deploy, probably at all, but certainly not in any sufficient quantity to make a significant impact on the prospects of safely effecting sales of RMBS (ie without running serious risk of prompting unhelpful or even

adverse reactions in the market). However, there are also limits, in my view, on the extent to which private sales could be sensibly deployed, and I am satisfied that the general risks of CCC engaging in trying actively to set up such sales were significant.

1817. Having up to now focused on the expert evidence with regard to use of special sales techniques, it is appropriate to turn here to the Defendants' own evidence on this topic. This is really that of Mr Stomber, because, as I made clear above, this was a point which I certainly found troubling during the trial, and which I have therefore looked at closely.

1818. A large part of Mr Stomber's second witness statement was devoted to explaining that he was aware of the techniques advocated by Dr Maini, or at least of the simultaneous buy and sell strategy, because he had even used that when he "worked on a trading desk". There is no express reference to working on a trading desk in Mr Stomber's account of his work history and experience in his first witness statement, but I infer that it was part of his early experience at either Pacific Bank or Deutsche Bank. It may merely be that the terms in which he described those positions in his CV included, but did not make clear to the outsider, the fact that this involved trading activity. He was not cross-examined as to his assertion of such experience.

1819. The Plaintiffs submit that his evidence is not to be believed because it is an *ex post facto* justification of his (CCC's) inaction in this regard, not included in his first witness statement and having been (the Plaintiffs suggest) prompted by the damning production of Dr Maini's expert evidence. However, despite what had become the centrality of this point given the fact that Dr Carron's more superficial approach had been undermined, and even allowing for the fact that it may have arisen only somewhat late in the progress of the case, Mr Stomber was scarcely cross-examined at all about his evidence that the techniques suggested and expanded on by Dr Maini could not have been deployed practically by CCC and the reasons for this. The salient part of Mr Stomber's cross-examination took place in the very last session of his oral evidence, on the last afternoon, immediately after the short adjournment. It was effectively two questions only, the first being:

> "Q. *Is it your evidence that although you were aware of the methods proposed by Dr Maini those methods were not available to CCC because it wasn't a trading desk*?"

1820. The answer, in summary, was that it was much more than that, and was first, that CCC was not itself a broker or a dealer and was therefore confined to dealing with 10 – 12 such entities itself and second, that a trading desk in an investment bank was very different from a "buy and hold" fund (such as CCC); CCC did not have a team of sales persons with contacts of a thousand or more potential purchasers of product around the world, and its inventory, unlike that of a bank trading desk, was disclosed publicly every month when it was obliged to publish information on its asset profiles in accordance with its listing regulations.

1821. The other question, which followed, was simply:

> *"Q Do you accept that you could have retained someone to assist you deploying all the strategies that Dr Maini outlined?"*

to which the answer was "no", because his strategies were not relevant to CCC and (as I understood Mr Stomber's answer) those strategies were deployed in a different world, because

"A ……*I make my money by buying the security and holding it and receiving interest income. An investment bank makes its money through the bid/offer and buying and selling securities."*

1822. Neither answer was investigated or challenged further (although I should record that Dr Maini in his further responsive evidence did dispute the assertion that CCC was limited to dealing with 10-12 or so institutions; I regard this as peripheral). Advocate Wessels concluded his cross-examination of Mr Stomber very briefly after this, largely by putting various general criticisms raised by the Plaintiffs to him and asking if he accepted these - which he unsurprisingly did not.

1823. Mr Stomber's evidence of his explanations for not causing CCC to pursue Dr Maini's suggested strategies was thus, it seems to me, not actively challenged. I am not, of course, obliged to accept it if I find it implausible or unconvincing as a matter of logic or common sense, or if there is other countervailing evidence which is so forceful that I am persuaded that Mr Stomber's evidence cannot be accepted, but I am entitled to assume from the paucity of cross-examination that these were the only points on which the Plaintiffs wished, or felt able, to challenge Mr Stomber's evidence on this topic. Their case thus really depends on my concluding that Mr Stomber's responses on these points were inadequate or implausible.

1824. I have taken into account the fact that Mr Wessels had had his time limited with regard to his cross-examination of Mr Stomber. I do not need to make any allowance for this, however, for two reasons. The first is that my refusal of Mr Wessels' application to extend Mr Stomber's cross-examination so as to require him to give evidence beyond the six days originally scheduled for his evidence occurred the previous day and Advocate Wessels therefore had plenty of time to adjust his cross-examination on this point appropriately to its perceived significance. The second reason is that, in any event, he concluded Mr Stomber's cross-examination with half an hour to spare from the timetable. I cannot conclude, therefore, that cross-examination on this topic was curtailed because of time constraints.

1825. Having initially been concerned that Mr Stomber had not really answered the point that there were expert techniques available which he ought to have known about, and could have used or instructed to be used on CCC's behalf to achieve sales to CCC's likely advantage, on looking at the detail of the case on this aspect, much of which I have referred to above, I have come to the conclusion that my initial misgivings were in fact misplaced, and that I should accept Mr Stomber's evidence on this topic, supported as it is by Dr Niculescu's views, and by submissions which I do find to chime with common sense. At the end of the day, Dr Maini's evidence does not convince me that CCC could have sold RMBS as submitted by the Plaintiffs. By implication Dr Maini seems to accept (and in any event I so find) that CCC, even through CIM, did not have the advanced trading expertise to carry out his suggested sales techniques. I do not regard Dr Maini's response that such expertise could have been brought in to give CCC assistance to be either feasible, or to have any sufficient evidential support. Nor does it meet the further point, which I would also accept, that even in itself, such a move could quite well attract the kind of unwelcome interest or speculation which was justifiably feared.

1826. I have not yet mentioned that Dr Maini's sales techniques would also require, he himself said, to be supported by the acquisition of hedges, such as against interest rate volatility. This adds yet another element of sophistication, complexity and cost, all of which suggests to me that Dr Maini's proposed sales techniques are very much the preserve of those engaged in the

specialist financial derivatives trading markets, and it would not be unreasonable to see them as unsuitable for CCC.

1827. The Defendants' fundamental criticism of Dr Maini's evidence is that it is too focused on the issue whether CCC could have achieved sales at all, rather than whether they could have been achieved at an acceptable price, which the Defendants submit is the all important issue. Standing back from the detail of Dr Maini's evidence, I find this criticism to have force. A case as to the price which the Plaintiffs say could have been achieved, ie that the "modest discount" to IDP prices meant no more than about 11 bps, was very late in the day in coming forward, and Dr Maini's evidence viewed in detail simply does not persuade me that it was likely that CCC could have sold $2½ - $3Bn of RMBS a month for several months, between September 2007 (still less August) and December 2007 or later at a discount of no more than around 11 bps from IDP prices at the time; it only satisfies me that Dr Maini believes that he could have done. His confidence, though, is expressed with hindsight, after a wide examination of much more evidence than either was, or reasonably ought to have been, known to CCC at the time, from a background of particular personal expertise, and from the position that his proposals are never going to have to be tested against possibly disastrous consequences if they were wrong, which was the situation facing CCC's managers and directors. I am actually very sceptical that Dr Maini's confidence would have been borne out even if he had set about the task himself, but in any event that is not the test.

1828. Dr Niculescu's view, having considered the general evidence and his impressions at the time, was that CCC could realistically have achieved no more than sales of about $1Bn of its RMBS without moving market prices down or suffering a substantial discount. I find this more persuasive, but also that this was not a significant amount in the general scheme of things. I am quite satisfied that it was not unreasonable for those in charge of CCC's business to be cautious, at the time, about selling possibilities, and to be justifiably fearful about the imponderable effects of reactions in the then current markets, which any such attempts could generate if identified to CCC.

1829. Finally, the scenario proposed by Dr Maini is, in any event, now venturing a very long way from the simple allegation that it was so obvious that CCC could have safely and successfully sold RMBS to the extent of between half and the whole of its portfolio in the latter half of 2007, that it was negligent for its directors not to perceive this, and not to embark on a programme of doing so in September 2007.

6. Outlook for the future

1830. The last aspect to which it was important to have regard in deciding whether or not to continue the capital preservation strategy of not setting out to sell RMBS at this time was what course the future appeared likely to take, so far as could be gauged. Obviously the decision whether or not the balance of risk and benefit favoured selling or holding would need to try to take into account the likelihood of market circumstances moving favourably or unfavourably to CCC.

1831. There are three aspects to this, though they are, of course, linked. The most obvious would be the general prospect of price improvement or deterioration in the value of Agency floaters. The second is the prospects of a reduction in the availability of affordable funding and the third is the possibility of another major market disruption. The real issue, in each case is the extent to which the Defendants perceived and considered these factors, and did so with due care and

competence. The expert evidence on this topic can only provide context for evaluating the Defendants' decisions and actions.

(a) Price improvement/deterioration

1832. For various reasons which will by now have become obvious, the prospect of price improvement (or otherwise) in CCC's RMBS would be a material consideration in deciding whether it was better to hold on to those assets and hope to gain the benefit of such an improvement (return of margin and perhaps some improvement in either availability of funding or terms of funding in consequence of the increased value of the security on offer), or to conclude that the present situation was too precarious and seek to sell those assets, thereby crystallising losses and - hopefully but crucially - increase the liquidity cushion to a more comfortable level, from which position the best course for the more long term business of CCC could then be assessed.

1833. The Plaintiffs submit that the Defendants' decisions banked on price improvements, and certainly on market conditions not worsening, but that they had no reasonable basis on which to expect such market "*normalisations*" in the near future (which they define as their chosen period of twelve months), and more specifically that the Defendants could not have reasonably expected a flight to quality.

1834. As already mentioned, "flight to quality" is the phenomenon of investors moving, in difficult financial times, away from more risky investments and into "safer", high quality, investments, thereby raising the prices of the latter. The Defendants say they saw CCC's RMBS falling into this latter category, and therefore as potentially likely to benefit from such a trend.

1835. The Plaintiffs dispute this, and rely on various statements by each of the Defendants in oral evidence, acknowledging the unpredictability of the market in which CCC was involved and confirming that their observations of the market throughout the material period – from August to CCC's collapse - were that it was in a turbulent state of disarray. They also point out that each of the Defendants accepted, in varying terms when it was put to them in cross-examination, that they had not observed any actual flight to quality in the prices of CCC's Agency floaters during the material period. The Plaintiffs also submit that the Defendants' expert evidence (Dr Niculescu and Dr Hubbard) to the effect that those in the market expected and reasonably expected improving market conditions in this time should be disregarded, because it was all based on theory and bore no relation to the reality, the reality being revealed in the contemporaneous documents, such as Mr Stomber's occasionally dramatic emails and other communications, and confirmed by the Defendants' own evidence as mentioned above.

1836. Dr Niculescu identified four factors, although they somewhat overlap, as to why he thought a market observer might reasonably conclude in the autumn of 2007 that Agency floater prices might well rise. The first was the prospect of declining interest rates. This was good for the relative attraction of CCC's capped floaters in several respects; in particular, it reduced cap risk and increased the likelihood of prepayments being made, this latter being particularly desirable when such assets are priced below par. The second feature was indeed the likely prospect of a flight to quality as described above. The third, linked with the first, was statements by the Federal Reserve that it would be taking steps to try to stabilise markets and improve liquidity, such as by cutting interest rates. This would be beneficial for CCC because its Agency floater prices had suffered, primarily, from the effects of market illiquidity inhibiting purchasing. The fourth, and linked with the second, was the fact that Agency

discount notes had recently experienced a price increase – a flight to quality – and as the quality of those instruments was quite similar to that of CCC's Agency floaters, it was reasonable to expect similar considerations to begin to apply to these as well.

1837. Neither of the Plaintiffs' material experts, (principally Dr Carron but also Dr Maini) actually disputed the effects of the factors mentioned by Dr Niculescu. Their criticisms were more of the extent to which it would have been reasonable for the Defendants to rely on these factors as matters of comfort or encouragement with regard to potential price improvement.

1838. Dr Maini's criticism was in fact a small point made only in his late Supplemental Report that it was unreasonable for CCC (Mr Stomber) to expect pre-payment speeds to double in February 2008. It was based on Dr Maini's general personal recollection of the parameters for some recalibrations (unidentified) of prepayment speed models in late 2007. I would be hesitant in any event to place much weight on such a late and unsupported assertion from Dr Maini, but as the point is only subsidiary, and the Defendants referred me to other aspects of the evidence which suggested that Mr Stomber's views on prepayment expectations were both a considered view and reasonable when examined in its actual context, I can place no weight on Dr Maini's criticism. It also relates more to February 2008, which is later than the time with which I am concerned, although I mention it here for convenience.

1839. Dr Carron's principal criticism was that the Defendants had placed too much reliance on the idea that a flight to quality was something which would produce a prompt return to "normalcy" of CCC's Agency floater prices. They, or more particularly Mr Stomber, had mistakenly relied on the flight to quality phenomenon as being exemplified by the aftermath of the LTCM crisis, when what had really happened there was that it was Agency pass-through prices which had, indeed, recovered within a month or so, but Agency floater prices had taken about 6 months to recover. It was therefore really fixed rate securities which had benefited from a flight to quality in 1998, and this did not and had not applied to floating rate securities such as CCC's RMBS.

1840. From this, I deduce that either the experts disagree as to whether CCC's RMBS assets were assets which would reasonably be expected to benefit from a flight to quality at all, or their disagreement is not so much <u>whether</u> it was reasonable to anticipate an upward price improvement, but <u>when</u>. It does not seem to me that I need to decide this, though. Mr Stomber's opinion was, I find, the lead and guiding opinion to the Defendants in this matter, and given his sphere of expertise, reasonably so. If I accept his evidence that he believed that CCC's RMBS were the kind of assets that would gain the benefit of a flight to quality, the only question is whether this was a reasonable view for a businessman and director such as he to hold. The fact that at least one expert upon whose evidence I feel able to rely (Dr Niculescu) holds that view is strong support for the proposition that it would be within the range of reasonableness.

1841. I do not find that Professor Hubbard's evidence really takes the matter any further. Giving evidence about the financial markets from a general macro-economic perspective, from his experiences and researches he said the general market perceptions at the time with which I am concerned was one of reasonable optimism with regard to improving financial market conditions, and specifically liquidity. He derived this from his own plot of what he described as the "Forward TED Spread". The TED Spread is an index of the difference between the risk free US Treasury Rate of interest and LIBOR, which is the rate of interest at which banks lend,

unsecured, to each other. It therefore represents a risk-burdened rate, even if not greatly. This spread widens in times of market disruptions, when lenders charge higher rates for unsecured loans and increase their demand for the safety of Treasury Bills. The "Forward TED Spread" is Dr Hubbard's own representation of the same difference, mapped forward from any given date by comparing, on the material date, forward LIBOR rates and forward Treasury Bill rates of the same forward projection in time (3 months). This represents the market's anticipation of future rates, and is thus a measure of current optimism (where the anticipated spreads go down in the future) or pessimism (where they widen). His results suggested that through the last four months of 2007, the forward expectations of the TED spread in three months' time had been continually those of an improving market, even from moments when the current TED spread had itself widened in fact. It is a graphic representation of market sentiment at the time, and its apparent optimism led him to conclude that prices of Agency floaters would be seen as likely to improve.

1842. Professor Hubbard also took the view that this positive outlook was supported because the markets viewed the interventions of the Federal Reserve positively. He listed the cuts in interest rates. I have already mentioned 18th September 2007. Further cuts of 25 bps took place on 31 October and 11 December 2007, of 75 bps on 22 January 2008 and again of 50 bps on 30 January 2008, and finally, but after CCC's collapse, of 75 bps on 18 March 2008. There are other interventions cited, including the infusion of funds into the markets to increase liquidity, concentrated in August 2007, December 2007 and March 2008. Dr Hubbard's view was that these interventions had been received positively, as regards market sentiment at the time, although when shown some of the emails in the case in cross-examination, he agreed that many had considered the Fed interventions to be "too little too late", although he himself thought that this was generally in the light of hindsight. He also accepted that the purpose of Federal Reserve intervention was the general one of stabilising the economy as a whole, and except in specific exceptional cases, it was not aimed at rescuing any particular economic institution, or, except where vital to the general economy, any particular financial market sector.

1843. Professor Hubbard's conclusions therefore support Dr Niculescu from more of a macro-economic perspective. However, and precisely because of this, I have not found his conclusion to be of great assistance in relation to the narrow question with which I am here concerned; it is too broadly based. I have therefore placed no direct reliance upon it. My impression from the contemporaneous documents in the case is indeed that those with whom I am concerned regarded the Fed's interventions, welcome as they were, as being both slow in coming over the second half of 2007 and not really sufficient when they did. Nonetheless, I have certainly gained the broad view, from the overall evidence in the case, that general market sentiment was that after the 9th August crisis, the market ought to recover gradually back towards the state to which everyone had become accustomed before mid-2007, and this is consistent with the effects of Dr Hubbard's research.

1844. As regards the time with which I am here concerned, the first question is therefore whether I accept Mr Stomber's evidence, and by association that of the other Defendants, that they believed that the prices of CCC's RMBS assets were likely to improve in the not-too-distant future, and the second is whether such a belief was reasonable.

1845. I am satisfied that the Defendants did hold that belief and I am also satisfied that it was not unreasonable for them to do so. First, in broad terms, it seems to me that 30th September was

less than two months after the shock of the 9th August crash. It had taken much of that time for markets to calm down, and the memory of previous apparently "normal" times pre August 2007 was not so far distant that it ought necessarily to have been discounted as the general norm to which markets could be expected to drift back. That would, I think, have been a reasonable background mind-set, although no more than that.

1846. Second, though, I am satisfied that Mr Stomber did genuinely believe that CCC's RMBS ought to benefit from a flight to quality which was likely to happen and, as indicated above, I am satisfied that this was a reasonable view to entertain. The Plaintiffs submit that the anticipation of a flight to quality increase in CCC's prices was misconceived and effectively wishful thinking. As mentioned, they cite the acceptance by all of the Defendants individually, at different points in their cross-examination, that they had not seen any actual flight to quality in the prices of CCC's Agency floaters. However, putting the question in this form disguises, by making unspoken assumptions, what the speaker has in mind as being a "flight". Looking at the figures for CCC's agency RMBS prices (see Dr Carron's chart mentioned above), it is right to say that there was never any sudden and marked rise in prices at any time which might be what would be expected by the use of the word "flight". The graph of both secondary and IDP prices shows prices fluctuating but with no marked really sustained or steep rise (or fall) over this period. But the real point at this time is not whether the Defendants did or did not see what could be described as a "flight" to quality, but rather, whether it was reasonable to expect such a flight, or at least a trend towards improvement in prices as a reflection of their solidity and credit quality, rather than a trend towards significant further deterioration.

1847. The evidence shows that Mr Stomber was basing his prediction that there would be a "flight to quality" principally on his previous experiences in the LTCM crisis, but eventually came to the realisation that the market was behaving differently in the circumstances of late 2007. This does not cause me to think, though, that his initial impression was incompetent or negligent.

1848. The Plaintiffs rely on a striking email of Mr Stomber's dated 17th August 2007 (and thus preceding this point in time) that

> *"Believe me I get it – the fixed component rallying during a flight to quality swamped the spread component"*

as evidence, supported by Dr Carron's interpretation of the email, that Mr Stomber had failed to appreciate that the flight to quality after the LTCM crisis was confined to fixed rate rather than floating rate securities and was not therefore an appropriate comparator for CCC's securities. However, Mr Stomber was never, so far as I can see, cross-examined on this document and asked to confirm or explain its interpretation. Indeed, the only question which appears to be potentially pertinent to this alleged misapprehension was on the fifth day of cross-examination:

> *"Q. You never saw any flight to quality extending to capped floaters, did you, until before CCC failed in 2008?"*

Mr Stomber answered this by accepting that he had not seen, during this period, anything like the

> *"…type of flight to quality that I saw in '98".*

1849. This does not seem to me (and did not at the time) to accept the proposition that the flight to quality of 1998 was confined to fixed rate securities, but rather that the same degree of price improvement as in 1998 did not occur. Any ambiguity in the word "type" was not explored. I do not, therefore accept the Plaintiffs' characterisation of Mr Stomber's evidence as a recognition, subsequently ignored, that he had been wrong about the likelihood of a flight to quality which would benefit CCC's assets, so serious as to require a revision of his general opinion that CCC should benefit from price improvements as the quality of its assets came to be recognised.

1850. Even if the flight to quality which occurred after the LTCM crisis were focused on fixed rate rather than floating rate securities, I am not persuaded that it was negligent to fail to make this distinction in the state of general knowledge of autumn 2007. Neither am I satisfied that the distinction itself was so major as to invalidate any expectation that a flight to quality factor would tend to produce a rise in prices for CCC's assets as well. The issue is whether it was reasonable for the Defendants, as at the end of September 2007, to think it reasonable to expect that some degree of flight to quality which would benefit CCC's asset values was likely to occur. I am satisfied that it was.

1851. Third, the prospect of a general upward tendency in prices was supported by the accepted proposition that these RMBS prices would be bound to return to par at some stage because they would pay out in full at maturity – although I accept that this is part of the quality of the asset taken into account under the second point.

1852. Fourth, I find that Mr Stomber did expect, and reasonably, that interest rates were likely to fall, and this would favour CCC's RMBS values.

1853. Fifth, I find that, as at 30th September, there was cause to be (and CCC was) positive because of the Fed cut in the target Federal Funds rate of 18th September 2007, which was both likely to benefit CCC because of a reduction in cap risk, and which was also a positive towards improving liquidity. I find this because although Mr Conway had not set any store by the Fed's injection of liquidity in response to the August crisis, the disillusionment with the Fed expressed in CCC's internal memos did not materialise until later. The cut in interest rates had an immediate salutary effect on LIBOR, which must have been observed, and this gave rise to a general sense of relief and therefore optimism in the markets. Indeed, although there is no direct evidence of this, I find this ethos of optimism in the email of Mr Stomber of 27th September 2007, referred to above, and a similar earlier email of Mr Trozzo of 26th September.

1854. The Plaintiffs do not rely on any evidence or indicators which are argued to suggest that RMBS prices were more likely to go down than up. They rely only on the general and acknowledged perception that the markets were unpredictable, which of course led most, if not all, of the Defendants to agree in cross-examination, that they were not capable of predicting, at least with accuracy, factors which would influence the price of CCC's securities, nor when they thought the markets would return to "normal". An example is Mr Sarles' acknowledgement that markets could have gone up, stayed the same, or could have gone down "*obviously".* I do not find these acknowledgements of what is indeed, in the abstract, a totally obvious proposition, to detract from my view that overall, the Defendants did have a cautious faith that CCC's asset prices would begin to improve again.

1855. I add here, that I make these findings in the context of the Defendants' submission, which I also accept, that CCC was not dependent on such prices improving quickly, for its survival, nor

even on their not falling at all. CCC had some room, even if uncomfortably small, to withstand a slight worsening, even, of conditions in the market. It could also, I find, have a reasonable expectation that Carlyle would support it as against any such moderate worsening.

1856. Whilst I recognise that this last proposition rather depends on what is meant by a "slight" worsening, I do not accept the Plaintiffs' submission that "*it was apparent that even a slight further market deterioration could result in CCC's insolvency"* (emphasis added) where that effectively means "any" deterioration. Indeed, and now looking forward, the fact that CCC did survive the effective deterioration in market conditions which accompanied the commercial and investment banks' respective year end adjustment activities in November and December 2007 vindicates the view that this perception would have been reasonable.

(b) Funding availability

1857. The question here is whether, looking forward, the Defendants could reasonably anticipate that sufficient funding would be available to enable CCC to continue financing the holding of its portfolio of RMBS.

1858. Funding requirements came in two forms, the funding required for margin calls (liquidity) and the repo borrowing required to maintain ownership of the RMBS at all. The former, the liquidity requirement, was linked with price levels, which I have reviewed above. I have found that as long as prices did not decline significantly, liquidity held by CCC, or on the books of its repo lenders if prices improved, could be reasonably seen as available.

1859. The latter, borrowing availability, is linked with the trials and tribulations of procuring the constant regranting of repo finance, on affordable terms. It is therefore linked with the issue of sustaining haircuts at a manageable level, which I find, on the evidence above, certainly had to be under 4%, but could probably be sustained at about 3%, as an effective rate. Unless repo was available on such terms, it was not, in practice, available at all.

1860. This matter - the viability of continuing repo funding - is the crucial "downside" problem of the capital preservation strategy, as I mentioned at the start of this discussion. It is the adjudged gravity of such financing risk as against the adjudged gravity of the risks of trying to relieve it by selling RMBS, which is the main element in the judgement whether it was reasonable to pursue the capital preservation strategy, or not. In initially describing the parties' cases above I have summarised the Plaintiffs' arguments that CCC was, and the Defendants ought to have recognised that it was, on the edge of a funding failure, such that it should have been seen as absolutely imperative to take steps to reduce funding pressure by selling assets, and the Defendants' response that it was neither as extreme, nor as clear, as that.

1861. In their opening submissions, the Plaintiffs focused very much on the plummeting of CCC's recorded excess repo borrowing capacity between 17th August 2007 and 17th September 2007, illustrated graphically in Mr Shaw's Exhibit B-5. It was a drop of over $10Bn and it reduced CCC's soft line borrowing capacity to 113% of actual requirements. They submitted there that any reasonable and rational director in the position of the Defendants at the time would have been "*alarmed*" by the extent and speed with which CCC's repo capacity had diminished in that time, and that it was reckless of the Defendants to permit CCC to continue in business with only this level of available borrowing after that time. Effectively they submitted that this reduction in repo borrowing capacity ought *ipso facto* to have been seen as indicating that

CCC's business was no longer sustainable, at any rate at the level of RMBS holding which it currently held.

1862. In their closing submissions, the Plaintiffs laid less emphasis on the statistics for borrowing capacity figures, but based their argument more on what they submitted were in effect admissions by the Defendants of their knowledge that CCC's funding position was dire. They have cited various quotations from the evidence of the Defendants, in particular Mr Conway, Mr Stomber, Mr Hance and Mr Allardice in which they acknowledged that they were concerned "every day" with the possibility of CCC going under, or capital being at risk, or with news being terrible, or suchlike.

1863. I do not find these statements to be of much support to the Plaintiffs' contentions that the Defendants really knew that CCC was not capable of surviving with its then level of available repo finance, mainly because, read in context, they strike me as generalisations, simply emphasising that the speaker was well aware of the seriousness of the situation and did pay attention to it. Some of the remarks relied on, certainly in the case of Mr Hance's comment about "*the news everywhere was just terrible*", do not relate to the time period I am here dealing with.

1864. My first impression was that the Plaintiffs' initial stress on the magnitude of the reduction in CCC's excess borrowing capacity between August and September 2007, and the gravity of this situation compared with what had originally been thought to be appropriate for CCC, had some force. The Plaintiffs also suggested that there was an absence of apparent discussion and recognition of this in the contemporaneous paperwork, which suggested that the seriousness of this had not really been examined, or fully appreciated.

1865. In the end, though, having looked at all the evidence, I am satisfied that the seriousness of the situation was appreciated adequately by the Defendants, for what it was. The level to which available repo capacity fell, on a general overview, did still remain above CCC's actual requirements by about 10%. Whilst this was not comfortable, as it gave little room for rolling repo away to other suppliers, it was enough to meet CCC's actual financing requirement. The Plaintiffs' contention that a mere 10% excess in available borrowing capacity should have been seen as making the continuation of the business on that basis unsustainable and doomed therefore depends on whether or not it was reasonable to think that there was an adequate prospect that general repo availability (whether absolute, or in terms of the haircut demanded being in excess of 3%) would remain and not continue to decline after 17th September 2007.

1866. I find that the evidence suggests that there were reasonable grounds for thinking that a further decline was not inevitable. Apart from the underlying general sense that markets had calmed somewhat over the previous month, CCC's repo position crystallised and was re-set twice a month with the cycle of repo rolls. The full repercussions of the August crisis had not had time to work their way into the system by the repo roll of 15th August 2007, but would have become reflected during the following two rolls, such that it was reasonable to take the view that repo funding conditions had broadly "re-set" after the effects of the August market disruption by the time of the 17th September roll. Therefore, whilst the reduction in spare repo finance capacity was concerning, and no doubt very concerning, and whilst it would no doubt be a good thing to alleviate that concern by reducing pressure on repo requirements if possible, making that decision did not necessarily have to be done on the basis that financing risk was a

factor for "alarm" on that side of the balance, and that some kind of emergency reaction was the only appropriate response.

1867. Both the Defendants' witness evidence and the contemporaneous documentation show, I find, that they did appreciate that the situation was very serious, but the display of their reactions was tempered, first by the fact that they were being apprised of the situation as regards repo line availability as it developed, rather than with a single sudden revelation of the total reduction as it appears from Mr Shaw's graph, and second by the fact that there was no immediate emergency measure to be taken in any event, as Mr Stomber and Management were charged with dealing with the situation, and doing so in accordance with the strategy which had been decided upon only three or four weeks earlier. In addition, the seriousness of the situation, however grave, was only one matter to be fed into the overall judgment about the best way forward, at any particular time, for CCC.

1868. It is clear from the contemporaneous documents that Mr Stomber was keeping the Defendants, I think all of them but certainly Mr Conway, Mr Hance and Mr Allardice, well up to date with the position on repo availability as it unfolded, and all the Board was supplied with summary details in the ALCO pack papers. In that situation, I again do not find it surprising that there are no other recorded discussions of the repo availability position; they took place, in practice by the emails and such other communications as took place.

1869. Ultimately, therefore on reviewing the evidence, I find that the Plaintiffs' submissions with regard to the immediately alarming state of CCC's repo financing availability are somewhat over-stated; whilst the matter was certainly serious, a level-headed review still suggested that all was not necessarily lost with regard to the ability to maintain enough repo funding, and certainly that there was sufficient prospect of this to justify contemplating continuing with the strategy of defensively seeking to preserve CCC's capital assets. CCC had succeeded in keeping up the necessary funding to finance its RMBS portfolio at its then level. Although this had been hard work and at times perhaps nerve-wracking, I am satisfied that it was reasonable, in September 2007, to expect that it would be possible to continue doing so for the following repo rolls and thereafter, absent any major disruption in the markets.

(c) Possibility of a second market crisis

1870. This leaves, lastly, the question whether, and if so how, the Defendants ought to have contemplated and planned for the occurrence of a second crisis.

1871. The Plaintiffs complain that the capital preservation strategy gave CCC no prospect of surviving a further market deterioration. I have already rejected this argument as regards any "slight" deterioration, and anything greater but still gradual would have allowed the opportunity for further consideration and adjustment. The real issue here is the superficially more forceful point made by the Plaintiffs that the capital preservation strategy did not address, or provide any protection, from the possibility of a second sudden market crisis, and the first question is therefore whether it was only reasonable to assume the likelihood of there being one.

1872. The Plaintiffs rely again on the fact that Messrs Hance, Stomber, Allardice and Sarles each in contemporaneous documents after August 2007, recognised the possibility that "*this could happen again*" (although I observe that, once again, they tendentiously distort Mr Sarles' acceptance in oral evidence, that for the sake of argument "*let's say maybe [a] 20% [chance]*

at the most" into a submission that he thought that there actually was a 20% such chance). Again, though, I do not place much weight on these recognitions, for two reasons. The first is that recognising that it is possible that such a situation could occur is simply stating the obvious. The more important question is: how likely is it to occur? The next major consideration is: what is it practically possible to do to protect against such a situation if it should occur? Once again, the balance of risk, benefit and practicality comes into operation.

1873. The expert evidence on this point strikes me as being all to the effect that the prospect of there being a second crisis similar to that of August 2007 within any short time after that crisis was extremely remote. Dr Webster said as much:

> "*the probability of having an adverse move of the orders of magnitude that we saw, call it seven or eight standard deviations, followed by another significant move that would require an additional margin call is extremely remote."*

1874. She described the liquidity crisis of August 2007 as being an extreme event with such a statistically small likelihood that the possibility of a similarly extreme event following within a short time was so remote as to be virtually zero. The likelihood was to be measured in "centuries".

1875. Dr Carron was perhaps inclined to be less extreme, but I think even he accepted that the probability of two such events occurring within a short space of time was remote. It is now, but I think with hindsight, more widely recognised by statisticians modelling financial markets that the phenomenon of the "fat tail" – where there are in fact more instances of outlying extreme outcomes from a situation than the ends of the conventional bell curve graph of normal distribution would suggest – is more common in fact than simple statistical theory would suggest. However I am satisfied, from the expert evidence generally, that the August liquidity crisis itself was not foreseen and not foreseeable in mainstream financial circles, and that after it had hit, the likelihood of a second such market shock in short order (in fact even a worse financial crisis as that in March 2008 turned out to be) was generally regarded as very remote.

1876. The Defendants, in their evidence, certainly acknowledged that market events such as a second systemic liquidity crisis could be imagined, but they equally add that they regarded the possibility as remote, expressing this in varying degrees. In the Defendants' submissions, it is pointed out that CCC was always at risk of a systemic withdrawal of funding, simply because its business model depended on the continued availability of such funding. They submit, though that that was part of the inherent risk in CCC's business model and the price of returning the attractive yields which were part of that model. CCC took steps to protect itself against one such systemic crisis, and they were in fact successful. The need to protect against two such unlikely events in quick succession was not something that CCC could reasonably be expected to have catered for, nor, after having suffered but survived one such shock, was it unreasonable for it to regard the occurrence of a second as extremely unlikely. It follows, the Defendants submit, that it was not unreasonable to proceed on such an assumption.

1877. But, in any event, there was in practice no feasible means of protecting CCC against a second such shock whilst it was suffering the aftermath of the first. This is a return to the argument that restoration of the liquidity cushion was paramount, without having regard to the means by which this might be done. The Defendants object that the Plaintiffs' approach, and those of their respective experts, simply ignores this last point, declaiming that it was imperative that

CCC "do something", (which was obviously sell RMBS) without paying any attention to the feasibility, or practicality, or risks, of this.

1878. Weighing the expert evidence and the Defendants' evidence, I am satisfied that the risk of a second systemic liquidity crisis, or "run on repo" as the March crisis has been described, was something which was generally regarded at that time as highly remote, even though the recent occurrence of August 2007 might well cause people to refer more to such a possibility. The question whether the Defendants as directors of CCC ought to have tried to take any positive steps to protect CCC from such an eventuality therefore depends on the balance between four factors: the perceived likelihood of the risk, the perceived gravity of the consequences, the availability of practical steps which could be taken and any collateral disadvantages which might arise from taking such steps.

1879. The Defendants' case is that the perceptions were, as to the first (the likelihood of the risk eventuating) that this was seen as remote and I have said that I find that reasonable. The second, the perceived gravity of the consequences, was obviously potentially catastrophic. The third, the availability of feasible steps to protect against that eventuality, is that they were limited – probably confined to selling RMBS, which was itself in no way guaranteed to provide adequate protection from such an extreme event. The fourth, the collateral disadvantages, were those attaching to selling RMBS and were imponderable, potentially uncontrollable, and also capable of being catastrophic.

1880. In my judgment given this balance, it could not be said that it was unreasonable to regard the possibility of a second liquidity crisis as something which simply could not, practically, be guarded against in the circumstances, and therefore there was no point doing anything other than ignore it. Such a reaction was, I am satisfied, certainly not outside the range of reasonable decisions which the hypothetical reasonable director of CCC could have taken.

(iii) Other considerations

1881. The above are all factors which would reasonably influence the material decision as to whether to sell RMBS as opposed to continue to hold them, and are those on which the expert evidence has had great bearing. They are not, though, the only matters which have been argued to affect the material decision to continue the capital preservation strategy.

1882. I have mentioned the fact that selling RMBS would crystallise and lock in capital losses for CCC, but the important consequence was that this might simply be being done during a temporary fall in prices which would recover. The Plaintiffs have suggested that too great and unreasonable prominence was given to this consideration, but the point is one of balance. As observed elsewhere, if Directors are too quick to "cut losses" by selling off assets, they will then be criticised if it should turn out that the losses could actually have been avoided.

1883. As a factor on the side of favouring selling and deleveraging, the Plaintiffs have argued for a reputational benefit. They argue that such an action would even work in CCC's favour as regards funding, because after the August crisis "responsible deleveraging" was respected, seen as a positive sign by repo lenders and was therefore a factor which countered any perceived risks of such deleveraging.

1884. There is no evidence that the Defendants ever actually considered such a point. However, I also find it to be more theoretical than real. Whilst it was propounded by Mr Welles, I did not

find his evidence on this topic to be convincing. My reason for this is that whilst the reaction of repo lenders might be vaguely favourable I judge that this would have a very minor effect, if any, within their consideration of a response to CCC as a seeker of repo finance. It would be lost in amongst all the other factors including the broad apparent respectability of CCC, the Carlyle name, the solidity of the collateral security, and the effects of the banks' own internal pressure or policies affecting their readiness to provide funds to CCC. Second, and more significant as a reason for not regarding this as a factor of any weight, the adverse consequences of selling RMBS which were feared by CCC would operate in the reactions of the banks' trading desks rather than their repo desk. It does not appear to me, from the evidence, that traders who are on the trail either of making an advantageous trade for profit, or getting out of a disadvantageous position to avoid loss, would be likely to be paying much regard to respect for the relevant target party's judgement about responsible deleveraging.

General conclusions for September 2007

1885. The decision, as to whether to sell or continue to hold RMBS in September 2007 was a balancing exercise. It is, therefore one which is in principle a matter of business judgement, and one on which there may legitimately be differences of view. I am concerned here only with whether the decision made was outside the range of reasonable such business judgements and perhaps, if *prima facie* this is so, whether it was nonetheless conscientiously arrived at, in practical terms, according to the respective standards of care of the individual Defendants.

1886. In his witness statement Mr Stomber stated his views of the situation at the end of September to have been:

> *"Although a sale of some RMBS seemed more feasible in late September than it had appeared in mid- or late August, the secondary market still had not improved enough that a large player, such as CCC, could carry out sales of any meaningful volume without depressing prices or raising concern about its financial health. As a result, continuing to hold the portfolio while focusing our efforts on improving financing was, in my view, the most prudent course".*

1887. Mr Conway similarly says that his view was:

> *"It remained true, as it had been in August, that a sale of RMBS would involve a trade-off between, on the one hand, the potential benefit of some increased liquidity (and decreased leverage) and, on the other hand, the certainty of permanent losses, risk of downward pressure on prices and market perception of distress. In August, the Board's judgment had been that the downside outweighed the upside, and as of the end of September, I thought that remained the correct judgment, although I realized that if circumstances changed (whether in the market or for CCC, or both), then the calculus might be different.*"

1888. I am satisfied that these views were genuinely held by each of them, and I am satisfied that they were reasonably held. I am satisfied that the other members of the Board were of similar views, whether arrived at independently or because they received the views and advice of Mr Stomber and Mr Conway, or others, and because those views were judged to be convincing. This would have happened in all probability through such contact as they had with each other. Mr Allardice and Mr Hance were both generally involved in considering CCC's activities on a frequent basis and I have no doubt they considered the material points actively and properly. I

am satisfied that these views were not only genuinely held, but were perfectly reasonable in all the circumstances, and certainly within the range of views that a reasonable director of CCC might properly and rationally hold at the time.

1889. I conclude therefore, that there was no breach of the Defendants' duties of skill and care to CCC with regard to the continuation of the capital preservation strategy in September 2007 or as at 30th September 2007, as alleged.

Further point - CCC's engagement with the markets

Was CCC's engagement with the markets colourable?

1890. Before leaving consideration of facts surrounding the Defendants' alleged breaches of duty to CCC at this time, I should refer to one further matter. This is the fact that, despite the purported feature of the capital preservation strategy being that CCC would take advantage of selling opportunities which presented themselves, they never in fact did so. The Plaintiffs have focused on evidence about this, deploying it as circumstantial evidence to rebut the Defendants' assertion that there genuinely was such a strategy, and to support the Plaintiffs' contention that it was an *ex post facto* rationalisation of what was in fact an improperly motivated, or utterly negligent rigid decision not to sell at all, or simply a culpable absence of any actual strategy at all.

1891. At a general level, the Plaintiffs' complaint made in Advocate Wessels' closing speech was that even if the Defendants had been deploying the strategy which they claimed, there was still a lack of consideration as to whether sales of RMBS could be effected, which was culpable because it arose from their disorganisation. According to the oral evidence, Mr Stomber had not followed up the possibility of making sales because the Board had decided at the August Board Meeting not to do so unless opportunities presented themselves, and so he did not look further, but the other Board Members, in particular those charged with executive decision-making powers, believed that the possibility of making sales would be monitored by Mr Stomber and brought to the Board if necessary. It was therefore obvious that in consequence, Advocate Wessels submitted, the question of actually initiating sales was simply never considered at all after the August Board Meeting by either faction - certainly not before the next Board Meeting in November - and this was a culpable omission.

1892. I do not think that this criticism is fair. Once a policy decision is made in general terms, its purpose is to set the direction of travel for those concerned to implement it and it does not have to be perpetually revisited, reviewed and reconfirmed. Mr Stomber had been given direction by the Board, and it was a direction which I infer he actually agreed with. He pursued that direction, and kept the Board informed, often in great detail, of what was occurring in the markets. I find it reasonable, in all the circumstances, that the Board Members should expect that if initiating sales became a possible or recommended course, then this would be the province of Mr Stomber and his Management team. However, insofar as this means that responsibility for continually considering the merits of this course rested with Mr Stomber, it does not seem to me that his failure actively to do this expressly and record doing so is surprising. It does not mean that the possibility would not have been in the back of his mind, and as a matter of common sense I am satisfied that it would have been. The intervening ALCO meetings, I am satisfied, also served to keep the circumstances which might reasonably invite such reconsideration before him and his team. He did not pursue or raise the point, I am satisfied, because he perceived - and reasonably perceived - that the uncertain

circumstances in the market did not make it a realistically sensible course to consider during September 2007 and in the few weeks thereafter, before the November Board Meeting. In any event, the objection that the possibility of CCC's initiating sales was not reconsidered only has force if it could also be shown that it would have been bound, reasonably, to result in a different course of action being taken from that which was taken, and the evidence does not satisfy me of this.

1893. The evidence supporting this criticism at a more detailed level came principally from Dr Maini, but once again in his later, Addendum Report, citing facts which he said suggested that CCC was not properly engaging with the market to induce prospective sales. The Plaintiffs rely on this as evidence of an aversion to selling at all, rather than a justifiable fear of doing so. The evidence consists principally of Dr Maini's collated examples of CCC not, in his view, responding to or engaging with messages or approaches in the market, which could, in his opinion, have been turned into sales opportunities.

1894. I have mentioned in the narrative of September, the initiation, on 5th September 2007, of an enquiry suggesting the possibility that UBS might purchase RMBS from CCC. This appeared in an enquiry that day from Mr Glascott of UBS to Mr Greenwood, which gave some general characteristics of RMBS which UBS claimed to be looking for and to which, in response, Mr Greenwood "showed" (ie supplied details of) certain bonds which did not correspond with the enquiry, even though CCC in fact held bonds which seemingly did. The Plaintiffs rely on this as evidence that CCC was not genuinely trying to sell.

1895. The ensuing course of this incident was that in response to the non-complying bond details actually given by CCC, UBS then gave CCC more detail of what they were looking for, saying that this corresponded to what they had themselves traded. This included a degree of "seasoning" (prepayment track record). Later on the same day, UBS said that they had purchased $165Mn of a "worse" bond than CCC had offered, but they would see what they could do with the bonds which they had been shown. A week later UBS reported that they were still working on CCC's bonds, but *"might be able to get more traction on seasoned stuff."* It does not appear that anything further was done by CCC towards meeting this enquiry, and it ultimately came to nothing. I note also that UBS never reported any interest in the bonds which CCC had offered.

1896. Shortly after the initial UBS enquiry, and for the rest of that day (5th September 2007), Mr Stomber was reporting to Mr Conway and Mr Nachtwey the possibility of being able to "lighten" by up to $1Bn, and that evening, having been informed of UBS's purchase of bonds from another dealer, he was still telling Mr Conway that *"we will continue with our orderly sale of 1bil".* The following morning he reported that negotiations were seemingly not about price but more about "*which paper do they want",* but in answer to a direct question he expressed the view that UBS had simply been window shopping and seeing if CCC were a distressed seller.

1897. On the evidence I have been satisfied, and I find, that there was a genuine intention within CCC to engage in and be open to selling $1Bn of RMBS if the terms were right, just as there had earlier been a genuine attempt to engage in a sale of $4Bn of RMBS to JP Morgan if they had come up with an acceptable price and (I also find) genuine enquiries of both Freddie Mac and Fannie Mae. I also find that this enquiry from UBS was being handled by Management of the appropriate level (in this case Mr Greenwood rather than just Mr Ng, in view of the size

and, I suspect, the fact that this seems to have been, if not the very first, then the first relatively major, reverse enquiry that CCC had received after the policy decision of the 23rd August Board meeting) but on the basis of the general approach instructed by Mr Stomber, and with his background oversight.

1898. Whilst Mr Stomber seems to have concluded rather quickly that UBS was not genuine, (he is sceptical by nature), if Mr Stomber had no intention of selling at all, then his reports of this possibility to Mr Conway and Mr Nachtwey were entirely disingenuous, time wasting and an elaborate charade, - and for no plausible reason, since Mr Conway is supposed to have been of the same fixed intention. Second, sending a list of securities which one had no intention of selling was pointless, yet such a list was sent. It is not clear if this was done by Mr Greenwood before, rather than after, he communicated with Mr Stomber. If the former, then it is even more inconsistent with an understood general policy that CCC was simply not going to sell RMBS under any conditions. I therefore infer and find that CCC actually would have sold the bonds which it described, at the right price. The alternative is that this was some kind of devious smokescreen for a fixed and rigid policy of not selling on any basis (although it is not clear why such a smokescreen should then be needed), or for trying to obtain information whilst actually having a fixed and rigid policy of not selling on any basis. I find this far more implausible than that the communications were perfectly genuine but just did not go very far.

Was CCC's engagement with the markets incompetent?

1899. In arguing that CCC was not genuinely engaging with enquiries, the Plaintiffs make much of the fact that the bonds shown by Mr Greenwood did not exactly meet the description given by UBS for its "axe" (ie its "ask"), when CCC did actually hold some other bonds which did so. This point did initially trouble me somewhat, not so much because it cast doubt on CCC's willingness to sell, but rather more on the basis of the case into which the Plaintiffs latterly shifted their challenge, namely that of incompetence. It did appear to me that this episode might be evidence of a lack of skill and understanding of the market, and a failure to appreciate the importance of characteristics such as seasoning and their effects on the attractiveness of the securities. This, however, is a shift of direction of attack which I do not think is really open to the Plaintiffs, because, on examination, it is not expressly pleaded.

1900. The only breach of duty alleged against the directors (or against CIM, who would also be implicated in any charge of incompetent investment management) which is capable of covering an allegation of incompetently failing to sell is to be found in Paragraphs 339B.6 (Carlyle Directors), 339D.6 (Independent Directors) and 339F.8 (CIM, and TCG and Holdings). It is universally framed in the general terms of "*refusing and/or failing to investigate all potential avenues available to CCC to sell RMBS assets on the best available terms"* with modifications of minor detail arising from the precise relationships of the respective Defendants. There is no other alleged breach which could encompass an allegation of incompetent handling of an actual possible sales opportunity, and even the assertion which is the only candidate for that interpretation would require giving the phrase "all potential avenues" the very broadest scope. In its context, the allegation made in the Cause certainly does not read as if it is aimed at specific incidents, as contrasted with the investigation and formulation of a general strategy. In other words the accusation pleaded is made at the policy level and not at the operational level. The fact that the pleaded charge is levelled at all the Defendants in substantially similar terms, and even levelled at the Independent Directors at all, strongly reinforces that interpretation.

1901. On that view, it is not open to the Plaintiffs to convert their original case that this was deliberately devious or obtuse conduct, designed to obscure an intention not to sell any RMBS on any basis, into an allegation of negligently inept handling of a particular potential purchase inquiry with damaging consequences.

1902. Even if the Cause can be literally read as covering such an allegation, I do not think that this was clear from the pleading, and the Defendants did not have their attention adequately drawn to this alternative basis of the charge of lack of skill and care against them, whether collectively or individually before trial. It really only emerged in the course of the trial itself. It follows that I cannot draw any adverse inferences from any absence of evidence directly answering such an argument, because this arises, it seems to me, from such specific attack on the Defendants' actions reasonably not having been perceived by them in advance. However, since much has been made of this particular incident, I feel I should consider it.

The UBS Enquiry

1903. Looking at the sequence of the exchange of the above messages carefully, I am not satisfied that they should, in all the circumstances, be interpreted as evidencing any lack of skill, understanding or competence, either by those directly concerned or on the part of Mr Stomber as the presumed supervisor of this incident. I have heard evidence, in particular from the Plaintiffs' own RMBS expert, Dr Maini, that a good deal of posturing and feinting is often part of the process of negotiating an OTC sale/purchase of bonds, depending on the impression one may wish to create in the market (because this may well be passed on by dealer "chatter"), or as part of the skill of persuading a counterparty into a desired transaction or avoiding being metaphorically painted into a corner oneself. Indeed, the Defendants point out that the response to UBS was very much in line with the kind of negotiating dance which Dr Maini said would be commonplace in trying to effect a sale without revealing one's hand, avoiding any suggestion of being under pressure, or trying to jockey a sale into assets one might prefer to dispose of before others.

1904. Looking at the comparison of the characteristics of the bonds offered and those which the Plaintiffs say more nearly met Mr Glascott's enquiry, it seems to me that this could easily be the case. Whilst the bonds offered appear to have the lowest seasoning in the list – only about a year - it does not seem to me to be correct that they were not seasoned at all, as the Plaintiffs suggest, and I note also that they were actually those showing the highest yields, which I would have thought made them potentially the more attractive. I am therefore unconvinced that the response of CCC was obviously unreasonable, or merely colourable.

1905. The Plaintiffs do not satisfy me that this incident should be characterised as incompetence as to understanding of market preferences or suchlike, either. There is undoubtedly a huge amount of material which I have not looked at, generated by the every day work which I am satisfied was going on amongst the managerial and operational staff at CCC at the time, and on balance I think that the concerns which may have come to my mind as to any arguable lack of skill are really the result of my (fortunately) not having had to engage with the details of such material, and therefore my sense of some gap in my acquaintance with the totality of CCC's activities at all levels.

1906. I would add, though, that even if I were to have concluded that this incident had been actual negligence or stupidity, I am not satisfied that it led to any identifiable loss of opportunity for

CCC. There is simply insufficient evidence to justify any such conclusion, even as a matter of probability.

Other enquiries, generally

1907. Dr Maini refers to more such evidence about approaches which he claims could have led to sales for CCC but were ignored. Most of these are in September 2007, and it is more convenient to deal with the substance of all these at this point, as a single topic.

1908. Two such further incidents are expressly cited in the Plaintiffs' closing submissions, in addition to the UBS incident just referred to. The Defendants suggest that these must therefore be thought by the Plaintiffs to be the best examples of their allegation, but the Plaintiffs insist, as always, that they rely on everything Dr Maini had included, although sometimes as multiple references, in his Addendum Report.

1909. On 13th September 2007, in the first of the incidents specifically cited by the Plaintiffs, Goldman Sachs made an enquiry of CCC which was received very noncommittally by Mr Ng, and not followed up. It was, though, with regard only to $100-$150Mn worth, and would generate therefore only $2-3Mn in liquidity. The Defendants suggest that it was probably not followed up because the price (spread in the "low 70s") was not good; they calculate this to be the equivalent of 65 bps below IDP.

1910. Also on 13th September 2007 Merrill Lynch broadcast that they were seeking 6.75% capped floaters for the same buyer as for some 6.5% caps. However, again the price appears to have been unattractive, as the price indication for CCC's 6.5% caps was $98.9 and the sale in question had in fact been at $98.125.

1911. In the context of Dr Maini citing a possible technique of spotting or seeking out "matchers", or information about market activities in bonds of which CCC held matching tranches, on 17th September a dealer at Bear Stearns informed Mr Ng that he had just sold $50Mn of a bond "*fns 380 f7 @ 58dm*" of which CCC owned $192Mn. This was the precursor to the second incident specifically relied on by the Plaintiffs, which took place on 31st October 2007. At this time Bear Stearns had actually suggested that they could sell the whole of CCC's position in this bond at "*very close to your cost!*" The dealer had elaborated in terms which suggested that he had a client with a specific need for that bond. Dr Maini suggests outright that "*CCC could have sold it to Bear Stearns*".

1912. Mr Stomber, when shown this in evidence, acknowledged that this enquiry ought to have been followed up, and I find that he was right to do so. This does seem to be the kind of enquiry which CCC could and probably should have cautiously responded to, as it appears to be a potentially "easy" and beneficial sales opportunity. However, even having said that, I think it still premature to infer that a sufficiently good price would have been obtained; the evidence suggests to me that a vague offer of a "good" price will often be thrown out as a means of simply getting a start to a negotiation, or even just a reaction which can itself provide useful information. I therefore consider that the evidence would have to be stronger before such an inference could be made.

1913. Mr Stomber was not directly involved in this matter and could only speculate on why it was not followed up, although he pointed out that the size of the tranche was small, such that there would have been little liquidity generated. Dr Maini subsequently challenged this reasoning

as well, saying that sales of small tranches will very often achieve better prices. This may well be true.

1914. I have already explained why I am not prepared to draw any adverse inferences from the absence of Mr Greenwood as a witness, both generally, and with regard to this particular topic. The result is that the evidence is simply what it is. Whilst there could be reasons, not readily apparent after the event, why this enquiry was not followed up at the time, I cannot ignore Mr Stomber's reaction that it should have been.

1915. However, even if I were to find that this incident was negligent, it would not, in my judgment, give rise to any successful claim by the Plaintiffs against the individual Defendants for several reasons. First, as I have said, there is the technical reason that it is not adequately pleaded as a cause of action. Second, even if it were, it is negligence only at the operational level, and could therefore, in my judgment, only give rise to liability on the part of CIM, and not of the individual directors of CCC. (This includes Mr Stomber, since any involvement of his was at best supervisory only and therefore only, I would hold, in his capacity as "Management" for CCC, ie as CIM, and not personally as a Director of CCC). Third, it is not, in my judgment sufficiently egregious a fault in the general order of things that it would ever amount to "gross" negligence, such that it would prima facie (I have not heard argument on this) be within the exculpation provisions of the IMA of which CIM is entitled to the benefit. Fourth, and this really concludes the matter, I am not satisfied, on the evidence and on balance of probability, that any actual damage was suffered by CCC as a result, and none is either pleaded or, to my mind, even calculable.

1916. The further criticisms made by Dr Maini of CCC's engagement with the market refer to approaches or market chatter which are far less strongly indicative of the possibility of an actual sale opportunity. The criticisms seem to be rather more that the style and extent of CCC's involvement in the market was lacklustre and less energetic than it should have been to achieve results, and that it did not use communications as opportunities to get engaged in the market. This is of some materiality to the charge that CCC did not in fact have any genuine intention to sell RMBS at all, but I have already rejected this, and none of the cited incidents establishes anything else of materiality in the action. I mention further examples simply for example and completeness.

1917. Dr Maini refers to notification on 27th September 2007 from Lehman to Mr Ng that they had sold a part of bond FNR 07-54F, a 6.75% capped floater of which CCC held some $628Mn, at $98.25. In fact, Dr Maini does not suggest that this disclosed a potential opportunity to make a further sale, but only an opportunity to gain market "colour". The size of the relevant trade is not disclosed and the IDP price at that date was $98.74. The price was thus 49 bps below IDP prices. Nothing, it seems to me, can be inferred from this exchange, except that it goes nowhere towards supporting the Plaintiffs' case that prices 11bps below IDP prices could have been achieved.

1918. Dr Maini mentions an enquiry from UBS on 10th October to the effect that they were seeking any 6% capped strip floaters off 7% IO collateral, which was not followed up. However, CCC did not own any RMBS of this type. Nor did they own bonds with caps as high as 7.5%, the subject of another enquiry which Dr Maini cites.

1919. As a last example, on 29th November 2007, Merrill Lynch announced that, with regard to bond FHR 3262, they were looking for the floater because they held the IIO and knew where the PO

was. However the size was not stated. CCC apparently owned some part of this bond. The possibility of a transaction coming out of this enquiry, though, is purely speculative.

1920. From the examples of market "conversations" like the above, and such as I have seen being conducted elsewhere in the evidence, it appears to me that Mr Ng, a junior employee, was conducting these under the broad instruction that CCC was not selling, and that whilst he should engage in market chatter, he should not depart from that line. This would be perfectly reasonable in the circumstances, but could well have the result that approaches which more senior and seasoned players in the market might have sensed to have some potential mileage in them, and would have handled in a more nuanced way, were handled more bluntly by Mr Ng, and well on the safe side of his instructions. None of this causes me to question my conclusions and to think that the actual policy of CCC was other than as the Defendants have stated, and that the absence of any actual sales being effected arose because, in whatever circumstances at any particular time, no sufficiently attractive or worthwhile chemistry took place to progress anywhere.

1921. In the circumstances, therefore I do not find that either the UBS episode - or indeed any other instances of enquiries which were not followed up or otherwise came to nothing, and whether alone or in combination – are sufficient to support a finding that the Defendants had an unduly rigid, irrational, or improperly motivated intention not to sell RMBS. I am satisfied, rather, that they are broadly consistent with the policy of being minded to make sales if a sufficiently significant and worthwhile opportunity presented itself or could be negotiated with sufficient apparent nonchalance, but at the same time being extremely careful to convey such nonchalance. The underlying strategy was, reasonably, one of patience and opportunity only.

1922. Whilst worthwhile opportunities would be a matter of fact and degree, I do not find it to have been unreasonable for CCC to be hesitant about pursuing opportunities much below $1Bn (thus releasing between $20Mn and $30Mn in liquidity and reducing the overall requirement for repo finance by that $1Bn amount), although these would also have to be at a price which did not generate a loss that wiped out the benefits. Smaller opportunities would generate less gain and would therefore carry less weight against the considerations of not appearing to be over-eager to sell. The nonchalance requirement was that CCC must avoid, at all costs, looking as if it was under pressure to sell. In September/October 2007, suitable opportunities were likely to be scarce; the evidence is that at this time the markets were suffering generally from over-supply because of the number of failed ABCP funds, the sale of whose assets was flooding the market.

1923. In summary, then, I do not find that the evidence on this topic, when examined, negates the Defendants' assertions, which I accept, that there was a willingness to take opportunistic but prudent advantage of opportunities to sell RMBS and deleverage to some extent, if such opportunities were perceived. The degree to which this was appropriate was then a matter of business judgement. I am satisfied that there is one individual incident (Bear Stearns, but in October 2007) where such a prima facie opportunity was apparently not investigated, but even if this could be characterised as negligence, it does not provide any grounds for any recovery in this action by the Plaintiffs, for reasons given above.

(c) Contractual/tortious claims against CIM

1924. Having hitherto focused on the claims against the individual Defendants, I now turn to the claim in contract or similarly in tortious negligence against CIM.

1925. Given that there was no Board Meeting during this period (September 2007), there is reason for considering CIM's involvement in the affairs of CCC closely, on the basis that decisions about continuing or changing the policy with regard to selling RMBS or not would, in the first instance, have been likely to have been initiated, quite properly, by "Management". This observation applies particularly to the issue of whether CIM, as an investment manager, ought to have had more appreciation of the potential use of the sales techniques put forward by Dr Maini. This is because these ultimately seem to have become the main reason why the balance of risk and benefit with regard to the conduct of CCC's business has been argued to have tilted in favour of initiating a programme to effect sales of RMBS as submitted by the Plaintiffs.

1926. I have indicated that in my judgment, CIM as investment manager would properly have been expected to have and to exercise a greater degree of expertise in the affairs of CCC's business than an ordinary director of CCC, but I can see nothing which is material to CIM's obligations of care with regard to investment management for CCC under the IMA, which has not also been material to the performance of the functions and duties of care of Mr Stomber, as an expert, but advisory and non-voting, director of CCC. In the end, therefore, for the same reasons as lead me to conclude that Mr Stomber was not in breach of his own individual duties of skill and care to CCC, and having also considered the wider actions and advice of CCC's Management as the embodiment of CIM in the performance of its contractual duties to CCC during this period, I am not satisfied that there was any breach by CIM of the duty of skill and care imposed upon it by contract.

1927. I do not see that any point arises with regard to CIM's potential contractual duties of loyalty and suchlike under the IMA.

1928. The Plaintiffs do not, in fact, seek to suggest that there are any materially different points to be made in respect of CIM's liability from that of the other Defendants, and devote only a small fraction of their closing submissions to mentioning this claim.

1929. Considering the matter at the end of September 2007, I therefore dismiss this claim against CIM for the same reasons as in relation to the individual Defendants.

(d) Wrongful trading

1930. The test for liability for wrongful trading is whether, at the material time, the Defendants knew or ought to have known that the company stood no reasonable prospect of avoiding insolvent liquidation. I discussed this test briefly in relation to August.

1931. I note here, and it is a point generally to be remembered, that this is not the same as a test of whether the company was, or was likely to be, in a position to make sufficient profits to be able to pay dividends, let alone attractive dividends. It is not wrongful trading to continue in business despite being unable to meet profit aspirations as long as the company is not incurring debts which it has no reasonable prospect of being able to pay off.

1932. On the evidence, and whether the criterion for an insolvent liquidation would be merely that of being unable to pay debts, or being unable to pay debts as they fell due, I am not satisfied that the circumstances up to and at the end of September 2007 were such that the Defendants or any of them did or ought to have concluded that CCC stood no reasonable prospect of avoiding going into insolvent liquidation. The considerations were the same as at the end of August in principle. However, CCC's financial position had actually improved slightly during this

month, there was no obvious potential problem looming over the horizon, let alone anything as to which the conclusion should have been that CCC stood no reasonable chance of meeting it. The bullet points referred to in the email of Mr Stomber regarding the PwC going concern review, and Mr Trozzo's further comments (see 26th and 27th September emails) were, I find, reasonable points which could fairly lead to such a conclusion. I have previously discussed and considered the views which it would have been reasonable to take of CCC's financing risks, both in relation to margin calls and the sustainability of its repo financing.

1933. The classic situation in which a company is clearly unable to pay its debts as they fall due is that in which continuing business in the same way as hitherto will, on past performance, result in a continuing accretion of losses such that the company is going to be unable to meet its liabilities, and it would require some out of the ordinary event, or change of fortune, for the company to avoid this eventuality. CCC's situation was rather the reverse. If it continued business in the same way as hitherto, it would continue to make small profits, and it would require some out of the ordinary event, or change of fortune, for it to fail for insolvency. Looked at this way the test is whether the Defendants ought to have concluded that there was a real prospect of such an out of the ordinary event or change of fortunes occurring. For reasons already given, I have concluded that there was no reason to do so.

1934. As I have said above, whether or not CCC would be able to devise an attainable business model which would provide sufficiently desirable returns for investors might be unclear, but that is not the same test as the test for wrongful trading and is a long way from it.

1935. I conclude that the Defendants were not guilty of wrongful trading during September 2007. I therefore dismiss the wrongful trading claim for this date.

12. The Claims: OCTOBER and NOVEMBER 2007

Did the Defendants culpably fail to review/revise their strategy between 1st October and 30th November 2007?

General overview

1936. In their pleaded case, the Plaintiffs next invite examination of CCC's situation as at the end of November 2007, and repeat that, even if the Defendants had not been guilty of breaches of duty or wrongful trading before, they were or had become so by then.

1937. At the end of September 2007, CCC's financial position had improved somewhat since August. Throughout October it continued to do so, but began to decline in November 2007, when dealings with CCC's repo lenders became more problematic once again as the banks' year ends (30th November for investment banks and 31st December for commercial banks) approached. At this time, their requirements for the presentation of their balance sheets placed pressure on their lending desks, which was reflected in their willingness or ability to lend. This, however, was not an unanticipated matter, because it is (on the evidence) a well-recognised feature of the financial markets.

1938. As at 1st October, CCC's liquidity cushion was recorded as $48Mn (7.2%) and its capital was valued at $665,945,580. These figures rose steadily to $140Mn (19.2%) and $729,262,109 respectively on 31st October 2007, and indeed, at the week-end of 2nd/5th November 2007, the nominal liquidity cushion briefly achieved 20.1%. It thus apparently achieved the magic 20%

original investment guideline figure, although by this time, of course, the portfolio itself consisted of 99% RMBS rather than the original diversified asset allocation, and the liquidity cushion included the Carlyle loan of $100Mn. From that point on, though, the liquidity cushion wavered somewhat and began to decline.

1939. On 8th November 2007 the Carlyle loan was converted from a term loan to a revolving credit facility of $100Mn. This improved the interest payment position for CCC; CCC repaid the $100Mn loan to Carlyle, instead taking $20Mn of the available credit line a few days later. The unused available sum was, though, still included in CCC's recorded liquidity cushion, on the grounds that it was a cash sum available for liquidity cushion purposes if needed.

1940. The Plaintiffs criticise this treatment as inappropriate. It does not seem to me that it matters greatly, as these figures were for internal use. Recording it this way has the merit of continuing the daily reporting figures on a similar overall basis, although, it makes less obvious the extent to which borrowings have actually been taken up.

1941. On 13th November 2007, at the time of the next quarterly Board Meeting, the liquidity cushion stood at some $113Mn (16.3%) of which $100Mn was unused credit line, and capital was recorded as $694,844,208. At the end of November, the liquidity cushion was recorded as $71Mn (10.5%) of which $40,000 was unused credit line, with capital value being $676,349,070.

1942. Apart from the continuing ongoing requirements of managing CCC's affairs by negotiating the on-going requirement for vital repo funding, monitoring prices to anticipate and try to avoid margin calls, and generally keeping abreast with developments and events in the financial markets, the period from October to November 2007 was also marked by five particular material features or events.

1943. The first was the conduct of PwC's quarterly audit report, and the "going concern review" which it had intimated that it would be making and which has already been referred to because of its anticipation in September 2007. The second was preparation for and the holding of the regular Board Meeting, on 13th November 2007. The third was the release of the autumn third quarter financial statements. The fourth was the Autumn Carlyle Paris Investor Conference, taking place on 20th November 2007, and the fifth was the purchase in the market by each of the individual Defendants of varying but significant quantities of CCC's shares.

1944. Looking outside CCC itself, throughout this period there were items of negative news in the financial markets regularly arising. CCC's repo lenders announced major write downs on six occasions in October. On 1st October UBS announced $3.4Bn, on 3rd October, Deutsche Bank announced $3.1Bn, on 5th October, Merrill Lynch announced $5.5Bn and a further $2.9Bn on 24th October, on 15th October, Citibank announced $5.9Bn and on 18th October, Bank of America announced $1.45Bn. This continued in November. On 4th November Citibank announced a further $2.1-$5.1Bn write down; on 7th November, Morgan Stanley announced $3.7Bn, on 9th November, Wachovia announced $1.7Bn, on 13th November, Bank of America announced a further $3Bn and on 16th November, Barclays announced $2.7Mn. This stream of write downs provide context and background for the actions taken by CCC, which the Plaintiffs invite me to keep well in mind.

1945. An account of the events of this period follows.

Early October 2007

1946. I have dealt, in the last section relating to September, with the suspension of the Investment Guidelines on 1st October 2007, the implications of this and the conclusions to be drawn, and have found that this was reasonable and proper. I do not repeat this here.

PwC Going Concern Review

1947. This was current from the beginning of October through to the time of the November Board meeting when PwC's conclusions were presented to the Board. I have already referred to the start of this at the end of September.

1948. The PwC going concern review is another matter which is not directly relevant to the complaints in the action. The facts relied upon are not alleged to found any cause of action for the Plaintiffs. However, it has assumed evidential importance regarding facts which do so.

1949. In a nutshell, this importance arises because the Defendants have pointed to the fact that PwC, as CCC's auditors, endorsed the assertion that CCC could be regarded as a "going concern" (essentially meaning: a company which appeared capable of continuing its business and meeting its financial obligations for the following twelve months at least) in both its review of CCC's 2007 Third Quarter financial statements and in its subsequent Year End statements. The Defendants rely on this as objective evidence that their view of CCC's continued viability was objectively reasonable, and more directly, that it was reasonable to be of the view that there was a reasonable prospect of CCC's avoiding going into insolvent liquidation, thus negativing the accusations of wrongful trading.

1950. The Plaintiffs' riposte to this has been that the Defendants cannot rely upon PwC's reports because these were of limited scope, and they were not an independent verification of the Defendants' claimed views, because they relied on input from the Defendants themselves and/or CCC's Management which was, and was known to be, inaccurate, unduly optimistic and in certain instances edited to make it more favourable.

1951. This issue therefore requires some reference to the detailed facts of PwC's involvement, and it is more convenient to deal with this in the context of discussing the arguments made by the Plaintiffs than as part of the general scene setting narrative for this period. I leave discussion, therefore, until later, noting here only that PwC's investigations and enquiries of Management took place during October, with their report due for presentation to the Board at the 13th November Board meeting, with a view to incorporation in the Third Quarter report which was to be reviewed and endorsed for publication at that meeting.

1952. On 2nd October, Mr Stomber reported the coming to fruition of a $500Mn repo line from Credit Suisse, negotiated in September. At the same time the Carlyle Strategic Alternatives Working Group was meeting with an agenda to discuss, inter alia, the completion of the Mubadala transaction and a potential IPO of Carlyle itself.

1953. On 3rd October Mr Stomber reported obtaining an additional $1Bn line from Lehman, after meeting at a high level with one of their executives - though it is not clear from the agreed repo utilisation chart prepared by the Plaintiffs whether or when this actually was taken up, and the Plaintiffs say that in fact this was wishful thinking, as the increase was never approved by Lehman's repo desk itself. Mr Stomber was also in active negotiations with Citi to try to

maintain the 2.5% haircut level after expiration of their initial 60 day agreement to this, negotiated by Mr Conway in August. He succeeded in doing so, once again using the Carlyle connection for CCC's benefit, although the available line was reduced from $7.5Bn to $5Bn.

1954. Otherwise, and later, CCC made efforts in October to establish more diversified, and stable repo lines, seeking, though ultimately apparently unsuccessfully, to establish new repo lines with Fortis, Societe Generale, ABN Amro and Barclays. Work with Wachovia to conclude an MRA for a term repo line continued.

4th October 2007

1955. The month of October 2007 saw gradual but fluctuating improvement in the market for Agency floaters. The handful of Westways liquidation auctions was concluded in early October 2007. Prices on Agency floaters stabilised and even improved, resulting in the return of some margin to CCC. Mr Stomber was of the view that it was the early signs of market recovery, and the Defendants point to independent market commentary as of 4th October which expresses similar views, certainly in relation to the market for Agency RMBS with a 7% cap. This appears to have been prompted by the Westways auctions.

1956. In a set of emails on 4th October 2007, Mr Stomber updated CCC's board in his usual detailed way. He referred to the more optimistic comments above, noted that the ECB had announced that it would leave interest rates unchanged at 4% in the light of the slump in the housing market, which was favourable for CCC because, historically, its type of assets did well in a flight to liquidity when credit defaults increased and interest rates were kept low. He referred last to a distressed auction of $800Mn of 7% capped floaters by Citigroup at an average discount margin of 55-57 over LIBOR, a narrowing (price improvement) over previous spreads and a fact which would enable CCC to exert pressure on lenders, particularly Citigroup and Lehman, who were marking their collateral at higher spreads (lower prices) as a backdoor haircut.

1957. Mr Stomber was thus optimistic that his forecast recovery was slowly but surely materialising, and conveyed this to the other Defendants; Mr Conway and Mr Hance both say in evidence that their recollection is of being reassured at this time that the decision not to sell RMBS had been the right one. Mr Stomber was, however, very anxious, as he said in one of his emails of this date, that there should be no early conclusions as to what CCC should look like going forward. Mr Stomber continued to send updates to the full Board on a roughly weekly basis throughout October, informing the directors of current market conditions and their implications for CCC.

4th October - ALCO Meeting

1958. The 4th October meeting was attended by Messrs. Trozzo, Stomber, Greenwood, Melchior, Buser, Allardice, Ng, Rella and Hunt. Mr. Trozzo noted improvements in the market, and that it was expected that the Federal Reserve would ease interest rates in October; Mr Greenwood noted that short term interest rates had already fallen. Focusing more specifically on Agency floaters, Mr. Greenwood noted that prices had become more stable, and also that as mortgage interest rates fell, this was beneficial for CCC because it brought in prepayment capital.

1959. Figures and indicators were calculated up to the date of 28th September. CCC's continued failure to comply with certain Investment Guidelines was noted but viewed as temporary and

the result of history. It was also noted that CCC's indicators, such as VaR, were still reflecting the disrupting events of August. Although, therefore, their consequent ratios might look ominous, both Mr Conway and Mr Hance said that they were not particularly concerned by this as VaR is backward looking rather than forward predicting. Total liquidity had increased from $67Mn to $85Mn from 17th September to 28th September, and the liquidity cushion then stood at 7.2%.

1960. Conscious of the Board's wish to think forward to when CCC could begin making investments again, and to plan how its business model might then look, Mr Stomber advised patience with regard to this in an email of 5th October 2007. Mr Conway and Mr Hance both agreed and they say that they continued to think, throughout October, that it was still premature to begin trying to form a new business model for CCC, until it was really clear that market conditions had stabilised. Mr Stomber also expressed, at the time, pessimistic views on the economy and that this cautioned him against moving back into credit risk assets, too early. It is now said that the view then was that it might well not be possible to make more investments for many months, although how firmly that view was held and articulated at the time, without the benefit of hindsight, I am not certain.

1961. On 10th October, the Mubadala deal, which had been contracted in September 2007, was completed.

1962. On 12th October 2007, Mr Stomber's report to the Board was to the effect that the work of pressing CCC's repo lenders to mark prices more reasonably was underway, relying on recent market conditions. There had been no more distressed sales of ABCP that week, which was a good sign for it meant that the flood of such paper on to the market might well have abated, giving the opportunity for demand to catch up with supply and prices to rise in consequence. He also reported that high level negotiations were taking place with JP Morgan for a new repo line, and that management was starting work on the high level business plan which would be discussed at the November Board meeting.

1963. He also wrote at this time to Messrs. Trozzo and Greenwood reflecting, with the benefit of hindsight, on some of the "*mistakes*" that he thought Management had made over the past several months, including that CCC had pushed too hard for low interest rates, should have spent more time building its relationships with repo lenders, and could improve its internal communications. He explained this as part of the general importance of looking back to see what lessons could be learned for the future. I accept that this is the case, and this email is not to be treated as a formal admission, although I can and do find it to be evidence of his thinking at that time. Mr Stomber also commented that there was a second, but would not be a third, chance at "fixing CCC". I do not regard this as particularly significant, either. It simply strikes me as another example of Mr Stomber's inclination to use graphic comment.

1964. As regards review of the decision whether to sell or hold RMBS, this choice was clearly brought to Mr Conway's attention at around 13th October 2007 by a message, from an investor, Mr Jacco Reijtenbagh, expressing disappointment in CCC's performance and blaming Management for not foreseeing troubles in the mortgage market. This was a suggestion which Mr Conway thought was unreasonable, given that it had been a global crisis which was unforeseen generally. Mr. Reitjtenbagh further suggested in his email that "*Carlyle could sell the whole portfolio with a discount to for example Pimco and take a loss*." Mr Conway, with

his customary measured style, treated the merits of this suggestion at face value in his written evidence

> "*There were several problems with this idea. First, I did not think it was necessary or in the interests of CCC or its shareholders for CCC to sell off its whole portfolio. Second, even if it were technically feasible to do so, selling RMBS continued to entail the same risks that we had sought to avoid in August, and I was sure that if CCC attempted to sell off its entire portfolio to anyone, it would be offered deeply distressed prices. . . . Third, this was not a decision for Carlyle to make and not a loss for Carlyle to suffer; if CCC's Board opted to try to wind down CCC, the losses associated with that would be borne by CCC's investors (i.e., including Mr. Reijtenbagh and me and many of my colleagues).*"

1965. Taken at face value, Mr Reitjtenbagh's suggestion does seem to me to show some naivety and failure to appreciate the particular characteristics of Agency RMBS which distinguish them from non-Agency and subprime securitised mortgages, the market dynamics which would affect the level of any such "loss", and also the actual relationship between Carlyle and CCC. More likely, and as Mr Conway himself says (politely) that he perceived it, it was an attempt to pressure Carlyle into buying his shares back and relieving him of the losses on his investment.

1966. On any basis, though, this message clearly put the choice of selling or holding squarely into Mr Conway's mind, and up for consideration at this time. Mr Conway says in his evidence that faced with this prospect, he still did not consider it advantageous for CCC's shareholders to attempt to sell large quantities of "money-good" Agency floaters into a still-dislocated market, and saw a policy of selling as being more risky than a policy of holding. Mr Stomber, Mr Hance and the other directors shared this view, reiterating that the risks of selling what might be seen as the tip of the iceberg of a $23Bn portfolio, despite having announced a capital preservation strategy, were of a different level of risk as to price from that attached to selling $800Mn bonds out of a known broken ABCP portfolio, which is what had been done in the most recent Westways auction.

1967. Consistent with the Board's uniform reaffirmation of CCC's capital preservation strategy at the beginning of the month, Management continued to implement that approach throughout October 2007.

15th October – repo roll

1968. At the Freddie Mac repo roll of $9.1Bn of securities on 15th October, Mr Stomber delightedly reported to the Board that CCC had managed to make some progress in persuading repo lenders to adopt more favourable marks and had consequently received back $17Mn in margin – "*total liquidity $115 MM".*

1969. An email of this date from Mr. Stomber to Mr Conway shows that at this time the question of CCC raising new capital was raised between them, but rejected, with Mr Stomber expressing the view that in CCC's current conditions such a deal was not "doable", quite apart from the effect of diluting shareholders' capital, which he did not consider in their best interests. I have already found that this was a reasonable view in September 2007. Nothing had sufficiently changed in the interim to suggest any different view.

18th October - ALCO Meeting

1970. The 18th October ALCO meeting was similarly attended by Messrs. Trozzo, Stomber, Greenwood, Melchior, Green, Hance, Ng, Rella and Hunt.

1971. The update on market conditions and sentiment broadly reiterated that expressed at the 4th October meeting. Mr. Greenwood provided an update on market conditions, as being still "bearish" with the expectation of a further interest rate cut. As to CCC's portfolio, he commented that there was still "slow but steady" price improvement and no more distressed sales since 5th October, with interest and mortgage rates falling. However these had not yet produced significant effects for CCC. A decline in the rate of Fannie and Freddie new issuance was put down to the glut of supply on the secondary market.

1972. Referring to documents in the ALCO pack compiled on 15th October 2007, Mr. Trozzo confirmed the small but steady increase in the value of CCC's portfolio since the end of August. He reported also that liquidity had increased (from $85Mn on 28 September to $97.9Mn on 15th October) and the liquidity cushion had doubled from the last meeting to 14 %.

Mid October 2007

1973. On 18th October, Mr Stomber was able to report that liquidity had improved by $33Mn since September; he assessed the liquidity cushion at $123Mn (the daily report figures appear to put it at $116Mn gross, $111Mn net), and that his opinion on the economy was "bearish" (ie gloomy), but this was good for the likely value of CCC's securities. This reflected email exchanges with Mr Conway the previous day regarding the weakness of the US economy and there being no good economic news. On 19th October Mr. Stomber again observed to Mr Conway that the economy was in trouble and that the Federal Reserve was being slow in its responses, but said that CCC would do well in such times, because his view was that the developing problems were credit-related and there could well be a *"liquidity event quickly compounded by a credit event*". He indicated that he expected a bumpy ride to come. Mr Conway expressed his agreement.

25th October - repo roll

1974. This was the day of the Fannie Mae repo roll, and Mr Stomber was able to report a $20Mn improvement in liquidity which he now put at $147Mn, in consequence. Mr Hance responded noting the improvement, and with gentle encouragement for Mr Stomber and his team.

1975. Mr Stomber had successfully negotiated the reopening of a repo line with Bank of America, first for $500Mn and then $1.5Bn by the time of the 25th October roll, although the Plaintiffs, rather churlishly, insist that this was therefore not a "new" line.

1976. Mr Allardice showed particular interest in CCC's funding situation. An exchange of emails between Mr Stomber and him on 21st and 27th October shows them both recognising that seeking to secure CCC's financing was very important, and that the difficulties of doing so could increase. Mr Allardice observed that lenders' liquidity could evaporate, and therefore cause major difficulties for CCC, very quickly indeed; Mr Stomber was of the view that as RMBS were "self-funding" because of interest receipts, banks therefore would, or should, be readier to lend because they would not be issuing unsecured debt. They both say in evidence

that they did not consider the total evaporation of liquidity to be at all a likely event, at that time.

Late October 2007

1977. Mr Conway sought to explore a 90 day repo line from Bank of America, but with a 2.5% haircut. Mr. Duffy of Bank of America replied that a longer term typically would require a higher haircut but that he was exploring whether Bank of America might be able to dispense with that requirement for CCC. In the end, though, this came to nothing. Likewise negotiations with Wachovia were continuing. Owing to their lack of experience in the repo market, though, it was now proposed that the deal be re-structured so that they stood as an agent between CCC and other repo lending parties, and as guarantor of the $2Bn 364 day line to CCC.

1978. At about this time, Mr Stomber began, obviously sensibly, to voice his concerns about the imminent year end of the banks, when they would seek to conserve liquidity over their financial year ends for presentational purposes, and might retract lending for this reason. He was particularly concerned about UBS and Citi. Mr Conway said that he shared this concern but felt that it would be temporary and that CCC could succeed in weathering the situation. The negotiation with JP Morgan was still in train at this time.

1979. An email from Mr Allardice to Mr Stomber on 26th October 2007 shows his recognition of the great significance of repo funding risk, commenting that repo finance can disappear very quickly and, in effect, that this risk should not be underestimated.

1980. Mr Stomber summarised the status of negotiations with repo lenders in a 30th October email to the Board, (although several of the apparent possibilities - ABN Amro, Barclays, Société Generale and, ultimately Wachovia - came to nothing in the event).

1981. On 30th October 2007 Mr Stomber expressed interest in purchasing more stock in CCC to Ms Cosiol. Mr Zupon had already enquired when this could be done, earlier in October 2007. The answer to this was, apparently, that it would be some three days after release of CCC's Third Quarter financial statements, when it would be accepted by the regulators that CCC personnel would no longer have access to inside information not generally available to the public. The enquiry prompted Ms Cosiol, at this point, to seek advice from both Dutch and U.S. counsel as to how this might be done, and what disclosure obligations might be necessary, depending on whether individuals bought in their own names or collectively through the CCC Coinvestment vehicle, as previously used to make purchases by the Board and Carlyle affiliates on the initial private round of fundraising.

1982. Mr. Stomber's pessimism about the weakness of the U.S. economy was validated when the Federal Reserve cut interest rates by another 25 bps to 4.5% on 31st October. Falling interest rates, even though a sign of a slowing economy, were seen by Mr. Stomber as beneficial to CCC because it reduced the perception of "cap risk" on its capped floaters, which would increase their attraction and therefore price, and it also encouraged prepayments and thus natural deleveraging of the portfolio. Balanced against this assessment that a bad economic situation would do CCC's assets no harm, though, was the countervailing possibility that a bad economic situation might make it more difficult for CCC to obtain financing.

1983. The Plaintiffs point out that Mr Stomber was apparently also focused on the future analysts conference call, which would take place a fortnight later after publication of CCC's Third Quarter financial results, with regard to paying a dividend, stressing that "*our investors need a dividend*".

1984. At this time, the end of October, the value of CCC's portfolio - now entirely Agency floaters - was $22.18Bn, with a capital of $729,380,263 according to CCC's own internal cash files (although it later published an IFRS-adjusted value of $674,177,107). The liquidity cushion stood at 19% in the internal figures, but this therefore became 22% in the Investment Manager's monthly report. The average haircut on CCC's outstanding repo lines was 2.65%. CCC had repo capacity of $23.3Bn with twelve different lenders, of which $21.4Bn was in use. Its leverage ratio (as calculated by Professor Hubbard) was 30.4x.

November 2007

1985. November would be a significant month because of the holding of the next formal Board Meeting, the review and release of CCC's Third Quarter Financial Statements and receiving questions about these, and the Carlyle Paris Investor Conference.

1986. Moving into the month, though, CCC's position had improved. Its liquidity cushion had risen to around the "magic" 20% mark, its NAV had increased to an unadjusted figure of around $725Mn, and the gradual amortisation process had reduced CCC's total RMBS assets from nearly $23Bn as of 31 July to $22.17 Bn.

1st November - ALCO Meeting

1987. On 1st November, ALCO met to discuss the state of the markets. The meeting was attended by Messrs. Trozzo, Stomber, Greenwood, Green, and Melchior, with, amongst others, Messrs Hance and Allardice (by telephone) and Messrs Ng and Rella, and invitees from Carlyle's US Leveraged Finance Group.

1988. The Committee observed that the recent interest rate cut by the Federal Reserve was helpful for CCC's securities, but the Fed had suggested, and the market anticipated, that further rate cuts in December were unlikely. Mr. Greenwood noted that GDP in the United States was up unexpectedly but that there were lingering concerns about the credit markets, which was what market participants were really focused on. Concern, for example, at a rumour that Citi might be announcing a $9Bn write off related to its subprime holdings was noted.

1989. Mr Greenwood talked the meeting through a documented "Review of Markets". Spreads for 7% capped floaters continued to narrow, but new issuance remained at a historic low, although there had been a slight increase in new issuance volume in October over September. A 9% increase in refinancing applications had been noted, which, once again augured well for prepayment rates and assisted CCC's portfolio. Mr Greenwood made a brief comparison of Annaly's stock price, where its business had benefitted from the recent interest rate cuts, but noted that CCC's share price continued to fall, on little trading volume.

1990. Mr. Trozzo reviewed the compliance reports in the ALCO pack and noted that "*the liquidity cushion had recovered to a level above 20%*" and that "*[a]ll other compliance guidelines were in order*." The relevant slide showed that total liquidity had increased from $97.9Mn on 15 October to $137Mn on 26th October. The ratio of the liquidity cushion to 20-day VaR

continued to improve, reaching 0.7 on 26th October, but Mr. Trozzo nonetheless cautioned that liquidity was still not at desirable levels given the state of the market. Mr. Greenwood "*then walked the committee through the RMBS capped floater price change components and analysis*," noting in particular a decline in 10-year swap rate which "*lead to a price increase in the portfolio*", and Mr. Stomber observed that "*with Fed rate cuts accompanying language indicating a reluctance to cut rates further, volatility may start to ease which would also benefit the portfolio*."

1991. With regard to repo, Mr. Trozzo stressed CCC's negotiations for new and increased repo lines and that management were working closely with repo counterparties to manage CCC's repo funding over the year end – the November fiscal year end for some investment banks and December calendar year end for the remainder.

1992. Later that day, in his daily liquidity update, Mr. Stomber reported that CCC's liquidity was at $142Mn and reported that Wachovia had "come through" and "*we expect to have our $2bil for the Dec rolls*." He also reported, however, that the general economic news was not positive, which was causing Treasury prices to rise and yields to fall. The alert that Citi might turn out to have balance sheet difficulties suggested that CCC should take precautions by seeking to set up alternative fall-back repo availability. Mr Hance endorsed the proposal to take "*Citi evasive action if needed".* On the same day, rumours of a capital shortage at Citi prompted Management to begin preparing for the possibility of having to move some of CCC's repo line from Citi to other dealers, and as part of this preparation, Mr. Stomber asked Mr. Conway to try to finalise a new repo line with JP Morgan in time for the November repo rolls.

2nd November – efforts to secure year end repo cover

1993. With regard to the year-end rolls, Management began listing efforts to lock down year-end financing. On 2nd November, Mr. Trozzo sent an email outlining steps Management planned to take to obtain early assurances about the availability of funding over year end. This identified goals and concerns. The new JP Morgan line, anticipated to be possibly $2Bn with a 2.5% haircut, was only "*a phone call away*", and a new line with ABN Amro for $500Mn would be in place by month-end, but "*Wachovia will take a bit longer to Dec*." As regards December, he indicated that "*Wachovia's $2 bln is in place*" although he suggested CCC might not employ it then but might instead save it to start in January 2008. It was reported that even based on a conservative assumption that several repo dealers either decreased or merely maintained (rather than increased) their lines, Management still expected CCC to have sufficient excess capacity to be able to *"temporarily help Citi and take them down significantly*" and potentially earn an "*IOU*" such as a "*[l]ower HC after year-end*." I find this a useful illustration of the thinking behind the way business negotiations develop in these markets.

1994. A chart had been prepared showing borrowing needs against available lines and it gave Management's projections which expected to get through both November and December year ends with excess capacity. For December, year end figures showed expected repo capacity of over $26.6Bn as against current use of $21.4Bn, and thus $5.2Bn of excess capacity, which the Defendants point out was roughly equal to the pre-crisis minimum borrowing capacity guideline of 125%. This presentation has to be seen in perspective, though. It included, although perhaps not unreasonably in the expectations of the time, the anticipated $2Bn line from Wachovia, and whilst it did not include the $1.2Bn of additional capacity available from

Deutsche Bank, that was only available at a 4% haircut (imposed for amounts between $1.8 Bn and $3Bn), a rate which the evidence suggests would have been unacceptable.

1995. That same day an updated draft of the Board Book that would be used for the upcoming Board meeting was sent to Mr. Allardice as Chairman of the Audit Committee, for his review, including the Q3 Results and Analytics slides which were based on information then available. Notably promptly, Mr. Allardice proposed that he and Mr. Stomber should review the Board materials together, in advance of their circulation to the rest of the Board. He suggested that Mr. Stomber should, in particular, "*review [the] where we think the markets are going slide . . . given the latest trauma out in the markets.*" He commented that he thought the "*likely case*" scenario being presented by Management was "*still reasonable, no question,*" but said they should look through it together.

1996. Mr. Stomber's update for 2nd November noted that the liquidity cushion had reached $149Mn, a post-crisis high, but he also reported that given recent announcements by repo lenders he was preparing for a worst case scenario in which lines were reduced, requiring reallocation across lenders.

Early November 2007

1997. On 5th November, Mr. Stomber reported that Citi's capitalisation problems did not appear to be as bad as he had feared, and he believed that Citi would not ask for more than a $2Bn reduction on its $5Bn repo line, if they asked for any reduction at all. He also reported that Management was in discussions with Lehman and Bear Stearns regarding repo availability over their November year ends, as CCC sought to address proactively what it perceived as the likely next period of stress. He also noted that he expected Amro to provide a $500Mn repo line. Shortly after, he obtained commitments from UBS and Lehman to maintain their current repo financing through the end of the year.

1998. On 6th November 2007, Mr Conway noted interest amongst Carlyle affiliates and entities in purchasing CCC stock (I infer that the market price was beginning to make this appear a good investment to those in the know) and it was also decided that any such investment should be made collectively, through CCC Coinvest, for tidiness and efficiency.

1999. Mr. Stomber's daily liquidity update of 7th November reported the current state of CCC. Liquidity had remained level at $146Mn (19.6% of adjusted capital) and had remained at or around that level for nearly two weeks. He reported the slow progress in finalising repo documentation with Wachovia, putting it down to the fact that Wachovia was not a major player. Management, though, received confirmation that JP Morgan was reinstating a $2Bn repo line with CCC.

2000. Because of rumours about Citi's financial difficulties with write-offs, he noted again the need to prepare for Citi's possibly shrinking its repo line - a typical example, I note, of market players taking protective action based on market rumours - although he thought CCC would still be able to maintain a base level of repo with Citi. Mr Stomber reported that he and Management were seeking to nurse CCC's repo lines through the end of 2007, but expected a freeze on the MTM value of CCC's securities as counterparties simply sought to get over the year end. Mr Hance again replied in agreement and encouragement, approving the defensive approach to managing CCC's repo lines.

2001. There were a number of negative developments the following day as Mr Stomber then reported. He wrote a general email to Messrs. Conway, Hance, Allardice and Loveridge, noting that banks were hoarding liquidity, using distressed pricing to justify margin calls, and that repo availability was coming under pressure. With the market getting "*uglier*" as the year ends approached, CCC was still working to obtain additional repo capacity from Lehman. Mr. Allardice, to whom Mr Stomber sometimes wrote individually as (it seems) a mentor-cum-ally, responded expressing his belief that there were "*seismic shifts*" taking place in the economy such that year end pressures were likely to be particularly acute. He stressed again a view which he had previously expressed about the dangers of disappearing repo financing. Mr. Stomber replied to the effect that everything that could be done was being done, and the leverage of the Carlyle name was, at least, a benefit.

2002. Whilst the Plaintiffs suggest that one more obvious thing that could have been done was to sell Agency floaters to reduce leverage, the Defendants suggest that this not only assumes that a price could be obtained which would reduce leverage (Mr Stomber's evidence was that prices were essentially frozen at that time) but it ignores the various risks of selling and moving the market, which have been rehearsed before. In this context Mr Conway observed "*I'd say we weren't anxious to sell, at least not until we could sell at a price a lot closer to par*."

2003. The Defendants also point out that this pessimistic view of prices is supported by market "*color*" being reported by traders at the time. A conversation with a dealer a few days later on 13th November revealed that he had "*not seen floaters this wide even in the August carnage"* and "*[spreads] [were] shockingly wide*", attributing the lack of demand which was driving floater prices down to "*mtges. . . and year end lack of balance sheet*" – ie banks lacking the availability of funds to lend, but as a year end problem. Later on 8th November Mr Stomber wrote another email to Mr Allardice, reiterating his expectation of increased instability in the funding markets owing to year end pressures on first the investment and then the commercial banks to reduce apparent repo financing exposure over their November and December year ends (respectively).

2004. This tightening up on finance availability over fiscal year ends is a well-recognised occurrence in the financial markets. This is recorded by Mr Hance in his witness statement and acknowledged by Mr Welles in his expert report. I note that Mr Stomber, in anticipating difficulties to come, said that he was "*scared*".

2005. On 9th November, Carlyle made a special distribution of $1.2Bn of the proceeds of the Mubadala private placement to its partners. Mr Conway received $280Mn, as did his co-Founders. Mr Zupon received $7Mn and Mr Hance $950,000.

2006. On 12th November Citi informed Mr. Stomber that it would make its full $5Bn repo line available to CCC for November.

13th November - Audit Committee and Board Meetings

2007. These meetings took place consecutively; the Audit Committee Minutes are misdated 16th November 2007. Both meetings were in fact attended by all Board Members, by all other ALCO committee members, by representatives of PwC (although not Mr Reville, who was on honeymoon), and by Miss Cosiol, as Legal Counsel, taking her customary notes. They were particularly concerned, of course, with reviewing events since the August crisis, CCC's intervening progress towards recovery, and agreeing on a chart for its future course. There

had already been prepared, for presentation to the Board, CCC's Third Quarter Financial Statements (to 30th September 2007), the draft Management Discussion and Analysis ("MD&A") relating to these, and the proposed draft CEO Letter to be sent by Mr Stomber to CCC's shareholders. The papers also included PwC's Auditors' Report on the financial statements, which in effect endorsed the view that CCC qualified as a "going concern" by not including any caveat in this regard.

2008. These are obviously important meetings. The evidence includes both the documents referred to above, the relatively short formal Minutes of the meetings and Ms Cosiol's comprehensive handwritten notes from which these were prepared, as well as witness statement and oral evidence from the Defendants. Reviewing all this evidence in detail would be disproportionately lengthy, but the following account is intended to give an appropriate flavour, and mentions points of potential particular materiality.

13th November - Audit Committee Meeting

2009. The Audit Committee, which had last met on 25th July 2007, met first at 9 am at Carlyle's offices in New York, with the primary purpose of reviewing the formal quarter end documents for publication and circulation to shareholders. This meeting was chaired by Mr Allardice, as Chairman of the Audit Committee.

2010. Mr. Stomber explained that the goal of the draft CEO letter was to explain to the reader what had happened both in the relevant quarter and since and in particular to explain the reasoning behind the belief that, once distressed sales of ABCP had ceased, asset values would inevitably *"bounce back"* and improve, because the inherent value of the securities had not changed. He believed CCC had a "*safe portfolio w/[a] reasonable dividend if [it could] simply hold [the] securities*" to maturity. There was then a general, and quite detailed, discussion of both the CEO letter and the MD&A, with amendments suggested to ensure that it did not convey any undue optimism or inaccuracy about the position, especially in view of the somewhat more negative turn of events in the previous few days. Management provided updates on certain aspects of the business, and were challenged by Board Members as to the accuracy of statements and whether they were factually supportable. As an example, when Mr Stomber addressed the repo financing situation, explaining that Citi had agreed to maintain its line at $5Bn, that the new repo line of $2Bn from JP Morgan also was in place, and "*$2 billion @ Wachovia (almost up [and] running)"*, Mr Sarles pressed as to whether the commitments were guaranteed, and commented that even if the promises were regarded as reliable, they would fall if the counterparty needed to survive.

2011. Mr Stomber advised that it was too early to determine what a new liquidity cushion guideline should be, and the Board would be in a better position to discuss this after getting over the end of the year. This was reflected in the MD&A which revealed that the current Investment Guidelines had been suspended and the appropriate level for a liquidity cushion was being "*evaluat[ed]*".

2012. The Plaintiffs argue that this statement was false in the light of the actual decisions of the Board to defer such "evaluation", and it was put to several witnesses that they were not in reality "*evaluating*" the appropriate level for an updated liquidity cushion guideline at all, as they were doing nothing. The Defendants argue that, read in all its context, the statement was perfectly accurate, and the underlying reasons for not attempting, yet, to fix a liquidity cushion level or guideline were perfectly sound and reasonable.

2013. After reviewing the terms of the CEO letter, the MD&A report, the draft Third Quarter financial statements and their footnotes, the committee turned its attention to the PwC review of CCC's Third Quarter financial statements. The presentation by PwC on this topic was treated as its presentation to the CCC Board, since all Board Members were present.

2014. PwC reported that they were prepared to issue their report based on their review of the documents previously supplied to them subject to the changes just requested by the Committee. Following their review they were able to report that in their view everything was in compliance with IFRS requirements and they were prepared to issue an unmodified opinion, with no "going concern" qualification. It is recorded that they confirmed that they had "*independently priced [the] RMBS securities in their entirety*" (which Mr Allardice, in fact I think correctly, interpreted or recalled as meaning all of them individually, rather than in the aggregate) and they explained why, from an accounting perspective, they concurred with Management's use of IDP prices for the purposes of valuing CCC's portfolio, rather than the "*distressed prices from repos.*"

2015. As already mentioned, the Defendants rely on PwC's report as evidential support for their case that they were not guilty of any breach of duty or wrongful trading; they rely on it now, and they also say that they relied on and took comfort from this report at the time. The Plaintiffs say that it was not legitimate for them to do so, because, underlying this report was input from the Defendants themselves (more precisely Mr Stomber and his team, whose work in this regard was known to the Defendants) which the Defendants knew or ought to have known was incomplete, consisted of doctored or manipulated information supplied to PwC, and that in particular the supposedly "independent pricing" of CCC's RMBS could not be viewed as any form of independent verification because the final total came to a mere $72 difference in aggregate on a portfolio of over $22 Bn. This remarkable outcome, it is said, demonstrated that PwC had simply gone to the same pricing source as CCC and accepted these prices without question. I consider these contentions later in the context of the parties' respective submissions.

2016. After final "AOB" items regarding compliance in Guernsey, in which Mr Loveridge played an active part, and the record of the proposal to develop internal audit functions for CCC in 2008, the Audit Committee Meeting concluded. It had lasted over two hours, which in itself is an indication of the amount of discussion undertaken, and the extent of this is supported and illustrated by a review of the topics and comments recorded in Ms Cosiol's handwritten notes.

2017. Before leaving my overview of this meeting, I need to refer to one matter raised by the Plaintiffs, although going, in effect, to the Defendants' credit, particularly that of Mr Allardice (although the other Defendants and especially Mr Stomber by general association).

2018. The formal Minutes of this meeting were prepared in draft by Ms Cosiol, although only after some delay, and were submitted to Mr Allardice as Chairman for his approval. He reviewed and amended these draft minutes in conjunction with Mr Stomber, and returned a change tracked edited copy to Ms Cosiol on 5th February 2008. Although this is a long time after the meeting, it was well before the events of the end of February 2008 which began the precipitation of CCC's collapse.

2019. Mr Allardice's amendments, compared to Ms Cosiol's draft and her handwritten notes, were quite extensive. The Plaintiffs' criticism is that they were editing of illegitimately self-serving proportions; they were a deliberate attempt to remove "unhelpful" comments and references

which disclosed grave and significant concerns being expressed by or to the Defendants at the meeting, in order to present a more rosy – or at least bland - picture than was justified if appropriate dispassion had been applied.

2020. This accusation was put to Mr Allardice in cross-examination, Advocate Wessels inviting him to agree that certain of the comments which he had excised ought to have remained in the Minutes in order either to give a properly balanced picture or to record the concerns which were raised, rather than simply the bare outcome of the discussion. Mr Allardice defended his actions on the grounds that composing meeting minutes was both a matter of judgment and of personal style; his own style was to keep minutes short, and his judgment had been that the matters which he had deleted were appropriately omitted whilst still retaining the substance of what had been decided at the meeting.

2021. The significant objections amongst those made by the Plaintiffs were two. The first was that Mr Allardice had excised from Ms Cosiol's draft the note that, in the course of reviewing the section of the MD&A entitled "Liquidity and Capital Resources", *"Mr Green explained that, going forward, the real risk to the company was a "going concern" risk".* This had been the condensation of her note that Mr Green had said that "*real discussion [will?] [must?] be "going concern" as it was this year & expect that reporting 12/31 Financials look same as today*". The second objection was that there was no mention of Mr Sarles' expressed "*uncomfortable[ness]*" that there was "*no internal audit function and no plan in 2008",* especially having regard to the fact that CCC was a public company; this had been removed merely to record the upshot, namely that Mr Allardice was going to work with Protiviti, the entity contracted to maintain CCC's financial records, to develop such policies and procedures in 2008.

2022. I have compared Ms Cosiol's notes, her original draft minutes and the amendments made by Mr Allardice, (whether or not these were his own or Mr Stomber's comments) and reviewed these to form an overall impression of the mindset behind these amendments. They are varied in their apparent motivation. Some are there for the purpose of precise accuracy, for example where this was fundamental to Mr Stomber's oft-intoned mantra regarding the solid basis of CCC's RMBS portfolio and the implied guarantee of the US government, or the fact that "management's" marks were actually derived from an outside pricing service. Others show perfectly appropriate caution about unqualified statements of intention or predictions. An example is a reference to possibly being able to pay dividends being re-cast to add "*if the Board deems it appropriate*". Yet others remove references, explanations or comments which are unnecessary to the plain factual record of the Committee's business and the ultimate general thrust of the conclusion or discussion, or which are items of individual detail at a level inconsistent with the high general level of fact otherwise being recorded.

2023. They certainly, in many places, remove negative comments, but I do not see that they move the minutes outside the bounds of providing a fair record of the material upshot of the Committee's deliberations. The overall impression, to my mind, is of a draft made by someone less familiar with the subject matter and relative importance of matters under discussion, and therefore erring on the side of including material which might be of importance and perhaps with a naivety as to what should be regarded as "off the record", having then been overhauled by a far more seasoned and experienced person, who has learned that it is better not to provide hostages to fortune and to prune minutes to the minimum necessary for their utility as a record for those involved.

2024. In reality this is the way that minutes are often, perhaps even usually, prepared. I suppose it might theoretically be argued that the obligation to act in the best interests of the company requires that committee minutes should record all negative discussions, comments, fears and perceptions in order to provide evidence if the company should subsequently have cause to sue committee members, but this approach would be completely unrealistic. It would in practice redound to the disadvantage of the company by preventing or inhibiting frank discussions in case unguarded remarks made in the course of these were recorded irrevocably for future chewing over. It is also commonplace for minutes to correct misapprehensions and mistakes, even though these may well have been what was actually enunciated at the meeting. Once again it seems to me to be unrealistic to suggest that this would be improper. I therefore do not regard the extent to which these minutes have been demonstrably amended from the original draft of Ms Cosiol – neither a technician in the field nor a member of the Committee itself – to the more laconic but professional version in which they ultimately appeared, to have been improper. Nor do I regard it as in itself any reflection on the integrity or credit of Mr Allardice, or Mr Stomber or any of the Defendants, even if the overall end result is more anodyne and even optimistic than was the totality of the discussion which took place.

2025. In fact, I would consider the two amendments on which the Plaintiffs concentrated as justifiable in any event. Mr Sarles' "discomfort" at the lack of developed internal audit functions within CCC was being remedied, and flagging up that he raised this matter with discomfort is not, in my judgment, necessary for an understanding of the meeting and a record of the fact that internal audit functions were then being set to be developed. As to the other, whilst the Plaintiffs have understandably made much of the omission of Ms Cosiol's report of Mr Green's comments because it contains the words "going concern", her draft of this point was both imprecise and enigmatic in itself, and does not seem to me even to be an accurate representation of the tenor of her actual note, which talked about "discussion" and not "risk". Since, this was, once again, an incidental remark, taking the course of omitting it rather than re-casting it was, I find, perfectly reasonable.

2026. Finally, these criticisms are all ultimately, in themselves, of no materiality to the actual claims in the action.

13th November 2007 – BOARD MEETING

2027. The Board Meeting, with all members of the Board in attendance, began shortly after the conclusion of the Audit Committee meeting at 11.30 am with the same persons present (although now only two representatives of PwC).

2028. The Board first approved the new $100Mn revolving line of credit from Carlyle, replacing the previous $100Mn loan, referred to above and which had been repaid in full. This credit line had a 10% interest rate and required a 1% commitment fee payable in four instalments. The Board opined that the terms were fair as they were better than CCC was likely to be able to obtain from a third party, and the advantage to CCC was that interest was payable only on amounts actually drawn down. Whilst this benefit would be somewhat off-set by the commitment fee, the Plaintiffs have, in the end, made no serious complaint about the terms of the loan being unreasonable or oppressive. I would not find any such complaint to be made out and I need not consider this point further.

2029. The Board also approved an amendment to the definition of the liquidity cushion guideline to permit the undrawn portions of the loan to be treated as available liquidity, an amendment

which I have considered previously, and find to be a reasonable reflection of the practical position. The Board also discussed and approved the further suspension of the Investment Guidelines until 31st March 2008 to allow Management "*to better manage the fund in the best interest of the shareholders while they continue to review and revise the Company's business model.*" Each of the Defendants effectively confirmed in oral evidence that this was his view of the best steps for CCC at the time.

2030. The Meeting then turned to the updated business model projections that had been prepared prior to the Board meeting, originally as projections presented to PwC in connection with its going concern analysis. These had been contained in the Board Book of materials provided to the Directors in advance of the Board meeting. They thus show information which the Defendants had available to consider and inform themselves about before making any required decisions at the meeting itself. As the Plaintiffs questioned various Defendants about the implications of these materials, I need to describe some of them here.

2031. Mr Stomber explained how market events and the flood of ABCP on to the market from entities in trouble during the third quarter had affected the value of CCC's securities. He used a set of slides prepared under the heading "*CCC Q3 Results Support and Analytics*". They contained some projections under the heading of a "*Cash roll off analysis/Static Portfolio*," and two "*12 month Projected sources and Uses of Cash",* one being a *"Likely case*" and the other a "*Downside case*", with different assumptions and illustrating different outcomes.

2032. The "*Static Portfolio*" scenario was a cash flow forecast that documented exactly how much cash CCC could expect each quarter from principal pay downs (amortisations and prepayments) plus income. Giving rough orders of magnitude, that analysis showed that CCC earned positive net income of approximately $20Mn per quarter and could expect principal pay downs of roughly $20Mn per quarter (at an assumption of 1% pcm, said to be conservative) thus producing a total of around $40Mn per quarter. All other aspects of the portfolio remained unchanged in the static case (thus, unrealised losses and distressed pricing remaining the same, no new capital raised, portfolio composition being unchanged, haircuts remaining constant at 2.61%, no dividends paid, operating expenses remaining the same, and no change in prepayment speeds despite falling interest rates). This projection showed what would happen if essentially all of the cash generated were to be added to the current liquidity cushion. Under that scenario, CCC would continue to meet its obligations as they fell due and would gradually build its liquidity cushion by $40Mn each quarter.

2033. The "*Likely Case*" scenario projections, which in fact became the underpinning for the Business Plan Summary presented to the Board, were based on more varied assumptions than the static case. The *Likely Case* broadly assumed that markets and price levels would return to what was perceived as normal by mid 2008. It assumed no new investments in RMBS and no purchases of credit products until the third quarter of 2008, at which point diversification into credit products would be funded by a sale of $1Bn in RMBS, after (it was projected) Agency floater prices had returned to cost price (effectively par). Haircuts were assumed initially to increase to 2.75% by the year end and remain at that level until the third quarter of 2008, when they would reduce and continue at 2.5%. Under these assumptions, CCC could again, meet its debts as they fell due and dividends were assumed to recommence payment in the fourth quarter of 2008.

2034. The "*Downside Case*," assumed a more pessimistic course, but this time involving the sale of a significant quantity ($4Bn) of RMBS. The assumptions (apart from the obvious one that no dividends were to be paid at all) were that haircuts all moved immediately to 3%, and RMBS prices fell to the "*lowest point of Q3"* which thus came to represent supposed fair values. These latter assumptions implied a cash shortfall of approximately $13.7Mn in the fourth quarter of 2007, and it was posited that to meet this, there would be a sale of $4Bn of RMBS "*at lowest mark of Q3 to raise cash*", ie at repo marks only. Such a sale would, essentially, release the applicable 3% haircut, or about $120Mn in cash, and assuming that repo dealers' distressed pricing of collateral simply continued as it had been and did not change (worsen or improve) CCC would still increase its cash liquidity on that basis.

2035. Once again, as with the illustrations provided to the September investor conference, the Plaintiffs pressed several witnesses that the inclusion of this assumption of a sale of RMBS in the fourth quarter of 2007 as posited in the *Downside Case* showed that Management believed at the time that a sale of $4Bn of RMBS at CCC's repo marks was possible, and likewise the Board must have also done so when it accepted those cases. The Defendants' evidence was, once again, that these figures were simply theoretical illustrative assumptions. Of course if the downside case situation were to eventuate, and there were no other options for raising necessary cash, (such as further assistance from Carlyle), CCC would be compelled to attempt to raise cash to meet shortfall requirements through asset sales, and would have to take whatever risk these entailed, but this was not part of the expected "Likely Case".

2036. Returning to the course of the Board meeting itself, since the question is whether information supplied to the Defendants justified their decisions to continue with the capital preservation strategy, and the historical data disclosed was used as underpinning assumptions for the updated business model projections, it is necessary to look at some of the detail of the reasoning presented.

2037. Mr Stomber explained that the fall in prices for CCC's RMBS was blamed on the "*Large supply/demand imbalance as a result of liquidated ABCP programs",* but Management now expected liquidations to slow – none had happened for a month - even though the future could not necessarily be predicted. The slides analysed the various factors driving changes in prices for CCC's securities. Whilst noting that a "*rise in [interest] rates negatively affected the value of CCC's portfolio at [the time of the] IPO,*" rates had since fallen. Management observed, however, that "*the beneficial effect of lower rates on the value of our portfolio has been more than offset by higher [interest rate] volatility*" over the period from June, but that, more recently, the "*overall rate decline was of sufficient magnitude*" that it was "*supporting the value of our securities*." Importantly, it was observed that lower rates should lead to higher prepayment speeds. As interest rates decline, "*refinancing picks up, which also positively affects the value of these securities*." This good news was, though, tempered on a cautionary basis: "*Since IPO, rates have gone lower, supporting the value of our securities, however the current unsettled status of the mortgage financing market has dampened this benefit*."

2038. Management had also assessed the impact which rapidly declining rates had on interest rate volatility. Whilst lower interest rates were a positive for the value of CCC's securities, rapid changes in rates could be a negative because interest rate volatility creates uncertainty regarding future interest rates and this is reflected adversely in the price, because of the cap, and fears that it could become operable. Management provided a sensitivity analysis showing that a 1% change in cap implied volatility had a $30-40Mn impact on CCC's portfolio value.

2039. Finally, Management pointed out that the Option Adjusted Spread between Agency debentures and Agency floaters (like those held by CCC) was currently wide, and that this difference was historically anomalous and not sustainable over any significant length of time because it was irrational; this should therefore cause a narrowing of this differential and an increase in price for Agency floaters. ("**OAS**" is another financial metric, used to estimate future returns on a security relative to a benchmark after adjusting out the effects of changing interest rates on any embedded options in the security.) Management summarised its analysis of where it saw markets going in one final slide. They expressed the view that these factors made it reasonable to expect that "*spreads [would] continue to narrow*" for Agency floaters, and that the recovery that had taken place in October would gather momentum and eventually return the securities to par over the course of the next year.

2040. Management also pointed to some improvements in the repo market, and CCC's financing. They recorded increases in repo lines made available to CCC since the August crisis, these being $2Bn from Bank of America, $2Bn from JP Morgan, $1Bn from Lehman and $300Mn from Bear Stearns, with another $2Bn from Wachovia nearing completion, although it is fair to say that I am not sure that they reported the reductions that had taken place. However, details of all repo lines as at both 30th September and 6th November were given, together with comments in the latter report showing progress on securing repo lines over the year end. Mr Conway and Mr Hance added, in oral evidence, that they had been encouraged also by the reduction in interest rates made by the Federal Reserve, which would be expected to improve overall market liquidity and encourage banks to lend, particularly on Agency securities such as those CCC owned.

2041. The slides also considered and analysed the risk of higher haircuts, explaining why, on the basis of experience subsequent to August, CCC did not expect haircuts to go to 4% (the *Downside Case* had in fact assumed no greater than 3%), and how this was justified in the light of events since then; all CCC's repo lines were currently at 3% or below and CCC had been able to refuse and avoid the only requests for higher haircuts. The conclusion was that the August crisis had caused a single hike in haircuts but that they had subsequently stabilised. Management opined that 3% was now the "new norm" and also that, in view of the degree of protection it afforded repo lenders, no further increases could be expected, (although this analysis does, of course, assume that repo lenders would behave logically and rationally as CCC perceived it). This, according to Mr Hance, left a rise in haircuts as a possibility which could be conceived of, but was not a probability.

2042. Mr Stomber reiterated that his selection of Agency floaters for CCC's portfolio had been made precisely because they had historically performed well in a deteriorating economy in contrast to other securities with credit risk, and he expressed his conviction that, as the markets moved from the current "*liquidity event*" to "*possibly a credit event*," CCC would be well-positioned to take advantage of buying opportunities by selling its Agency securities after they had returned to more normal pricing and diversifying into what he anticipated would be even cheaper credit products.

2043. The business plan projection was given on the basis of a series of assumptions, approximating to the *Likely Case* mentioned above. Thus, haircuts were assumed to worsen to an average of 2.75% for the fourth quarter (they were currently about 2.62%) and not fall back to 2.5% until the third quarter of 2008. A gradual recovery of RMBS prices and repo marks to the more normal level of IDP prices, but only by July 2008, was assumed. Prepayment speeds were

assumed to continue at current rates only, with some diversification of assets and dividend payments possible from the third quarter of 2008. Obviously, therefore, leverage remained much the same, projected to be 33.3x by the end of the fourth quarter of 2007. The liquidity cushion was projected to rise from $140Mn on 6th November (the date of preparation of the slides) to $222Mn by the year-end, resulting from natural trends and prepayments.

2044. The minutes, and Ms Cosiol's notes, reflect that the Board reviewed this model "*at length*" and that it "*questioned several of the assumptions on which management based the model*." In particular, the Board asked about the assumption "*that the fair market value of the securities increases in the first quarter of 2008 when the value was currently down and not expected to increase*" given year-end pressures. Ms. Cosiol's notes record an extensive discussion of the projections underlying the continuation of the "*run-off plan*" for the near term. It extends from pages 20 to 30 of her handwritten notes. This written record shows that there was much Board discussion, and what it was.

2045. Mr Stomber's review of the projections highlighted the possibility of paying a dividend, even in a static scenario. There were various reactions amongst the Board to this, but all were made on the basis that whilst it was obviously desirable for a yield vehicle to be paying a dividend, it would only be done if CCC clearly had funds available to do so. The Plaintiffs light on such discussions, both here and at other points, as evidence of an improperly reckless obsession with paying a dividend, but as I have already said, I do not see it as such even here. Mr Stomber was obviously acutely conscious of the fact that he had been hired in order to provide and nurture a high yielding entity in CCC, and that after the August crisis he simply was not doing so. I do not find it remotely surprising, or reprehensible, that he should be raising the issue of dividend payments for consideration by his fellow directors. They were, after all, the voting directors whose reaction would govern the situation in the end.

2046. Throughout the Board's consideration, Mr Hance in particular, but others as well, were raising the question whether the proposals and suggestions made were actually viable in practice. Mr Hance commented that the projections did not deal with the question whether affordable repo was going to be available. He also observed that he had expected a faster bounce back in RMBS prices than had happened, and that the model did not address how CCC would survive a second financial crisis. He said in evidence that he wanted this point to be considered, whilst regarding the occurrence of another financial crisis so soon after the last one as highly unlikely.

2047. Discussions then moved to performance and a discussion of the future. There was much debate about this as well, and whether and when CCC might start reinvesting, and/or diversifying again, all set out in several pages of Ms Cosiol's handwritten notes. It was discussed that this was all dependent on when CCC's RMBS asset prices might recover, and when there could be confidence in this.

2048. Board Members asked various questions, raised different points and expressed different views. Mr Sarles counselled caution, because CCC was not a trading shop with substantial capital and could not take the risk of diversifying too soon. Mr Stomber was opposed to courting financing risk by doing so, stating that that was the biggest risk to shareholders. Mr Hance wanted management to be looking for ways to generate return on capital; Mr Sarles was comfortable with Mr Stomber's reluctance to start purchasing assets. Mr Zupon agreed with this and raised the possibility of raising further capital. Mr Stomber said that attempting this would be crazy and CCC should slow down and fix the fund, emphasising that he did not think

it appropriate to use the liquidity cushion to buy credit products. Mr. Allardice noted that using CCC's liquidity for a share buyback by the Company was one option, and it could be "efficient", a matter which had also been discussed at the Audit Committee meeting. Others observed that this was the wrong trade off. It was agreed that CCC needed to decide what was the best use to make of the capital which had been gathered into the liquidity cushion.

2049. Mr Sarles questioned whether the CCC model with leverage at 33x was a workable model, and Mr Stomber said that it was not, and CCC needed a diversified approach. Mr Sarles said in evidence that his comment was a reference to whether CCC would now start up with a model with leverage at that level. I rather doubt that; I think it was more likely a shorthand allusion, not simply to whether CCC could survive, but whether it could fulfil its intended function as a yield vehicle with such leverage. Mr Stomber urged that CCC needed to consider not only assets, diversification and dividend payments, but also financing it all, ie repo availability and the credit line from Carlyle. Mr. Conway said that in the long term CCC could probably get repo lines on longer than 30 day terms, and "*feel better"*.

2050. I have set out the above because, whilst not a full summary of the meeting, it gives examples of comments and suchlike which illustrate the amount of discussion, and the breadth of suggestions being tossed around in debate.

2051. The Board then discussed CCC's stock price, and the fact that CCC's shares appeared to be undervalued, and that there was little trading in them. Both the Board and Management hoped that the release of the Third Quarter results would increase confidence in the stock as lack of liquidity in the stock was perceived as a problem. After discussing the need to communicate the true value of the shares to investors, and address the issues inhibiting the liquidity of the shares, Ms. Cosiol's handwritten notes reflect the comment "*how do we handle? Pool $ & buy shares to help stabilize the price*." Members of the Board asked if it would create an "appearance" problem if they personally purchased shares from existing shareholders who had paid full price for those shares, and it was decided this would not pose a problem, as many of these investors had complained about the lack of liquidity in the stock. Mr. Conway stated his belief that "*the stock at the current trading price represented an excellent value*" and observed that individuals at Carlyle already had expressed an interest in buying shares; this possibility had been disclosed in the OM and the MD&A. Ultimately, it was decided that individual purchases should be made through CCC Coinvest, the same vehicle that had been used to make purchases in the original private round of fundraising.

2052. Ms Cosiol's notes record comments by Mr. Hance at the end of the discussion, summarising comments and the general consensus arrived at. It had been a "*good discussion – sensitizes us to the issues*". It was "*best not to jump in now*" and start buying either credit products or RMBS; rather, the consensus was to "*let it settle off.*" He observed that the business had "*changed on"* CCC's investors, and that the current model, operating in "*roll-off*" mode, no longer offered them the original proposition of a safe, liquid diversified security. The intention was to tell them that CCC was "*working to get back there*," but it "*may be difficult".* It was also recorded that it was not the intention to turn CCC into just another credit product investment fund, described as a *"Zupon fund".*

2053. Mr Stomber was plainly unhappy with the Board Meeting at the time and erupted into print with a typically lengthy and forthright email to Mr Conway and Mr Hance immediately afterwards. In it, he complained that the meeting was "*all over the map"* and that "*We*

discussed the current business plan and then discussed we had no business plan. Yet all agreed that if we met the current plan – all would be happy". He also highlighted that CCC was *"in the middle – not the end- of the market breakdown".*

2054. The Plaintiffs have highlighted this as contemporaneous verification of their submission that CCC's Board – the Defendants - were disorganised, dysfunctional and haphazard, and supporting that the decision to continue with the supposed capital preservation strategy and not sell RMBS, which was the upshot of this meeting, was ill-considered to the point of being reckless or grossly negligent. Mr Stomber has said in oral evidence that on reflection and with the benefit of time, he now thinks that the Board meeting reflected a healthy debate among competing views. I give my findings about this email and evidence later.

2055. The Defendants invite attention to CCC's Third Quarter financial statements, released immediately after their approval by the Board, and to the accounts given in the CEO Letter and MD&A of the difficulties CCC had faced and how it had dealt with them, Mr Stomber's and Management's thinking as to the reasons for previous and current difficulties and the expected course of future events, and CCC's present consequential investment strategy. This is because they say it shows the distilled thinking and beliefs behind what was agreed by the Board at the 13th November Meeting.

2056. I do not need to rehearse the detail of these two communications here. The CEO letter provides an executive summary of the points made in more depth in the MD&A report. I find that they both provided a lucid description of what CCC had done and the reasons for this, and expressly disclosed the resolved strategy of holding the RMBS securities *"whilst preserving shareholder capital until market conditions improved".* The account given of course reflected the views which Mr Stomber and the Defendants, and Management had formed of the likely future course of events. In essence, that view was that the value of CCC's RMBS securities (and therefore CCC's own position) would continue to recover, as would the market in fixed income securities generally, that the US economy was weakening but that that would benefit the value of CCC's securities, and that CCC would become well placed to take steps, in 2008, to rebalance its portfolio to include suitable credit assets, and begin providing an attractive dividend yield again. It was suggested that dividend payments might be resumed in respect of the fourth quarter of 2007, based on current market conditions. The steps being taken to ensure available repo financing were also outlined.

2057. The Defendants submit that these disclosures clearly and comprehensively set out how the unprecedented August liquidity crisis had affected CCC, what steps CCC had taken to address the crisis, and what both the near term and long term plans were for stabilising the company and then beginning to invest again.

2058. On the same day as these meetings, the $100Mn term loan to CCC from Carlyle was converted into a revolving line of credit, available until 2nd January 2009 at the discretion of CCC's Management.

2059. As anticipated, the additional pressures in the market caused by imminent financial year ends now began to cause the improvements in prices and financing which CCC had gained since September to falter and cease. On 14th November one of Mr Stomber's regular emails reported gloomily about the state of the market, that pressure on the banks' balance sheets was making things worse day by day, and that CCC was going to need to draw $20Mn of the new credit line from Carlyle to get through the 15th November repo roll.

2060. However, also on 14th November, Management succeeded in securing a 2-month repo line with UBS, which would help provide some increased certainty about CCC's repo terms during the year-end period. Mr Stomber explained in oral evidence that in an attempt to get ahead of the year end crises, CCC was trying to gain 60 day repo commitments. 20% of CCC's outstanding repo was extended to this, and Management was still negotiating the 364-day term repo line with Wachovia at this time.

2061. On 14th and 15th November legal advice received by CCC from its various counsel cleared the way for Board Members and other CCC affiliates to invest further in CCC through CCC Coinvest, with no requirement for prior notification or reporting of such share purchases. On 15th November, therefore, Carlyle Group issued a solicitation memorandum offering its employees and affiliates, as well as affiliates of CCC, the opportunity to invest in CCC shares. The memorandum noted that the shares were "*currently trading at a significant discount to their original offering price*." As was the case during the private placement, these purchases would formally be carried out through the acquisition of interests in CCC Coinvest, which would acquire the CCC shares. The memorandum informed prospective in-house investors that the "*purchases [would] be made on the terms and conditions specified by Bill Conway.*"

15th November – repo roll

2062. Mr Stomber had negotiated with JP Morgan for the reinstatement of a $2Bn repo line, which came on stream for the 15th November roll, although effectively on worse terms because they repriced CCC's securities. Mr Stomber commented that this made JP Morgan effectively at a 3.25% haircut rather than 2.75%. Citi had also widened its pricing.

2063. There were, in addition, demands for an increased interest rate, with the average ultimately increasing to 9 bps above LIBOR. Bank of America raised its interest rate for a 2-month repo roll by 22 bps (4.83% - 5.05%) causing Mr Stomber to complain internally and Management to roll for just one week so that the interest rate could be further negotiated.

2064. Lehman had proposed a 5% interest rate on its 1 month repo, but had reduced this to 4.85% on CCC's questioning whether, in view of other lenders quoting a range of 4.675 %– 4.75%, Lehman was sending a coded message. CCC had therefore moved all but $500Mn of its line away from Lehman. Lehman's attitude to both pricing and repo rates caused Mr Stomber to send a strongly-worded complaint to them, which caused Mr Conway to step in to try to de-fuse the situation. This did not cause Lehman to withdraw financing from CCC, although it apparently led to internal Lehman comments that behaviour like Mr Stomber's often presaged "business continuation issues". There is no suggestion, though, that the Defendants were aware of this.

2065. On this roll, balance sheet pressures caused a few of CCC's other repo dealers to reduce their lines (by approximately $1.6 Bn total). However, this repo roll was accomplished, although whilst CCC had $117Mn of liquidity prior to that day, after the repo roll this had dropped to $106Mn. Mr Stomber described this as a "bad" roll, and indeed, the effects of its problematic features were that CCC was not able to repay the $20Mn which it had drawn from the Carlyle loan facility as it had anticipated doing the next day.

2066. Having previously noted how year end considerations would put pressure on banks and affect finance availability and margin calls, Mr Stomber observed that additional pressures were arising because of deteriorations in the credit market, with ratings agencies now down-grading

CDOs and triggering their subsequent liquidations, and banks hoarding liquidity on their own balance sheets. He was still of the view, though, that the quality of CCC's securities should enable it still to obtain repo, and its security prices would hopefully begin to benefit from a flight to quality.

2067. CCC was able to roll over $9Bn of its repo lines and still have $2.2Bn of excess repo capacity, and despite the increased cost of its repo financing, the company was making progress toward ensuring that it would have financing available over the year-end. CCC's repo status report for 15th November showed that Bear Stearns, Bank of America, JP Morgan, Lehman Brothers, and UBS were all "*Good for [year end]*," while the remaining banks other than Morgan Stanley (which was listed as "*[i]nsignificant*") and Goldman Sachs (which had no comment) were listed as "*Expect OK for [year end]*."

15th November - Investor Call

2068. CCC held an investor analyst phone in conference on 15th November 2007, following the publication of its third quarter financial results. It was fielded by Mr Stomber, Mr Hance and Mr Green. In the course of it, they reiterated the same descriptions and explanations as mentioned above. Mr Stomber emphasised that the improvement in the value of CCC's securities was expected albeit with "*some tightening between now and year end*", referring expressly to the well-recognised phenomenon of banks withdrawing liquidity over their financial year ends. Mr Hance emphasised that CCC's strategy was *"focused on preserving shareholders' equity"*, plainly on the basis of giving time for the underlying security values to become restored. With the questioners focused on the benefit from their investments, Mr Hance emphasised that whilst the goal was to pay a dividend, preservation of shareholders' capital was the foremost consideration. There was discussion about the disconnect between the apparent value of the underlying assets and CCC's stock price. The question of CCC buying in its own shares was raised but parried. A comment from one caller that CCC's stock was tremendous value at its current price, was welcomed and agreed with. The Defendants submit that this analysts' call was a clear, transparent disclosure of what CCC was doing.

2069. The Defendants also invite reference to materials which were not examined in the trial itself, although they were in the trial bundles, being certain investment analysts' reports on CCC following examination of its 2007 third quarter results. These reports are produced within investment banks for the purpose of advising clients on investment opportunities. They point out that each of these analysts recommended that CCC's stock should be held; none recommended selling and none was critical of CCC's actions or its explained strategy. They suggest that this is strong support for the apparent good sense of the matters reported. They point out that both Deutsche Bank and Citi, in particular, reported in terms of what I might call cautious support for CCC. All this, they say is significant.

16th November - ALCO Meeting

2070. This comprised broadly the usual committee participants with Mr Stomber, and also Mr Sarles and Mr Allardice attending by telephone.

2071. There were mixed signals reported to the meeting. The terms of the 15th November repo roll were reported, and that interest rate demands for repo financing had risen slightly above LIBOR for the first time. This was put down to the year-end pressure and some deterioration in market conditions. Prices in the credit markets were depressed, and interest rate volatility

was rising; CCC's financing costs were thus rising somewhat, although income still exceeded them, but at the same time, financing availability and the depth of the liquidity cushion appeared healthy. The liquidity status report showed that repo availability had been actively followed up by management and was continually reported as being good over the imminent year end. Management did not expect any pressure on financing and the liquidity cushion up to the year end.

The Defendants purchase more shares in CCC

2072. On 20th November, 2007, the trading window for share purchases by affiliates of CCC opened, and the stock broker at Citi began to purchase shares on behalf of CCC Coinvest pursuant to Mr. Conway's instructions to purchase at no more than $10 per share.

2073. Each of the Defendants (as well as some members of Management) purchased additional shares in CCC. The sums invested by the Defendants at this point were as follows: Mr. Conway, $1Mn; Mr. Hance, $1Mn, Mr. Zupon, $500,000, Mr. Sarles, $200,000, Mr. Allardice, $150,000, Mr. Stomber, $100,000 and Mr. Loveridge, $100,000, (although they each had a very small proportion of this – around 2-3% - rebated under the Co-investment scheme). Messrs Trozzo, Greenwood and Melchior also subscribed lesser sums, and other CCC affiliates may also have done.

2074. Citi completed the CCC Coinvest share purchases for these commitments on 11th December 2007. Mr Conway had in fact requested to purchase $10Mn, but Citi were unable to make sufficient purchases to cover this and all other requests, so he scaled back his own request until all other requests, including Management's, had been met. From 10th to 31st December 2007 Citi continued to purchase more shares for Mr Conway, who eventually subscribed for $7.9Mn worth. The total purchase of CCC shares for all who wished to subscribe was $14.2Mn. The CCC Coinvest purchases were initially funded by a loan to CCC Coinvest from TCG, which was then repaid by CCC Coinvest, with interest, when it had received payment from the individual investors pursuant to capital calls.

2075. Each of the Defendants gave evidence that he made his own investment because of a firm belief that CCC's stock was undervalued and so would generate highly attractive returns in consequence, and it was not part of a scheme to stabilise the price of CCC's shares.

20th November - Investor Conference Presentation

2076. Carlyle's annual autumn investor conference was held in Paris on 20th November 2007 and included a presentation about CCC, the slides and audio commentary of which were made available to attendees remotely, through a live webcast. Mr Hance and Mr Stomber made the presentation and the slides and a partial audio transcription are in evidence. They show the presenters placing emphasis on CCC's capital preservation strategy, which entailed holding its Agency RMBS, described as its "core portfolio". It also contrasted this "short term" strategy with the "long term" objective of achieving targeted returns. Mr Stomber, though, also emphasised that CCC would not be hurrying into the re-diversification which was its long term objective, because the worst thing would be to do it too soon and *"then take a step down with the credit cycles".* Mr Hance reinforced this message of being sure of having ridden out current problems, stating the plan to be to *"modify our business model to reflect the changing in the funding dynamics, and to go forward with lower leverage and greater diversification.*"

2077. They were obviously conscious of disquiet expressed by investors at the depressed share price of CCC's stock and its consequent lack of liquidity, and they sought to give reassurance. Mr Hance gave a list of the reasons to be positive about CCC's situation, which seems to me to sum up the points discussed at the Board Meeting a week earlier: "*We really think the more information we get out about where the net book value [is], about the nature of the securities, about the fact that we don't have permanent impairment, about the fact that we have positive flow and are intending to pay a dividend next year, all of that will help".* Both Mr Stomber and Mr Hance, though, also referred to the fact that Board Members, including themselves, had decided to purchase more shares personally, and indeed were doing so that very day. Mr Stomber did so in opaque terms. He referred to taking action to "*enable the share price to move up*", or to "*try to improve that* [sc the low price]", but Mr Hance spoke more directly in saying that "*we're buying some securities in Carlyle Capital Corp in order to help stabilize the price.*"

2078. Market manipulation is, of course, an offence under the regulations of the Euronext Market exchange. Ms Cosiol, on hearing these remarks, was sufficiently concerned (she described it in oral evidence as a "*visceral reaction*") that she immediately emailed Mr Hazeleger at Linklaters, referring to these remarks, and asking if consequently "*we have a problem*", adding that "*the intention… was to purchase because they truly believe it[']s a good investment at the current price*". Mr Hazeleger immediately asked for a list of registrations to ascertain whether anyone from the AFM regulator had listened in. He subsequently emailed back that it looked "OK". In a telephone consultation at Mr Hazeleger's instigation later, Ms Cosiol asked if it would be permissible to omit Mr Hance's portion of the presentation from materials to be posted on CCC's website. She subsequently did so, and also removed the slides which had accompanied his remarks. She said that she believed that she must have been advised by Mr Hazeleger that it was permissible to do so, although she could not recall any actual conversation, and that she had edited the website materials in consultation with Linklaters.

2079. In cross-examination Advocate Wessels put it to her that Linklaters had given no such advice. However, from my impression of Ms Cosiol and on the balance of probabilities, I am quite satisfied that she would not have done this on her own initiative. I am satisfied that she did receive some such oral advice, encouragement, or concurrence from Linklaters.

2080. On 21st November, Mr Stomber reported that liquidity currently stood at $92Mn, inclusive of the unused $80Mn in the revolving credit line, but he expected it to be lower after the impending Fannie Mae repo roll which would take place on Monday 26th November. He expected to (and did) draw a further $40Mn on the credit line in the next few days. However, he commented, to all his co-Directors except Mr Zupon, that this was a *"bad news memo"* and that the "*market is spooked".*

26th November - repo roll

2081. CCC also successfully managed the 26th November repo roll and closed the day with $76Mn of liquidity, which Mr Stomber reported was slightly better than expected. After the roll, CCC still had approximately $1Bn of excess repo capacity with JP Morgan, and Management turned its focus to finalising the Wachovia term repo line and confirming excess repo capacity with Lehman of $700Mn. Mr Stomber reported, though, that he had intuitive misgivings about the underlying strength of the financial system itself, and he anticipated bold action from the US Government or the Federal Reserve.

2082. On 28th November Wachovia approved the MRA and letter of consent necessary to implement a 364-day term repo line with CCC. On the less bright side,though, Lehman on this day made a margin call of $19Mn on CCC, which Mr Stomber regarded as "outrageous" as it was based on a price more than 15 bps lower than any other dealer. He was incensed at this "cash grab" by Lehman for its year end, which left CCC's liquidity cushion at $65Mn. He commented on the "mistake" of being too concentrated with Lehman, who at that time provided 15% of CCC's total repo capacity, but he was cautioned against antagonising them by Mr Hance. In the last two days of November Mr Stomber's efforts succeeded in recovering some margin from Lehman, leaving CCC with $70.6Mn of liquidity on 30th November 2007.

2083. Within the Carlyle Group itself, the worsening financial markets caused warnings to be sent round that the economy was probably headed for a recession, and that personnel should take precautions to protect against rough times ahead.

29th November - ALCO Meeting

2084. CCC held another ALCO meeting on 29th November 2007, attended by the committee members (thus including Mr Stomber) and also Mr Zupon and Mr Loveridge by telephone. It was not a particularly eventful meeting.

2085. Mr. Greenwood reported that the recent news on the U.S. economy was generally negative. One month LIBOR had risen significantly, owing to the increased cost of borrowing over the year end. He commented that interest rate spreads between one month LIBOR and Federal Funds, after "*normalizing*" in September and October, had widened notably in November, a trend which he described as "*aberrant"* but nonetheless underscoring the *"severity of the credit and liquidity crisis that continues to grip the market"*. The TED spread also had widened, a reflection of investors' desire for safety (less counterparty risk) regardless of yield. He noted though, that the recent rise in Agency floater spreads was levelling off. Mr Trozzo informed the committee that it was widely expected that the Federal Reserve was going to cut interest rates again.

2086. Mr. Trozzo reported that CCC's portfolio was in compliance with its current guidelines. He warned that CCC's profit and loss statements would reflect a reduction in income caused by higher repo interest rates demanded by some repo counterparties, and that the liquidity cushion had fallen since the information in the ALCO pack papers, and declined by $17Mn that same day. It was noted that CCC had approximately $3.6Bn of two-month term repo lines, which provided relief from year end pressures. The trends in the five significant factors affecting the price of CCC's agency floaters were noted. No particular decisions were taken.

End November 2007 - Financial position

2087. At the end of November, CCC's records show that it had $21.94Bn of investment assets and a NAV of $675,623,735. Professor Hubbard's analyses show that it was using $21.21Bn of repo lines out of a total capacity of $23.54Bn with 13 repo lenders, on which it had a weighted average haircut of 2.67%. It thus had an excess repo capacity of $2.3Bn only, unimproved if not worse since mid-September. Its liquidity cushion stood at 10.5%. The upward course of liquidity from $48Mn at the end of September 2007 to $147Mn on 5th November had peaked and fallen back to $113.8Mn by the 13th November Board Meeting, but then still further, to $71Mn by the month end.

2088. As regards CCC's attitude to selling during this period the Defendants, and expressly Mr Hance, Mr Stomber and Mr Conway, explained that this remained the same as before; CCC would be willing to sell RMBS if the benefits of the transaction were both worthwhile in quantity and in price, consistently with its justifying what were perceived as the still very significant risks of being perceived to be a major player in the Agency floaters market which was in distress. In the context of the November markets, where there was little trading and prices remained under pressure, no such opportunities presented themselves, and CCC had to be cautious about being trapped into giving such an impression, for example, by showing too much eagerness over an enquiry, although Mr Conway insisted that, at an attractive price, CCC would have sold.

2089. The Defendants draw attention to an end of November exchange between Mr Ng and a trader at JP Morgan, which they submit demonstrates this attitude, and also the need to keep up appearances in the market. On 27th November 2007, when the JP Morgan trader suggested to Mr Ng that CCC should sell a $50Mn bond and buy a different $50Mn bond, Mr. Ng replied that CCC would "*entertain any trade ideas,*" but was "*hand cuffed to do anything through year end.*" The JP Morgan trader asked why CCC felt "*hand cuffed,*" and Mr. Ng explained that they were seeking to avoid "*any p/l [profit and loss] hits if any by selling".* He later agreed that CCC's willingness to sell would therefore be limited to transactions that could be done "*close to par,*" but explained this as that CCC "*essentially can't take any losses*" because they were "*try[ing] to hit dividend targets.*"

2090. This comment is, of course, consistent with the Plaintiffs' contention that CCC was doggedly and irrationally set against crystallising any losses on its books, and a pursuit of dividend targets, but it also seems to me that the whole exchange is equally consistent with the line which the Defendants submit that CCC had all along been attempting to tread, namely that of appearing confident, not giving away information but trying to obtain it, and keeping "in the loop" so as not to miss any truly valuable opportunity which might arise. In maintaining this front, it would be necessary to give innocuous but plausible explanations to third parties to avoid causing damaging speculation, and I am satisfied that the reference to dividend targets was just such a plausible excuse.

The Claims – October and November 2007 - Summary of arguments

Plaintiffs' case

2091. The Plaintiffs' central submission is that the Defendants simply continued on throughout the fourth quarter of 2007 in the same way as they had done in September, blindly hoping that they could ride out the adverse market situation, ignoring the fact that financial market conditions remained thoroughly uncertain at best, and should have been seen as deteriorating. Repo lenders were facing their own financial difficulties, CCC was struggling to maintain sufficient repo capacity and there was no good news on the horizon to justify a continued belief that CCC's financial situation would transform itself. Failing to take the required action in this period, particularly (I infer) at or as the result of the 13th November Audit Committee and Board Meetings, was either a breach of fiduciary duty or gross negligence. The Plaintiffs base this submission on the following matters which they invite me to find, on the evidence.

2092. They submit that CCC's financing situation was perilously fragile. As was known to CCC's directors, its repo banks had suffered huge losses and were facing their own liquidity difficulties which meant that there was a growing insufficiency of available repo capacity.

The Plaintiffs list the evidence of repo lending banks suffering massive losses (as witnessed by their announced write downs during this period) and showing that Messrs Stomber, Conway, Hance and Allardice, at least, were all well aware of this, that the economy was potentially going into recession, and that this was only the beginning of a bad situation. They cite also Mr Welles' evidence that those in the repo markets perceived at this time that the adverse conditions were going to play out over a very long period. They submit that it is clear that concerns in this regard were recognised and acknowledged by all the directors, certainly by no later than the 13th November Audit Committee and Board Meetings.

2093. They submit that the actual facts of repo availability, when examined, belie the suggestion that CCC was achieving the extra capacity which it obviously needed, even on a "soft" basis; Mr Stomber's claim to have negotiated extra capacity with Lehman – CCC's second largest repo provider – at the beginning of October 2007, was worthless. The capacity was never utilised and was probably never actually available, and Lehman became so notably "difficult" in November 2007 that CCC actually rolled repo away from them. By 15th October, CCC had become dangerously dependent on its two biggest counterparties, Citi and Lehman, who provided nearly half its total repo requirements.

2094. They submit that the signs, to be read from the difficulty of obtaining affordable finance, were that haircuts were rising inexorably to 4 %, a rate which CCC simply could not afford. It must have been apparent that they would certainly be that with any new provider. Affordable repo for CCC therefore meant concessionary rates, only achievable because of the Carlyle connection and it was therefore wrong and irresponsible to rely on these, which is what the Defendants were doing. CCC's attempts to put in place new repo arrangements had largely failed. Attempts to negotiate new standard repo lines with Sumitomo, Fortis, ABN Amro, Barclays and Societe Generale had all come to nothing by the end of October 2007 for various reasons. The allegedly "new" repo lines were no such thing; CCC had, in practice, only negotiated a reinstatement of previous repo lines of $2Bn each from Bank of America and JP Morgan, and on terms which, whilst heavily negotiated, were actually less beneficial than before, and again only because of the Carlyle connection. These lines, however, only compensated for the fact that CCC was compelled to roll a total of $1.5Bn away from Citi and $1Bn away from Lehman to avoid increased haircuts or repo interest rates, and they produced no material increase in CCC's repo availability. This remained perilously close to the full requirement capacity and, it is emphasised, only because of the Carlyle connection. They submit that there was no reason to think that the difficulties in financing already encountered were likely to ease by the year end. In particular, they point out that there was no evidence of any flight to quality.

2095. The prospect of obtaining long term repo finance was fanciful, because such structured repo would only be available at unaffordable higher haircut rates, and the Defendants were aware of this. The negotiations with Wachovia for a $2Bn one year term repo arrangement at a 3% haircut were never likely to be completed, and the Plaintiffs say that this really should have been obvious to the Defendants (Messrs Stomber, Conway and Hance in particular) because of Wachovia's inexperience in repo financing, and the fact that it was only negotiating with CCC at all because it was Carlyle's house bank. Whilst CCC did, (extraordinarily in a time of crisis) persuade two of their lenders to grant it 60 day repo over the year ends, this comprised only 17% of CCC's requirements. (Whilst the Plaintiffs also seek to diminish this by pointing out that others of CCC's lenders (11%) actually reduced their repo tenor to 7 days on occasions, I note that that was earlier, in September 2007.)

2096. The Plaintiffs submit that the evidence again shows that the Defendants were giving undue weight to the possibility of paying a dividend, and that this is evidence of recklessness in their approach to CCC's affairs. Dividends were being prioritised over what was necessary for CCC's financial survival. They cite, for example, Mr Stomber's email to Mr Hance of 31st October 2007 which I have noted above. They were also placing undue weight on the process of "natural" deleveraging. This would yield only $40Mn of liquidity per quarter, and on that basis it would take a further year in business to reduce its leverage level merely to 26x, still dangerously high.

2097. They submit that, in reality, CCC's position had not materially improved since the emergency Board Meeting on 23rd August despite the emergency measures then implemented. The fact that no Board Meeting was called before 13th November 2007 is evidence, they say, of a reckless disregard for the seriousness of that situation. They point to worsening factors across the board. The increased margin calls showed that, on a realistic view, the value of CCCs RMBS had continued to fall. The level of unrealised losses recorded on CCC's portfolio since both the August crisis and CCC's inception had continually increased; there had been $114Mn of further unrealised losses recorded on the portfolio since August. CCC's share price had halved. The apparent increase in liquidity was illusory because it depended on the Carlyle loan and even at 16.3% at the time of the November Board Meeting the liquidity cushion still compared unfavourably with the 20% figure originally thought appropriate, and still more with the 40% figure, which was plainly seen as desirable because it had been put forward at the September Investor Conference. They point to the ominous metrics and statistics apparent in Board and ALCO at meetings during October and November, particularly in factors known to be drivers of the value of CCC's RMBS (average price volatility, interest rate volatility, etc). The APV of CCC's RMBS had remained "elevated" during October, and the liquidity cushion to VaR ratio remained below 1 throughout October and November 2007 and thus far lower than the ratio considered appropriate in its original business model.

2098. The Plaintiffs argue that Mr Allardice's editing of the minutes of the 13th November Audit Committee meeting to remove references to "going concern risk", whether or not legitimate, reveals that there was real concern that CCC was not a going concern at this time.

2099. The Plaintiffs criticise both the conduct and outcome of the 13th November Board meeting. They submit that it failed to address or even analyse the reasons why market conditions had not improved (they say) since the emergency Board Meeting of 23rd August. Mr Stomber put forward no proper business plan for CCC, despite having promised one, but only a set of theoretical projections, based on optimistic assumptions that there would be an immediate and substantial improvement in the market. They submit that the Defendants had no reasonable grounds for believing that any such improvement would take place; several of the Defendants admitted, in evidence, that they viewed the business model projections as optimistic at the time, yet they did not demand any analysis based on deteriorating conditions, or a "worst case scenario", nor consider an alternative funding model, nor taking proactive steps to enhance liquidity and reduce leverage. There was no analysis of what liquidity CCC actually needed.

2100. In other words, the Defendants failed to take the "required action" previously identified All they did was to extend the suspension of the old Investment Guidelines and allow business, and the capital preservation strategy which had been discredited in practice, to continue as before. The only decision taken was, inadequately, to revisit the question of CCC's business plan and liquidity needs in 2008 at the next (February) Board Meeting. This was, culpably, just

deferring decision-making when what was needed was urgent action; it remained irrational and reckless for the Defendants to continue to run CCC with a "broken" business model, manifestly inadequate liquidity and repo capacity and no risk management controls.

2101. The Plaintiffs therefore repeat their complaint of the core breach, pointing out that Mr Stomber's own projections contemplated the sale of $1Bn of RMBS on a "likely case" basis, and $4Bn of RMBS on a "downside case" basis, which they argue suggests that such sales were regarded as possible. They make a general submission that the evidence of the successful Westways auctions showed that RMBS could be sold in quantities, even by forced sellers, at prices which were higher than CCC's repo marks, and yet Mr Stomber, in particular, took no steps to follow up this positive evidence of a selling possibility, merely using the evidence of such sales as ammunition to try to improve repo lenders' marks, rather than being a good indication that CCC would also be able to sell. They point out that despite this no steps at all were taken to implement such sales in practice. They repeat their complaint of the continued suspension of CCC's three Investment Guidelines until 31st March 2008 without any proper consideration or deliberation.

2102. They invite me to find that Mr Stomber's spontaneous strongly worded email following the Board Meeting was evidence of his contemporaneous and correct perception that the Board was dysfunctional, which he has subsequently tried to resile from. They point out that Mr Hance and Mr Conway accepted, in oral evidence, that they shared the view he expressed there, that the financial market breakdown was not over.

2103. The Plaintiffs aver, in addition, that statements in CCC's Quarterly Reports were misleading of the market in four broad respects; an assertion that CCC's liquidity at the end of September was "strong", a misleading account of the securing, or likely securing of apparently "additional" repo capacity whilst failing to mention off-setting reductions elsewhere, an assertion that the directors were evaluating the appropriateness of a minimum liquidity cushion when in fact they had deferred any such consideration, and the delayed, undetailed, undated and unhighlighted disclosure of the suspension of the minimum liquidity cushion requirement.

2104. They then point to the worsening of conditions after the 13th November Board Meeting – the opposite direction to that which Mr Stomber's projections predicted – and the continuing recognition of such deterioration in, for example, Mr Stomber's email of 21st November, and the "aberrant" relative interest rate trends noted in the 29th November ALCO Meeting. They submit that it was thus clear before the month end, that market conditions were worsening ominously, and that this was not due simply to the predicted "year end" pressure on banks' balance sheets but to grave general pressures in the markets. The implication is that it should have been recognised as such and that this would have led to CCC taking the required action, at that time.

2105. The Plaintiffs rely on the foregoing submissions to support the charges of breach of fiduciary duty, breach of duty of care, and wrongful trading against all the Defendants (they say that by this time the Defendants either knew or at least ought to have concluded that CCC stood no reasonable prospect of avoiding going into insolvent liquidation) and breach of contract/tort against CIM.

2106. I should specifically mention that the Plaintiffs cite the evidence regarding the purchase of CCC's shares by CCC Coinvest, starting on 20th November 2007, the fact that these purchases constituted almost the entirety of trade in CCC shares for the following month, and the

evidence, including the editing of the presentation at the Paris Investor Conference, that this was referable to an attempt to shore up CCC's share price. They argue that this was an offence under Dutch law, and also that failing to disclose that an entity connected with Carlyle was making the vast majority of share purchases in CCC before 21st December (when an updated share return was filed) was misleading the market. They submit that the share purchases were clearly made in order to manipulate the market and therefore "cannot be treated as providing any assistance to the Defendants' case for any purpose whatsoever."

Defendants' Case

2107. The Defendants' broad submission is that the decision to continue with the capital preservation strategy and not to change to a policy of selling RMBS remained a reasonable course in current market circumstances and their state of knowledge and belief at this time, ie October and November 2007. They submit that the evidence shows that that decision was in fact taken (or continued) properly, carefully and diligently in all the circumstances, but that in any event it was a decision which was well within the range of possible reasonable decisions at the time and therefore, on the *Charterbridge* doctrine, it was no breach of either their fiduciary duties or duty of skill and care.

2108. They submit that the considerations which had made it reasonable to adopt the capital preservation strategy in the first place had not materially changed. The advantages and disadvantages respectively attaching to selling RMBS or to holding RMBS remained the same, and there was no change in the balance of advantage and disadvantage sufficient to make a change of strategy the only reasonable thing to do. The Plaintiffs, they submit, stress the problems and negative factors facing CCC, but they ignore or diminish the positives and, most importantly, continue to ignore the dangers and disadvantages attached to selling. The material question continues to be whether the Plaintiffs demonstrate that in the situation at the time selling RMBS should have been seen to be the only reasonable course for the Defendants to adopt, and this is not made out on the evidence.

2109. The Defendants contest the Plaintiffs' assertion that CCC's financial situation had not improved since August. They suggest that on a reasonable assessment it had improved somewhat during October and early November and it had certainly stabilised. The fact is that CCC did succeed in securing sufficient and affordable repo finance to maintain its RMBS portfolio, which amortisations and prepayments did gradually reduce, as anticipated, during October and November. Whilst obviously the continued availability of sufficient affordable repo financing was and remained a matter of crucial concern for the Defendants, the fact that it had been obtained thus far was positive.

2110. The suggestion that it should have been recognised that nominal haircuts were inevitably going to rise to 4% or even 5% is an exaggeration which, they submit, is demonstrated by the fact that CCC was never obliged during its life, to accept a nominal haircut higher than 3%. They invite me to prefer the evidence of both Dr Webster and Professor Hubbard which, from different viewpoints supported the view that it was then reasonable to expect haircut rates to have stabilised and to remain at 3% after the dust from the August crisis had settled, to the more pessimistic evidence of Mr Welles, and, to an extent, Dr Carron. They submit that the objective data cited by Professor Hubbard shows that the general market perceptions throughout the period after the August crisis was broadly of similar optimism to the views taken by CCC's Directors (even if in the event they proved over-optimistic), which supports

the conclusion that they were reasonable views to hold and act upon. They criticise Mr Welles' opinion that CCC ought to have perceived a significant risk of haircuts rising above 3% as being largely speculation about what repo lenders might have worried about, coupled with over-emphasis on the small number of occasions when CCC's lenders raised the possibility of increased haircuts.

2111. They submit that whether or not the obtaining of repo finance was because of the Carlyle connection is immaterial; the important point is that it was obtained. The Carlyle influence was a fact, it was available to CCC to exploit, and there was no reason to disregard it in evaluating CCC's position and future. Similarly, the financial support rendered by Carlyle was a fact and its potential availability was likewise a factor which CCC's Directors were entitled to take into account appropriately when evaluating CCC's position and its near term future.

2112. The Wachovia negotiations, they submit, were genuine and were reasonably seen as being of substance. They had not foundered during this period, and it was wrong to suggest that Messrs Stomber, Conway and Hance ought to have expected them to fail rather than come to fruition. Criticism of the Defendants for describing the Bank of America and JP Morgan repo lines as "new", just because there had been lines in former times, was absurd and little more than a dispute about language.

2113. The toughening of repo finance availability over the financial year ends was a well known phenomenon and it had been predicted. It was not a development which presaged some further downturn in financial markets generally, and in fact steps had been actively taken to cater for it by the securing of some 60 day lines. The Plaintiffs' argument that the repo lenders' reluctance to lend should have been reacted to as some greater systemic problem is being wise with hindsight.

2114. Whilst the expected discernible flight to quality, and significant recovery of the value of CCC's RMBS, had not happened in October/November 2007, - prices had, rather, stagnated - that fact was recognised in Management's data collection and it remained reasonable, in the light of previous history and without the benefit of hindsight, to expect recovery to start within the not too distant future. It was understood and recognised to be ultimately certain. Although general economic indicators were gloomy, the question was whether this made a sufficient difference at the time to the merits of the capital preservation strategy to mean that it ought to be abandoned. It was a reasonable decision to aim to weather the banks' financial year end pressures and expect that circumstances would improve in the new year.

2115. Whilst recognising that the various statistics and metrics which the Plaintiffs continually referred to in cross-examination and submissions were concerning, the Defendants submit once more that these figures are merely a tool, and an aid to decision-making; they do not dictate decisions, which are properly made on the basis of much wider appraisals of benefit and risk.

2116. The Defendants submit that the argument that they took no steps to guard against a worsening of the financial situation is simply wrong as regards any slight deterioration, and infected with hindsight as regards a major one. CCC still had the resources to withstand some small worsening in financial conditions; such would likely be temporary (as with the financial year end pressures) and CCC had support from Carlyle potentially available to meet that. As regards a major deterioration – a second market dislocation – they submit that the Plaintiffs' case amounts to a contention that the Defendants should have taken a known risk (that of

attempting to sell RMBS) and the certain suffering of a realised loss which was potentially avoidable, to protect against the possibility of an unknown and unknowable risk of a future systemic change in the repo markets. They submit that this proposition is coloured with hindsight; it is now known that continuing with the capital preservation strategy did not enable CCC to survive the events of March 2008, but without that knowledge, the risks of attempting sales of RMBS were not justified as against the prospects of in fact being able to continue obtaining affordable repo capacity and not having to do so, or, at any rate, it was reasonable to take that view. The likelihood of such a second market shock was, on the evidence, reasonably perceived as remote.

2117. They invite me to accept the individual Defendants' evidence, oral or written, to the effect, in each case that he considered, from August 2007 to March 2008, that CCC was currently solvent, stood a fair chance of managing to finance its portfolio, and could reasonably expect improving market conditions, and that it therefore did not need to sell RMBS at prices which would crystallise permanent losses for shareholders and with the attached risks of precipitating an even worse position.

2118. The Defendants reject the accusation that they were prioritising the payment of a dividend over CCC's best interests. They point out that no dividend was ever in fact declared, and submit that it is not sinister, but only reasonable, for directors of a company supposed to be a yield vehicle, and with investors asking questions about when they will receive a return, to discuss the potential to pay a dividend. There is also, they submit, no evidence that this consideration ever had any effect on the decisions taken by the Directors. The declared objective was to preserve shareholder capital (and obviously to remain solvent whilst doing so) and the steps actually taken were consistent with that aim.

2119. In the end, ultimately, the Defendants' case is that the decision to continue the capital preservation strategy was driven by the same factors as previously in September, weighed up appropriately as to the conditions in October/November. Selling was high risk. The Defendants deny that the Westways auction results should have been regarded as evidence that CCC itself could sell similar amounts of RMBS safely at the price levels suggested by the Plaintiffs; this was unrealistic. However, CCC had a small but positive income stream. The logical prospects of the value and market for its RMBS improving were reasonable. As it was not suffering income losses in the interim it could pay its debts as they fell due. So long as it could obtain enough affordable repo financing and did not encounter significant margin calls, it would gain enough time for the markets to recover. It had managed to obtain such repo up to November even if with hard work, and also to weather margin calls with some help from Carlyle. It had the reasonable expectation of further such reasonable support if needed in the future.

2120. They submit, finally, that even if the continued pursuit of the capital preservation strategy had been a mistake – although they submit that on the evidence it was not, but was in fact the right decision at the time, citing Dr Niculescu – that would not in itself be enough to found a cause of action in negligence or negligent breach of contract (see, although in a US context, *CMMF LLC v JP Morgan Investment Management Inc* 543 Misc 3d 1226(A)) and still less a breach of fiduciary duty. It was merely an error of judgment.

2121. With regard to the specific question whether the Defendants could and did reasonably view CCC as a "going concern" they refer to their evidence of their views at the time. They cite the

fact that PwC endorsed this view in its Auditors' Report on CCC's Third Quarter Financial statements (given as at 30th September 2007, but signed off with effect at the 13th November Board Meeting) and in fact again, in its year-end report, to 31st December 2007, which was finalised in February 2008. This is a matter to which I will return in more detail, because as already mentioned, the Plaintiffs argue in riposte that the Defendants cannot place reliance on that support, because they knew or should have known that it was based on incomplete and/or misleading information fed to PwC by Mr Stomber and CCC's Management.

2122. As regards the criticisms aimed at the 13th November Board Meeting, the Defendants argue that most of these criticisms go merely, and ineffectually, to form and not substance. They dispute that, on the evidence, it can fairly be said that the Board, or Management did not carry out analyses, or conduct appropriate investigations, submitting that there is plenty of evidence that they actually did so, but in any event, they accuse the Plaintiffs of taking an unreal and rigid approach to the generation of written records, analyses and the holding of meetings, when the important point is the substance of what was done. The Plaintiffs' submissions simply insist, mechanically, that investigations or analyses should have been formally carried out without regard to whether this would have had any real point or been of any practical use, in the actual circumstances.

2123. They submit that the notes and minutes in evidence, as well as the witness evidence, show that the 13th November Board Meeting in particular had all pertinent matters before it and was an in depth and robust discussion of them; they invite me to find that Mr Stomber now accepts that his intemperate email of 13th November apparently criticising its conduct as *"all over the map*" was wrong, and the Board Meeting in fact reflected just healthy discussion. They submit that Mr Stomber's projections were simple projections showing the potential effects of certain assumptions as to the future, and that the *Business Plan Summary* was reasonable for the time; it was premature to try to construct any more immediate plan to remodel CCC's original business objectives, because the markets remained in too uncertain a state, with as yet insufficient recovery towards the (reasonably expected at the time) norm. The inclusion of sales of RMBS within the projections was again, simply an illustrative suggestion and did not prove any current acceptance that such sales could be safely undertaken, which was being ignored. Lastly, the argument that deferring further decision making to the February Board meeting was culpable is simply another way of expressing the charge that the Plaintiffs' "required action" was not taken.

2124. With regard to the accusations regarding the purchase of CCC shares by Co-Invest, and the timing of their registration, as being breaches of Dutch regulatory law, the Defendants question the materiality of this to any of the claims in the case. However, they submit in any event that the evidence, including evidence from the Dutch lawyers, shows that there was in fact no market manipulation. In very short summary the Defendants invite me to find that such trade based manipulation requires an intent to manipulate the market (thus rejecting a late suggestion by Professor Nelemans on the part of the Plaintiffs that the test would or could be the objective one of whether the market was in fact manipulated). They submit that, on that basis, the evidence shows that there was no such intention; the intention was to purchase the shares because they were good value, and not for the purpose of manipulating the market at all. If there were any such thought in the relevant Defendant's mind it would be no more than an example of the realism applied by Lord Sumption in *Eclairs Group Ltd v JKX Oil & Gas plc* [2016] BCC 79 [20]-[21], that businessmen cannot be expected to ignore any welcome collateral advantages of actions which they propose to take for proper reasons, even if they are

aware that such collateral advantage would itself not be a proper reason for the action. There is, they submit, no basis on the evidence to conclude that these purchases would not have been made by the Defendants, using their own money as they did, regardless of any prospect of thereby stabilising the share price. I should consequently find that there was no breach of Dutch law on the part of the Defendants arising from the share purchases by CCC Coinvestment Limited.

Discussion and Conclusions – October and November 2007

Breaches of directors' duties

2125. The breaches of duty actually alleged in the Cause against the individual Defendants in respect of this period from 2nd October 2007 to 30th November 2007 (I again deal with the contractual allegations against CIM and the position of the Entity Defendants separately) are, as against the Carlyle Directors, the matters listed in Paragraphs 367D.1-10, and 367E of the Cause, and as against the Independent Directors, the same matters using the same words *mutatis mutandis*, in Paragraphs 367F.1-10 and 367G , again as further particularised in Paragraphs 418A-N and 4124A-G incorporated here by Paragraph 368.

2126. Among these matters, the effectual breaches of duty, ie those which are capable of causing loss or damage to CCC, are the allegations at Paragraphs 367D.4 and 367F.4 first in the now familiar form of

> *"failing to insist that CCC either (i) sell down its RMBS assets to generate liquidity and reduce leverage, and/or (ii) raise additional equity capital to reduce leverage and/or (iii) conduct a restructuring or orderly wind down",*

with the last being tantamount to the first, in practical terms, because selling RMBS would be the only practical way of winding down the business.

(a) Breach of fiduciary duty

2127. Turning first to the issue of breach of fiduciary duty, once again, the allegations at Paragraphs 367E and 367G are of breach of fiduciary duty by preferring the interests of Carlyle Group (aspects of its reputational interests) to those of CCC, as previously pleaded in respect of September in Paragraphs 339C and 339E of the Cause.

2128. I can see no material events during October and November 2007, nor any difference in circumstances at the end of November, which makes these allegations materially more cogent or sustainable when applied to this later period.

2129. The consideration of furthering the Mubadala transaction as part of a "strategic objective" was spent with the completion of that transaction in early October 2007, in any event. I dismiss a faint suggestion that there was still the prospect of Mubadala taking an increased stake in Carlyle as there is not even a suggestion that anyone gave any thought to this. The considerations of Carlyle's reputation appear to me to be no different from previously. Only as regards the question of paying a dividend does it seem to me that I perhaps need to mention anything more than I have done previously, because there may be a greater number of references to such a point in the evidence for this period. I note in particular the importance which Mr Stomber's communications suggest that he attached to this (see 31st October email to

Mr Hance) and the fact that this was a significant topic for discussion at the 13th November Board Meeting.

2130. As I have previously stated, however, since CCC's very raison d'être was the payment of dividends, it is neither surprising nor reprehensible that those concerned with conducting CCC's business should feel obliged to air that possibility. It is, moreover, one thing to consider, and even announce, a plan to move forward with a view to paying out a dividend, and quite another actually to pursue that plan in a manner which would then be contrary to the best interests of the company. I cannot see that the possibility of paying out a dividend actually made any difference to the decisions taken by the Defendants in this period with regard to how CCC should move forward; its acknowledgment seems to me to have been just a nod to the fact that CCC's investors would want to be assured that CCC had such an objective in mind. It was really a statement whose main object was to reassure investors. I therefore remain quite unconvinced that the pursuit of payment of a dividend actually affected the Defendants' crucial decisions to continue not selling RMBS at this time. I am not satisfied that the extent to which any such objective operated in the minds of any of the Defendants was improper, or that it tainted the decisions actually made with an improper motive of somehow prioritising Carlyle's reputational interests to the individual interests of CCC as a separate entity.

2131. I referred above in the course of the narrative with regard to November, to my finding that Mr Ng's comment to a fellow trader that CCC was looking to make dividend targets was not evidence of any actual policy, but a convenient throw away excuse for showing nonchalance when gathering market colour.

2132. I have already said that I consider the allegation of an improper motive connected with bolstering the payment of fees to CIM to be unsustainable on the evidence. The only fees ever paid by CCC to Carlyle had been properly earned in accordance with the terms of the IMA, and I can see absolutely no evidence that the continued conduct of CCC's affairs was in any way influenced by an attempt to manipulate these to enable CIM to claim fees.

2133. I therefore once again dismiss the allegations of breach of fiduciary duty in respect of this period.

(b) Breach of duty of care

2134. With the effectual breaches of duty alleged distilling once more down to the core breach as alleged in sub-paragraphs 367D.4 and 367F.4, the remaining sub-paragraphs are again in the nature of particulars of that breach. For example, it is implicit in the allegations of "failing to prepare or procure the production of a viable business plan" for CCC, either at or after the 13th November Board Meeting (Paragraphs 367D.1 and 2 and 367F.1 and 2), that the "viable" business plan which the Plaintiffs mean is one which would have involved selling RMBS or raising capital. Failing to investigate "all potential avenues" for CCC to sell RMBS assets or raise further capital (Paragraphs 367D.3 and 367F.3) again simply states the core breach in different words (but see the discussion of this in relation to CCC's engagement with the markets in September). Failing to prepare or procure a "worst case scenario analysis" for CCC, (Paragraph 367D.5 and 367F.5) is a criticism of form and not substance since it cannot be alleged to have caused any loss to CCC except through its leading to the core breach.

2135. Paragraphs 367D.6 and 7 and 367F.5- 367.7 respectively allege breaches of duty by failing to seek and obtain investment or insolvency advice and by approving the continued suspension of

the original Investment Guidelines. These are, once more, matters which are not alleged to be causative of any loss independently of the core breaches.

2136. As to the allegation with regard to failure to take investment or insolvency advice, I gave my analysis of the effects and scope of such an allegation when considering September and that analysis leads to the same conclusions here. However, for the avoidance of doubt, and although it is technically of no impact on my conclusions, I make it clear that, examining CCC's financial situation at the end of November 2007 (or even 13th November 2007, as Mr Wallace chose to prefer for the purposes of his expert report), I conclude that CCC was not insolvent at the time, whether on the basis of the test which I find applicable in Guernsey law at the time of being "unable to pay its debts" or the broader test of being "unable to pay its debts as they fall due". CCC's own financial position had, I find, improved somewhat since September; it had moved a little further back from the "cliff edge" of disaster on that cash flow front, and now had a track record of managing to meet the market conditions which presented themselves, as had been predicted. It might be living hand to mouth (or "*roll to roll*" as Mr Allardice described it) but it was nonetheless succeeding in doing so. Whilst market conditions remained dire and financing could become more difficult because of the year end pressures on the banks, CCC had anticipated this and taken steps to cope with it. The overall position, therefore, was that CCC was meeting its debts, and whilst it might require hard work and persuasion to ensure that it continued to do so, I am satisfied that the prospect of its not doing so was speculative rather than there being no reasonable prospect that insolvency would be avoided.

2137. As to the allegation of culpably continuing the suspension of the Investment Guidelines in November 2007 this is made and defended on a similar basis to September, and there is no material difference in either the facts or the surrounding circumstances. I do accept that there had, by this time, been a further period of time during which it had not been possible to restore the original guidelines, but that is not in my judgment a decisive point. The present objective was to achieve running CCC solvently whilst preserving capital; the luxury of comfortable risk management guidelines was not available, and would not become available until market conditions settled to a point where CCC was able to transition to a new business model and devise suitable guidelines for that. I find that there remained respectable reason to believe that this could be achieved. In those conditions I do not consider that the continued suspension of the original Investment Guidelines, appropriate for a different market environment, was any breach of duty by the Directors, and I therefore reject this allegation as regards November as well.

2138. The complaint of approving the repayment of the $100Mn loan from Carlyle and its substitution with a revolving line of credit at a commitment fee "*without scrutiny*" when this was "*grossly inadequate*" to materially benefit CCC and did not address its longer term viability (Paragraph 357D.8 and 367F.8) simply focuses on one angle of the core breach. It no longer appears to be persisted in as a basis of claim, as already mentioned.

2139. Approving the redefinition of the liquidity cushion to include the undrawn debt from Carlyle "*without considering the effect of that upon CCC's long term viability*" (Paragraphs 367D.9) and 367F.9) is a bizarre allegation, not alleged to have caused any loss in itself, and simply diverting attention from the allegation of substance. In fact, as these funds were plainly available to meet calls on CCC's liquidity, it is difficult to see what objection there could be to this action, other than on presentational grounds. The complaint appears to boil down to an

allegation of lack of self-discipline, and is therefore at best merely evidential with regard to the core breach. Once again, it does not seem to be seriously persisted in.

2140. The final allegation (Paragraphs 367D.10 and 367F.10) is that of failing to convene a Board Meeting prior to 13th November 2007 despite the fact that "*Carlyle [sic] and CIM had done nothing to reduce leverage or increase liquidity as had been represented to investors…. would occur,*" nor had presented a viable business model to the Board. This again goes nowhere beyond the scope of the core breach itself, which I therefore move on to consider.

(1) Failure to raise additional equity capital

2141. I have already foreshadowed, in considering September 2007, that I would reject this allegation of breach of duty, and also the further associated allegations made generally that the Defendants never reconsidered their early rejection of this course of action.

2142. In fact I find this latter complaint unjustified as a matter of evidence and balance of probability. I have already stated that I do not regard it as culpable that options previously rejected should not be repeatedly reconsidered and recorded as being confirmed without any change of circumstance to give this any point. In fact, though, it is clear that the possibility was raised by Mr Zupon at the 13th November 2007 Board meeting, and was considered but dismissed at the time, as confirmed by the evidence of Messrs Stomber, Hance and Allardice.

2143. I find this evidence inherently probable. I also find that this action was reasonable. Although the Plaintiffs criticise Mr Zupon, in particular, for having accepted the judgment of others that this was not a feasible option, such criticism is, in my judgment, misconceived. First, there is the general point to which I have referred previously, that Board decisions are made by a majority. It follows that a minority view may be overruled by a majority decision. Given the nature of board decision-making, it cannot, therefore, be a criticism of a minority member that he did not "insist" on pursuing his position in the face of a majority decision to the contrary, and that must be so even if the arguments of the majority had failed to convince him. On that ground alone it seems to me to be extremely difficult, if not impossible, to bring home individual culpability to a Board Member because his point or opinion is overruled by the combined views and votes of a lawful majority of the Board, and he accepts this position. This would be so even if his own view turned out to have been the better one.

2144. Second there are two points specific to Mr Zupon. The first is that he had no vote; he was not in a position to "insist" on anything. The second is that by this time – 13th November - he was no longer involved with the day to day running of CCC's business because the assets within his specialist expertise had been disposed of. His duties were therefore largely confined to those of raising material points to ensure that they were aired, examined and not overlooked, and so that they could be pursued if appropriate. He did just that at the November Board Meeting. I do not find any justifiable criticism of his conduct at that time.

2145. Examination of the notes of the November Board Meeting also reveal, very clearly, that the possibility of attempting to raise additional capital was considered as part of a general discussion of financing issues, shareholder concerns, the balance of appropriate regard to payment of dividends or preservation of liquidity, stock prices, and suchlike. It was rejected as being impracticable, perfectly understandably.

(2) Failure to initiate sales of RMBS

2146. Once again, then, the central complaint is simply that the Defendants failed, during this period and in particular at the 13th November Board Meeting, to take the step of commencing to sell quantities of RMBS as the Plaintiffs plead they should have done. The issue is whether their decision not to do so was a breach of their respective duties of care at that time.

2147. On the one hand, the Plaintiffs stress the difficult and perilous financial situation facing CCC at this time, especially with regard to the difficulties of obtaining affordable repo financing and the fact that this had not improved, they suggest, in a further two months since September and was likely to get worse, together with the risks of continuing to hold RMBS at a leverage ratio of 30x or more, and they submit that a decision not to start selling RMBS in those circumstance was negligent to the point of recklessness and irrationality.

2148. On the other hand the Defendants stress that whilst the financial situation facing CCC was difficult, it had not significantly deteriorated since September 2007 and that a degree of expected imminent deterioration was catered for, that CCC remained cash flow solvent, that it remained reasonable (it was certainly, they submit, within the range of expectations at the time) to expect market conditions to recover sufficiently in the reasonably near future to restore the value and liquidity of CCC's assets, and that the many risks of attempting to sell – moving the market or being perceived as being in trouble or, still worse, a distressed seller – remained major, such that the balance of advantage, disadvantage and risk made a decision not to sell RMBS a perfectly reasonable one.

2149. I prefer the Defendants' arguments and submissions. In my judgment, this was a business decision. As such, it is not a decision which the court will lightly second guess. It is only where it appears to be incontrovertibly negligent that the court would do so. It is for the Plaintiffs to convince me that the decision not to start selling RMBS at this time was a decision which no reasonably competent, careful and diligent director, (with, insofar as material, the particular skills of any relevant Defendant) could reasonably have come to in all the circumstances at the time. They fail to do so. I am in fact satisfied that it was probably the right decision to come to at the time, but I do not need even to go that far.

2150. My reasons for coming to this conclusion are broadly those advanced in submissions by the Defendants. I will not be unnecessarily repetitive by setting them out in full detail, but make the following points. Where I do not, therefore, deal expressly with any argued point or matter of evidence, it can be taken that I have preferred the submissions or evidence of the Defendants or their experts.

2151. Once it is found, as I find, that the decision taken in September 2007 to implement the capital preservation strategy was itself a reasonable one, the issue with regard to any future date becomes whether circumstances had changed sufficiently that due skill, care and attention required that decision to be revisited and then changed. I do not, in fact, see the position with regard to repo finance as having materially changed between September and November. The level of difficulty in obtaining it was, it seems to me, fairly constant. The only material change was that a further two months had elapsed without a restoration of liquidity to the markets, or a notable improvement in obtaining finance, or the value of CCC's assets actually being seen to improve significantly. Given the fact, though, that CCC was solvent with a small but positive cash flow, and that the logic behind the belief that the value and tradability

of its assets would improve remained the same, there was reason to consider that this delay or stagnation was something which it was appropriate to try to weather.

2152. The timescale without improvement in prices was only a couple of months, and I am satisfied that it could be reasonably seen, at the time, as explained by the imminent financial year end pressures on banks; reduction in the availability of financing affects liquidity and has a depressing effect on asset values. The delay was not, I find, so long as to put that logic into question. Indeed, the improvement in the initial six weeks of this period, from October (after the effects of compulsory liquidations of ABCP funds had spent themselves) to early November, was some supporting evidence that the logic of expecting recovery, even if only gradual, was sound, and that year-end pressures were causing a mere temporary stagnation. I do not find the evidence to suggest that this should then have been seen as symptomatic of an imminent systemic failure in the markets.

2153. Neither do I think it was culpable not to see the improvements of October as a green light for now positively trying to embark on a sales programme, given the delicacy of CCC's position and the risks of selling. It does not seem to me that, in the circumstances which I have already examined in detail when considering September, the prices achieved in the Westways auctions were an obvious indication that CCC could expect to sell similarly large (as it would have been) quantities of RMBS, even over a period, even at similar prices, and the prices achieved in the Westways auctions were not, in fact, at the levels which the Plaintiffs contend CCC ought to have been able to achieve. Certainly I find that the evidence of the Westways auctions would not have been sufficient to justify any confidence in the safety and achievability of this course. Although the Westways auctions were forced sales, the market was aware of the quantity of assets involved. With CCC, there was a valid concern that the market would be well aware, as CCC was a public company, of the potential quantity of RMBS which might come up for sale, and this could easily affect the market's reactions. Being cautious in regard to selling was still, I find, not an unreasonable approach, in the circumstances of October and November 2007.

2154. I accept that Mr Stomber quite clearly, at the time, took the view that the financial difficulties of the markets were far from over, and that, at the end of November one was in the middle rather than at the end of the problems, but Mr Stomber had a dramatic style, and I interpret his emails with that in mind. They certainly seem to show mood swings. I have no doubt that he grasped at signs which could be interpreted hopefully, as he desperately wished them to be, but he also adverted to negative signs with the pessimism which I think comes to him more naturally, or at least did at that time. However, I have no doubt that he conscientiously strove to maintain a soundly based balance of reason in the judgements which he made and I am satisfied that he did so. Major difficulties there might be to come, but I am satisfied that at that stage it was reasonable to perceive the difficulties as being a possible general trend (the US economy was quite likely to go into recession), rather than as presaging a sudden systemic failure of the US financial systems which would completely disrupt the market, such as occurred three months later, and that such a gradual general trend was still one which CCC could survive.

2155. The other relevant circumstances relate to the evidence of the availability of repo finance on affordable terms. Internal email correspondence in October shows that the Defendants clearly recognised the dangers to CCC of shrinking or even disappearing availability of funding, and so forth, but this is a long way from saying that they did or should have recognised that these

dangers were then so acute that they demanded efforts to sell off RMBS despite the risks which this entailed.

2156. I have rehearsed the competing points made above. I think there is some exaggeration in both the doom and gloom points advanced by the Plaintiffs and also, the more rosy position which is now advanced, I think defensively, by the Defendants. It is a fact, though, and I find it of significance, that CCC did always manage to obtain repo finance on apparently affordable terms, ie never in excess of a nominal 3% haircut, and always below this on average, even when the effects of "backdoor" haircuts amongst some lenders were factored in. I accept the submission by the Defendants that proposals for increased hair-cuts were often not all they seemed, and could be either coded messages or "try-ons". Given this, I do not attach any great weight to what may have been throw away remarks in the course of negotiations. The evidence satisfies me that CCC's Directors could reasonably believe that in practice CCC would be able to juggle all its repo financing to continue obtaining funding at a 3% haircut (which was affordable) or below, as it had in fact done during October and November, and with some steps taken to ease the likely year end pressures.

2157. I do not regard it as a major significant factor that CCC was very close (within $2.3Bn on a total borrowing requirement of just under $22Bn) to full use of its lined up available repo capacity. Whilst it is obviously comfortable to have the semi-promise of significant extra soft line capacity to call on, CCC only needed its actual capacity requirement, and it had always achieved that. Indeed, in October and November it did so, even if coming very close to no excess capacity for a few days in early November, and with constant juggling required.

2158. I find it irrelevant that this might only be obtainable because of the Carlyle association. The fact is that it was obtained or obtainable in this way, and the Carlyle association was an asset of CCC, available for exploitation. That association would also continue to be available, for whatever it might be worth in practice.

2159. In addition, I find that it was reasonable for CCC to be expecting that the promised $2Bn line at 3% for 364 days from Wachovia was virtually a done deal at the end of this period. It is suggested that Mr Stomber's expertise (at least) should have told him that Wachovia were not a reliable party to complete such a transaction, because they were inexperienced and had had to turn to an agent/guarantor structure, the implication being that in the very end Wachovia was unlikely to be willing to take on such a role. I do not accept that proposition; I am satisfied, on the evidence of the negotiations, that at any rate up to the end of November it was reasonable for CCC's Directors to anticipate that the line from Wachovia could be secured. It might be that Wachovia was stretching itself because of its connection with Carlyle, but I do not see that as making it unreasonable to assume that Wachovia was intending to, and would, live up to its apparent word and intentions.

2160. As regards liquidity, there was if anything, it seems to me, an improvement since the end of September 2007, and indeed, this would reasonably have reinforced Management's and the Directors' belief in the capital preservation strategy. Of course, this liquidity included the availability of, first, the Carlyle Term Loan and latterly the unused balance of the similar revolving credit line, but in my judgment it was reasonable to regard this as available liquidity for CCC; all the indications were that it was reliably available. Once again, the falling off of improvement at the end of November was anticipated as a likely effect of the end of year pressures, and, I find that view not to have been unreasonable.

2161. The Plaintiffs' accounting expert, Dr Holstrum, put forward an argument that further continued support from Carlyle could not be taken into account because it could not be definitely relied upon, because he suggests that it would have been withdrawn if it would lead to the Carlyle Group's having to consolidate CCC into its own accounts. I am satisfied by the analysis of the Defendants' expert, Mr Carnahan, and by the Defendants' submissions on this point, that the argued likelihood of a requirement to consolidate arising out of loan support by Carlyle for CCC was speculative.

2162. I accept that there is some evidence, from later on, that this possibility would have played a part in Carlyle's assessment of the position. It is found in a recorded remark by Mr Conway at the Audit Committee meeting of 26th February 2008, that *"Carlyle does not want to be in a position where it has to consolidate CCC"* and that things were *"close to the line."* However, on examination in context, this remark was made in relation to a discussion about whether CIM should waive its incentive fee entitlement, and the matters which brought the position "*close to the line*" were not only "*credit support*" but also *"purchase assets…restricted stock and IMA".* This evidence therefore falls a long way short of clear evidence that Carlyle would have abandoned CCC to its fate on the financial support front if giving further loan support would cause the possibility of having to consolidate, even if, (and of which I am not satisfied) that would have been the consequence. I am certainly satisfied that it was not an apparent or likely consequence at the time, three months earlier, that I am here considering. I find the position at this time to be that whilst Carlyle would seek to avoid the inconvenience of consolidation if possible, that was not then, and probably not at all, a matter which would have caused it to have refused further financial support to CCC so long as it was satisfied that such support would be likely to be commercially effective.

2163. As regards other material parameters, whilst the seriousness of CCC's position with regard to leverage was both apparent and accepted, there had been no change in this. There had equally been no change in the danger factors which were perceived, whether expressly or more intuitively, with regard to CCC's selling RMBS.

2164. For these reasons, I find that drawing the balance of business judgement in favour of continuing the capital preservation strategy was a perfectly possible, reasonable approach. It was also reasonable to conclude that only a further major change or shock to the financial markets would de-rail the reasonable likelihood of a steady, if slow, climb to recovery. On the preponderance of the expert evidence, such a second crisis was historically, statistically and logically unlikely to occur imminently, and I am also satisfied that that is how it appeared to the Defendants, and reasonably so appeared to them, at the time.

2165. Dr Carron is the only expert suggesting the contrary, but even he only says that the possibility of such a systemic withdrawal of repo funding was "signalled" by the August crisis itself, and even then he agrees that the timing of the March 2008 crisis was not anticipated by market participants; in other words, he seems to take the view that such an event was "when" rather than "if". I am not sure, though, that he does go so far as to suggest that the inevitability of "when" was actually foreseen at all generally by the markets at this time, and if so, this seems to me to smack very much of hindsight. One knows from later events and analyses that the eventual meltdown of the markets in March 2008 was the result of an accumulation of ill-judged and ever more risky lending practices by banks in the subprime mortgage and CDO markets turning out badly, and coming eventually to affect the stability and solvency of the bank lenders themselves, but how much that was appreciated, and how far the consequences

could therefore be foreseen, from August 2007 before it actually happened, and, specifically, foreseen by ordinary market participants in their own particular corner of the wider market, is a different matter. It is this latter question that I am concerned with here.

2166. I do not understand Dr Carron to be saying more than that the signs of the ultimate disaster were in fact there to be read from August 2007. Whilst a small number of people (and no doubt more after March 2008 than before) may have seen and correctly (in the event) interpreted these signs in the second half of 2007, the evidence suggests that there was also a significant and much larger cohort of market participants and observers who did not expect any such second disaster to occur, but thought it most likely that there would be a gradual, if bumpy, recovery back to something approaching pre 2007 conditions.

2167. I therefore prefer the opinions of, in particular, Professor Hubbard and Dr Webster to Dr Carron. In any event, their difference of opinion supports the view that it would not have been outside the scope of reasonableness to subscribe to the expectation that a second severe market crisis was not likely.

2168. Mr Sarles, who seemed to me to give this possibility of an imminent second market crisis most credence, gave a figure of 20% possibility, but only as a maximum for the sake of argument in oral evidence. Even that is a figure significantly below likelihood.

2169. Perhaps more importantly, though, a second major crisis was in any event a matter which, it seems to me, could not, practically, be protected against at the time, because the only possible course was that of cutting losses by undertaking a major selling programme of RMBS, with the imponderable, potentially serious and uncontrollable risks which this entailed. These major risks would therefore be run in the unpredictable hope (not even a certainty) of forestalling the effects of a market event of certainly potentially catastrophic consequences, but apparently minimal likelihood. Therefore, to conclude that continuing to hold RMBS was the less risky and better course in CCC's interests than selling them was a business judgement which, even if there might possibly be divergent views, was certainly (I find) well within the range of a reasonable business decision in all the circumstances.

2170. Mr Sarles, with typical simple bluntness, summed up the thinking in November as being:

> *"…On the one hand…we've got this strategy that works in all of the cases except for the big problem, and that's - you know - we don't think too likely to occur. Even if we thought it was likely to occur, how we would deal with it is so problematic and we didn't see any way to do it that would work. So I thought we made the best strategy, we made the best choice possible, which was to stick with the capital preservation approach."*

2171. I find that this was effectively the Board's approach, and I find it was not unreasonable.

2172. With regard to the 13th November Board Meeting and associated Audit Committee meetings, having considered all the evidence of the notes, Minutes and surrounding circumstances I am satisfied that the Board meeting was appropriately held and conducted, and that it gave appropriate consideration to material matters. The Defendants did engage in thorough and searching discussion to the depth reasonably to be expected at a Board Meeting of a company such as CCC in the circumstances. It is suggested that there is no evidence that the Defendants actually discussed the supposed "business plan" which was presented and the

summary of which contained, it is said, unrealistic assumptions, such as the value of CCC's securities being marked at IDP prices by the third quarter of 2008, and that its liquidity would have risen to $220Mn by the year end. Having reviewed the evidence of the discussions which actually took place, I do not think this is a fair criticism. With it being reasonably seen as premature to make a defined plan for CCC, I am satisfied that proper and sufficient discussion with regard to CCC's future course, with the provided information as background material, was undertaken.

2173. But in any event, such a criticism misses the point. Even if I assume that Board Members negligently failed to examine the assumptions of Mr Stomber's illustrative cases in depth, to pull these apart for being unacceptably optimistic, and failed to insist on the preparation of some other worst case scenario, that is immaterial unless it would have made any difference to what they actually did. I am quite satisfied that it would not. The basic fact is that CCC had only two broad options; risk trying to hold RMBS or risk selling them. Whether or not Mr Stomber's assumptions as to the future in any particular case were optimistic or realistic, that practical choice was the same, and the decision which to follow depended on assessing the same balance of risk and benefit. The Plaintiffs' case would therefore depend on demonstrating that if a more "realistic" or pessimistic business plan had been put forward or commissioned this would have led to a different decision being taken as to the relative merits of holding or selling. They just do not do so. Having regard to the available options and on all the evidence in the case, I am satisfied that even if a more pessimistic view of when CCC's RMBS would begin recovering to par had been put forward or considered, it is only speculation to suggest that this would have given rise to a different decision on the relative merits of holding as against selling RMBS, and in fact, I think that in all probability the decision would have been the same.

2174. The Plaintiffs have submitted that the inclusion of suppositions that CCC's RMBS could be sold within the various "cases" put to the Board Meeting is evidence that they really believed that this could be done, but then chose to ignore the obvious benefits of doing so. The Defendants deny this, saying that those scenarios were only suppositions for illustrative purposes. I accept this evidence, because it seems to me to accord with the circumstances. These were illustrations as an aid to considering possible courses of events.

2175. I find the criticisms that the Defendants did nothing but defer decisions until February unjustified, for similar reasons. This was an actual decision, and not "no" decision. It is clear on the evidence, supported by the meeting notes in particular, that it was accepted that the crucial point was that markets were not sufficiently recovered or stable to enable CCC yet to take active steps to start investing again, or, in other words, to transition to a new business model capable of delivering the kind of shareholder benefits which CCC had originally been designed to produce. It is apparent that the fact that there could be no immediate prediction of when CCC might be able to invest again, together with the likelihood of imminent questions from shareholders about dividends, caused a good deal of concern and even frustration at the Board Meeting, but also a realistic recognition that it was still too early to start changing CCC's course. In those circumstances, and with CCC on a course of operating in capital preservation mode, deferring review of the situation, and any specific decisions, to the following Board Meeting was both reasonable and obvious. The Defendants were entitled to proceed on the basis that if there were any further major and significant change of circumstance, CCC had a Management team in position, and the system of ALCO meetings and reports, to bring this back to Board Members' attention appropriately.

2176. The Plaintiffs laid great stress on the general email of Mr Stomber later that evening (13th November), as evidence, and effectively as an admission, that the Board, and this meeting, had been dysfunctional and haphazard - "*we were all over the map*". I have looked carefully at this email and its surrounding circumstances. I do not find it to amount to any such admission or evidence. There is no indication that some sensible suggestion by Mr Stomber (and in particular some suggestion to sell RMBS, which is what the Plaintiffs are arguing was the only sensible course) was being capriciously or superficially overruled by voting Board Members, as I would have expected to find if Mr Stomber's real complaint had been the disorganisation, dysfunction or indecision of the Board. Indeed the upshot of the meeting was to continue with the capital preservation strategy, which was what Mr Stomber had effectively been recommending, even if *faute de mieux.* What I find happened is that during the meeting Mr Stomber found himself effectively being cross-questioned with regard to his analyses by, in particular Mr Zupon and by Mr Hance, on topics of which he had not been forewarned, and it was this which upset him, especially coming from Mr Zupon with whom he had a rivalry and a personality clash. Mr Stomber was already sensitive about CCC's position, and the stress of such unexpected cross-questioning caused him anger and frustration, and this is what was behind the intemperate terms of this email; Mr Stomber is highly strung, tends to express himself dramatically, and often does not suppress his feelings. For that reason, I can accept Mr Stomber's recent statement that he now accepts that the Board Meeting in fact reflected, as I find it did, healthy discussion. This culminated in an actual decision that the current strategy was correct.

2177. The above are my reasons for dismissing the claims of breach of duty of care against the individual Defendants during this period. There are, however, three other points which I feel I need to deal with specifically in connection with the Plaintiffs' criticism of the Defendants' conduct in this period, although the first is only marginal.

2178. I have recorded above the Plaintiffs' complaints against the Defendants with regard to allegedly misleading statements in CCC's Third Quarter 2007 reporting documents, in four respects. All four matters are all, also, yet again, allegations with no causative effect as regards the claims made in the action.

2179. Three of these (that CCC had "strong" liquidity, that the directors "were evaluating" CCC's liquidity needs, and that the disclosure of the suspension of the liquidity cushion was played down) I regard as having no substance at all. They are matters of impression or interpretation rather than clear factual inaccuracy, even descending, to my mind, to the point of pedantry. Amongst the three completely inconsequential matters, the question whether a liquidity cushion level is "being evaluated" at a time when one has agreed that it is not yet possible to make any firm or sensible conclusion because there is insufficient information available seems to me to be a matter of semantics; I do not think it seriously arguable that the MD&A was actually misleading in this respect in the circumstances - even if it mattered for the purposes of this case. As regards the more material point about whether the underlying reasons for not yet making a decision about appropriate liquidity cushion levels were valid, it seems to me that they were. I accept the recorded comment of someone at the meeting that a 20% (or whatever) liquidity cushion is not a target in a crisis; it is *"a buffer to be used in time of crisis*". The material point for present purposes is that, whatever the level of liquidity cushion which might ultimately be thought appropriate, it was plain that, in any event, in the interim until CCC adopted a more proactive business model with a liquidity cushion as part of it, CCC and Management were simply going to continue trying to add liquidity to CCC's position by the

means which they thought the most safe and appropriate, and in the interests of CCC in all the circumstances.

2180. Only one point does, I think, have some substance, and it is the complaint of conveying a misleading impression that CCC's repo borrowing capacity had actually been increased. Mr Conway, confronted in evidence with the statements made about increased lines having been agreed and the impression thereby given that there had been an increase in overall capacity, agreed that it "*would have been better"* if the decreases in other lines had been mentioned as well as the increases – the real position was simply that CCC had spread its repo finance somewhat - a good thing in itself, but not the same as additional capacity. This was an appropriate recognition by Mr Conway that the text as it stood was inclined to be misleading, but, as I have said, this fact has no impact at all on the claims made in the case. I have mentioned it only to illustrate that I do not find that the Defendants' conduct has at all times been faultless, but I am concerned only with whether any faults which I do find are sufficient to support the claims which the Plaintiffs have made in this action.

2181. The second matter is that of the purchase of additional shares by the Defendants on and shortly after November 2007 (and in the case of Mr Conway, further in early December).

2182. The Plaintiffs have alleged, in reliance on the written note of the 13th November Board Meeting, the express comments of Mr Hance excised from the record of the Paris Investor Conference on 20th November 2007, and the more oblique comments made there by Mr Stomber, that those purchases were made in order to stabilise CCC's share price, that I should make such a finding, that this is unlawful market manipulation under Dutch law, and that consequently these purchases "cannot be treated as providing any assistance to the Defendants' case for any purpose whatsoever."

2183. No authority is cited for the somewhat ambitious final proposition, and I reject it, whether as a proposition of legal principle or of evidence. That the purchases were made is a fact. Whether or not they were lawful under Dutch regulation is not part of any alleged cause of action against CCC, nor does it affect any assessment of damages. Neither is it, so far as I can see, any kind of circumstantial evidence tending to prove or disprove any of the causes of action alleged. Even assuming the Defendants had deliberately bought further shares in order to attempt to influence the price of CCC's stock, this would not provide even indirect evidence that the core decision about running CCC's business, ie holding rather than selling RMBS, was taken negligently or for improper motives. There is no connection between the two matters, and not even, in my judgment, any connection as regards credit.

2184. It follows that I do not need to make any finding as to whether these purchases were an offence under Dutch law, and I decline to do so. This is because it is unnecessary for me to do so for the purposes of this action, as indicated, but in addition, any such finding as I might make would be of no utility or impact for anyone, as it would simply be an (unnecessary) fact found by a Guernsey judge. A further reason is that I do not think it right to make any such findings based solely on the written opinions of two Dutch lawyers, however eminent, who have not been called for cross-examination, are only able to tell me at best what a Dutch court or regulatory tribunal (the AFM) would be "likely" to do, and who are not entirely agreed on the position in Dutch law anyway.

2185. The fact of the purchase, as contrasted with its regulatory probity, does, though, have some materiality in the case. Balancing this and the considerations above, I therefore make the following findings.

2186. I am satisfied that after the immediate aftermath of the August 2007 crisis had been weathered, the Defendants' collective approach to conducting CCC's affairs was along the lines of how CCC was going to be managed back to health and move to an appropriate new business model. They were acquainted with CCC's affairs and the subtleties of its financial circumstances to varying degrees, through monitoring its activities and performance, in accordance with their individual functions. In the course of this, first Mr Zupon (early October 2007) but then also Mr Stomber (30th October 2007) and, by the beginning of November at any rate, also Mr Conway, had each formed the view that CCC's shares were, logically, undervalued and were likely to be a good investment for when the anticipated recovery in the markets and the value of CCC's RMBS – principally the latter - eventually occurred.

2187. The first clear suggestion of using purchases to try to halt the steady decline in CCC's stock price came at the Board Meeting of 13th November, and may well have been prompted by Mr Zupon's comment, in the context of considering raising fresh capital, that the business and stock price would first need to be stabilised. It is clear that the possible effects of purchases of stock, both on the stock price and as to possible public relations problems, were discussed more than just superficially at the Board Meeting, and it would be quite unrealistic to suppose that the possible beneficial effects of purchases on the stock price were not in the minds of at least the more commercial of the Defendants as a consequence.

2188. I am perfectly satisfied, however, that each of the Defendants did genuinely believe, when making the purchase of further shares which he did, that those shares were underpriced and were a good investment as a result. They may, to a greater or lesser degree in any particular case, have believed, and been pleased, that the purchases would also have the desirable effect of helping to stabilise CCC's share price. However, this was not the principal motive of any of them.

2189. I am satisfied about this latter point because the sums which each of the Defendants invested were significant, by any standards. I do not have details of the personal circumstances of each Defendant to enable me to judge how significant or important the amount of his individual investment would have been to that Defendant. No evidence as to this was either led or sought in cross-examination. I am, though, satisfied that none of the Defendants would have made an investment of the magnitude which he actually did make without having the belief that it was likely to be a good investment for him personally, and none would have been prepared to risk throwing such money away simply for the purpose of improving CCC's share price. On the evidence I can see no plausibly sufficient incentive for any of them to do so. I find, therefore, that these further investments were made in the belief of the worth of the investment as its primary motive, although potentially helping to stabilise CCC's stock price was probably also noted as an incidental benefit.

2190. The materiality of these facts about such further investments lies in a different direction. I have previously considered, and found, that there was no improper collateral motive of conflicting personal interest, or conflicting interests of the Carlyle Group tainting the decision or advice of the Defendants (and Messrs Stomber, Conway, Hance or Zupon in particular) not to sell RMBS. I have also found that at earlier times (August and September 2007) the

Defendants genuinely believed that CCC could and would avoid insolvent liquidation. I made these findings without regard to the implications of the fact that the Defendants each, in November 2007, invested significant further sums of their own money into CCC. I find that this fact does, though, provide strong retrospective confirmation of this and also strong support for the proposition that the Defendants each did, honestly and genuinely, believe in late November 2007 that CCC was not in substantial danger of insolvent liquidation. It also suggests by implication that the steps which the Defendants were taking in the management of CCC's affairs were sincerely regarded as being in the best interests of CCC. Otherwise, the Defendants' readiness to hazard such significant amounts of their own money in CCC defies common sense.

2191. The third particular point relates to the PwC review of CCC's Third Quarter 2007 ("3Q2007") financial statements and its evidential value with regard to the reasonableness of regarding CCC as then being a "going concern", but as this is of particular relevance to the wrongful trading claim, I will deal with it under that heading.

2192. It follows from the above, that I dismiss the Plaintiffs' claim against the individual Defendants for breach of duty of care, as well as fiduciary duty, with regard to November 2007.

(c) Contractual/tortious claim against CIM

2193. Once again, the Plaintiffs do not seek to suggest that there are any materially different points to be made in respect of CIM's liability, from those which are made in respect of the individual Defendants and in particular Mr Stomber.

2194. When considering the position in September with regard to following up possible opportunities for selling RMBS, I dealt also with the enquiries regarding bond FNS 380f7 made by Bear Stearns, and concluded that on the evidence it was probably negligent (but not grossly negligent) for CIM personnel to fail to follow up this enquiry at all, as they had apparently not done. This event in fact falls within this time period and I therefore record it here. However, since I also found that there was no sufficient evidence that it would have resulted in a sale, or a sale which would have alleviated CCC's ultimate loss, it does not give rise to any entitlement to relief.

2195. Considering the matter at the end of November 2007, I therefore dismiss the contractual and tortious claims against CIM, for the same reasons as in relation to the individual Defendants and as just mentioned.

(d) Wrongful trading

2196. I have already set out the test with regard to wrongful trading when considering August and September, and the considerations which I set out there remain the same. They are the factors which I discussed above with regard to duty of care, as regards my findings as to the Defendants' assessment of CCC's financial position The only additional factor here is with regard to the investigation carried out by PwC into whether CCC could properly be considered to be a going concern, as part of its third quarter 2007 review of CCC's financial statements.

2197. The issue is whether, in defending their assertion that they honestly and reasonably believed that CCC stood a reasonable chance of avoiding going into insolvent liquidation in November 2007, the Defendants are entitled to rely on the fact that PwC carried out this "going concern"

analysis and concluded that CCC did so qualify, signing off on that proposition on 13th November 2007.

2198. The definition of "going concern" under both IFRS and US GAAS accounting standards, is that of an entity as to which there is "*no substantial doubt*" that it "*will continue in operations for a reasonable time, not to exceed one year*". There is no definition or guidance as to what is meant by "substantial doubt". Mr Reville paraphrased it as "*it's probable that this entity won't exist*" and said that, in his own mind he viewed the test as a 70% level of probability.

2199. PwC were not required to carry out such an analysis for their review of the Third Quarter 2007 statements, but chose to do so because of concerns about the effects of the August 2007 liquidity crisis. They were required under US GAAS to consider that point in carrying out their actual audit for CCC's year end Financial Statements, to 31st December 2007, and they (in fact Mr Reville) again concluded that CCC qualified, although, not unnaturally, making use of the work that had been done for the earlier review and updating this. The Defendants place further reliance on that fact in relation to later events, but it is convenient to deal with it here, as it is the same point.

2200. The Plaintiffs argue that the Defendants are not entitled to rely on the PwC certification firstly because the responsibility is on the directors themselves to consider and state whether the company is a going concern and, where it is necessary for them to do so, such as in year end accounts, they expressly certify that they have considered and confirm the point. The responsibility of the auditors is only secondary, and is to check and confirm the directors' view, to the appropriate standard for a quarterly review or a year-end audit.

2201. I do not think this point is disputed. The Defendants do not allege, as I understand it, that they formed their view that CCC stood a reasonable chance of avoiding insolvent liquidation in reliance on an opinion of PwC that CCC qualified as a going concern. They say, rather, that the endorsement of PwC of that view is support for the Defendants' independently formed view that this was the case. The Plaintiffs' case on wrongful trading effectively puts the Defendants' entitlement to claim this support into issue.

2202. The Plaintiffs argue that the Defendants are not entitled to invoke the endorsement of PwC of their alleged belief that CCC was a going concern because that endorsement was, to the Defendants' knowledge (or at least, I think, that of Mr Stomber and Mr Allardice as the principal liaison between CCC and the auditors) based on selective, incomplete and misleading information supplied by CCC to PwC, both in respect of the 30th September review, and similarly the year-end audit.

2203. Advocate Wessels, for the Plaintiffs, opened this contention high. It is based principally on the assertion of three matters. The first is the discrepancy between a "Carlyle Capital Corporation RMBS Repo Status Report" of 26th September 2007 which was internal to CCC and a similar document dated 30th September which was supplied to PwC and found in their files. This document tabulated repo lines, terms and usage with the various repo lenders. The former version contained various generally negative remarks such as about the reduction in availability, or worsening of terms being applied, which were absent in the latter, replaced, in general, by anodyne references to current meetings and negotiations. This latter document was the basis of what was presented to the Board at the 13th November Board Meeting, and it is suggested that this was even misleading to the Board.

2204. The second was a document listing CCC's compliance with Investment Guidelines, dated 28th September and purporting to show CCC passing certain Investment Guidelines when it did not. The only justification for an alleged "pass" certificate was that the original guidelines had been suspended - but the Independent Directors did not make this suspension until 1st October 2007, one day after the relevant 30th September date. Advocate Wessels opened that it looked as if a "false record" had been created for PwC.

2205. The third is a fact mentioned previously, that in confirming the validity of CCC's 30th September pricing for its RMBS, PwC had come to the singular conclusion that there was only a $72 discrepancy between their own supposedly independent pricing and that of CCC, on a portfolio valued at around $22Bn. This remarkable fact implied, Advocate Wessels opened, that all PwC could have done was accept the pricing sources supplied by CCC; they could hardly have carried out an independent pricing check producing such a small a difference. This meant that any reliance on the supposedly independent confirmation of values could not be valid.

2206. The Plaintiffs submit that the misleading purport of the information given to PwC by CCC is supported by, and explicable from, the tone of the various emails at the end of September which I have already referred to, in which Mr Stomber plainly regarded convincing PwC that CCC was a going concern as a mission, success in which was going to be a challenge. They criticise the points there made by Mr Stomber for stating only the positive side of matters such as increases or potential increases in repo lines, and the fact that the portfolio bore no credit risk, without mentioning the negative corollaries, such as the reduction of other repo lines and the fact that the ability to hold the portfolio was dependent on the vagaries of 30 day repo financing.

2207. They further submit, with many references to detail of documents given to PwC and comments made by them in their working papers, that Mr Stomber (and Mr Greenwood) conveyed unduly optimistic messages to PwC, including suggesting the "likely case" scenario mentioned above, with projections which were not only unduly optimistic but had already been invalidated by events. They say that PwC was not informed, even by Mr Allardice, the Chairman of the Audit Committee of concerns about, for example CCC's ability to maintain repo funding. Referring to a PwC comment which Mr Reville agreed, in evidence, was likely to have been a summary of matters presented by CCC, that "*there was normality returning to the markets*" they argue that PwC had clearly therefore been misled, because "the Defendants" must have known that in reality this was not true, as most of CCC's repo counterparties had ceased to rely on IDP pricing and were pricing to their own lower marks, asset prices were on a downward trajectory and repo financing was becoming more difficult to secure.

2208. The Plaintiffs' criticisms are largely based on the evidence of their accounting expert, Dr Holstrum, who was supplied with the pleadings in the action, company and third party papers and PwC's working papers disclosed in the action, the witness statement of Mr Reville, extracts from other witness statements, and some statements of assumed facts. It is his opinion, broadly expressed, that "*CCC's directors and managers did not provide to PwC full information for the purpose of PwC's review regarding conditions and events that might be indicative of CCC's inability to continue as a going concern*" in respect of either the 30th September review or the 31st December audit, such that PwC were not able to make an *"appropriate"* assessment of whether CCC was a going concern or not.

2209. Mr Carnahan, the Defendants' expert, disputes that any of the disclosures made by CCC to PwC were inadequate, stating that they conform to his reasonable expectations and what would have been standard in the "industry" at the time.

2210. The Plaintiffs invite me to prefer the evidence of Dr Holstrum to Mr Carnahan on the grounds of his suggested superior qualifications. Apart from two periods of practical experience in 1961-6 and 1978-83, Dr Holstrum was an academic holding posts as a graduate teacher and Assistant Professor or Professor of Accountancy from 1965 – 2004, and taking senior employment with the US Public Company Accounting Oversight Board from 2003-2009. He has published extensively and has held a position on the US Auditing Standards Board. Mr Carnahan's evidence is disparaged by the Plaintiffs as being largely confined to his time conducting actual audit and advisory work such that his opinions are based on nothing more than his personal experience and perception of ill-defined "industry standards" and reliance on the prestige of the auditing firms.

2211. I do not think it appropriate to make choices between two expert opinions based on a comparison of their credentials, especially without having had the benefit of cross-examination. Fortunately, I do not need to, because the real value of their evidence is, it seems to me, in assisting me in deciding whether or not CCC's Directors were entitled to take comfort, if they really needed to, from PwC's endorsements, in September and December 2007, of their expressed view that CCC was a "going concern". There is plenty of other evidence, which supports that, in particular that of Mr Reville, who was cross-examined for a day against the background of Dr Holstrum's paper criticisms.

2212. Dr Holstrum does not actually challenge the quality of PwC's work; he goes only so far as to say that he is "*not expressing opinions as to whether [that] work was in accordance with the standards of a reasonably competent auditor of the time*." He expressly asserts, though, that if CCC had provided PwC with accurate information, that would have led PwC to conclude that there was substantial doubt about CCC's ability to continue as a going concern for a reasonable period of time as at December 2007. The Defendants point out that he makes no similar assertion as regards 30th September 2007.

2213. This is a fact which might, on one view, be argued to put an end to the basis of the Plaintiffs' argument that the Defendants could derive no comfort from PwC's going concern opinion as of this date, because it would require a shift in the argument. The argument had been that the Defendants were not entitled to rely on PwC's going concern opinion because they must have known that it would be different because of their misleading disclosures; it now has to become that the Defendants were not entitled to rely on PwC's opinion because they must have believed that it would be different because of their misleading disclosures even though in fact it would not have been. This is getting extremely rarefied, and that precise point has mercifully not been argued. For simplicity I will simply proceed on the basis that such an allegation that the opinion would have been expected to be different if "proper" disclosure had been made was intended by Dr Holstrum to be implicit.

2214. Apart from the evidence of his witness statement, Mr Reville was taken though much of PwC's work. He explained what I think is an important difference between the formal "financial statements" (CCC's actual accounts) and the other reports, ie the MD&A and the CEO letter, which are all bound up together as part of the required quarterly "financials" but have different functions. Whilst only legally committed resources and solid facts could be included in the

former, it was both permissible and appropriate to include references to resources in negotiation or other material matters of intention, concern, or general views of market circumstances, in the latter.

2215. He agreed that the Third Quarter 2007 review by the auditors would be a less profound investigation than a year end audit, being an analytical review of management's opinions and an enquiry of managers, as required by accounting standard SAS 100. He explained, though, that PwC actually did do a full investigation as regards the "going concern" issue with CCC, because of its own concerns about the effect of the August 2007 crisis, even though this had not been strictly required. He also explained that the independent pricing exercise on CCC's RMBS portfolio had not been required upon a quarterly review, but had in fact been carried out at the request of Carlyle, in what he perceived to be a quest for best practice.

2216. As to the pricing exercise itself, Mr Reville was questioned at length about this. He explained, first, that CCC's RMBS were not difficult collateral to value, and he gave cogent explanation for this. They were of a sufficiently simple and common structure that there was actual market transaction "comparable" evidence of their values. It was not necessary to value on the basis of a complex modelling of how purchasers might evaluate the risk or value of particular less-than-common structural features of the securities. He invited comparison with the fact that there was simply a market "price" for IBM shares.

2217. With regard to the valuation exercise itself, Mr Reville also explained that PwC had a specialist securities valuation department, IMSAG, whose expertise lay in valuing securities, and who conducted the actual valuation exercise with regard to CCC's assets. He explained that they simply gathered all available data which would enable the pricing exercise to be carried out, and that it was perfectly possible that they had in practice had resort to the same pricing service (which operates as an information gatherer, not a valuer) as CCC would have used, if this had been the only pricing data source available. Their exercise was, therefore an independent valuation exercise, and its similarity to CCC's results was no reason to conclude that they had simply been led by the nose into taking CCC's figures, or using the same pricing source. Indeed, he said that with his experience of valuing simple securities such as these, he would have been more concerned if IMSAG's valuation had not been extremely close to CCC's, as prices ought to be "tight", just like IBM share prices would be.

2218. Mr Reville said, and I accept, that he took into account the evidence of CCC's repo counterparty valuations. Having himself had considerable experience of repo financing, he viewed the mark downs of the repo lenders as natural and normal behaviour in their own protective interests in a difficult market; those marks were not, therefore evidence of actual value, but simply a "data point" (ie a fact) to be taken into account in the process of "grabbing" all data that could shed light on actual market value.

2219. Mr Reville laid stress on the fact that there were not merely the actual formal meetings held with CCC personnel (on 13th and 16th October in particular,) but also that he had intimate knowledge of CCC's financial affairs from his habitual attendance at ALCO meetings and receipt of their papers, and that he was in virtual daily contact with Mr Stomber or members of CCC's Management – Mr Greenwood, Mr Trozzo and Mr Rella – or Mr Allardice, in which matters with regard to the going concern question other than those appearing in the paperwork presentations were also discussed. He was very firm that matters such as the detail of the availability of repo lines were discussed and were known to him, and had been factored into

his overall opinion. He explained, and I found it persuasive, that individual changes in the amount of available repo lines, or the fact that a "new" line was in practice a revival of a previous line, were not changes of such a fundamental level that they would have caused him to take a different view of CCC's viability as a going concern. Much of his opinion was formed on the basis of his concern to review how CCC was actually planning to deal with its problems, and the steps it was taking.

2220. In this context, he agreed that he would take into account the commercial clout of the Carlyle name. He said "*it's nothing nefarious; it's being an aggressive business person which is a prominent trait on Wall Street*", comments which I found both realistic and a matter of common sense. Similarly he explained that he would take account of the reasonableness of assuming that financial support from Carlyle would be granted if required, based on a common sense objective assessment. He also explained the difference between post report-date matters which might cause him to include an amendment to his expressed opinion on "going concern" and those which would not. In particular, he explained that with regard to the year end audit, the fact that CCC had suffered losses between the figures recorded in the 14th February 2008 ALCO pack and that of the 29th February when the year end reports were discussed, turning a $117Mn gain to a $16Mn loss, would still not have been such a factor, because "*It's general market volatility on an investment fund …….an investment fund by definition fluctuates….[.it] runs to the risk of the business*". This factor was, he said, adequately dealt with by the warning references to market volatility in the MD&A.

2221. I was impressed by Mr Reville's evidence, which had an underlying air of efficiency and thoroughness, tempered with realism and practicality. I am quite satisfied that he would be well alive to any natural human tendency of directors to present the best picture of their company with a view to demonstrating it to be the going concern, once any possible doubt had been raised, and also, as a very experienced auditor, of the need to test the consequent presentations made by the company's directors and managers rigorously and critically, as a result. I am satisfied that he did so in this case.

2222. The Defendants further produced, in their closing Factual Chronology, both a detailed account of the documents actually provided to PwC, and a separate appendix including refutation of Dr Holstrum's criticisms of misleading or incomplete production of information to PwC as a matter of fact, and in particular demonstrating that the allegedly incomplete or misleading aspects of the information provided to PwC were not not critical, or were remedied by the fact that PwC had the information, or the correct information, from other sources.

2223. Having gone through both the paperwork presentations and this commentary, I am broadly satisfied that these refutations are accurate and justified. My only concern has been that insofar as the fact that corrective or supplementary information which was only supplied to PwC with the papers for the Board Meeting of 13th November 2007 is relied on, I note that Mr Reville had formed his opinion previously, and did not attend that meeting as he was on honeymoon. I am not convinced that different or corrective information, not necessarily given with express reference to what it was correcting and at the last minute, would be sufficient to ensure reconsideration of an earlier opinion carefully and expressly formed on the basis of earlier information. I do not think, though, that this was what in fact happened in this case, however. I am satisfied from the evidence of Mr Reville, that none of the matters which Dr Holstrum criticises but which are refuted only on the basis of the provision of such last minute

information would or should have caused Mr Reville to revise the general opinion which he had previously formed, and which is what went forward in practice.

2224. On the evidence, the salient parts of which are mentioned above, I conclude, therefore, that PwC's endorsement as at 13th November 2007 of the expressed view of the Directors and Management of CCC that CCC was a going concern as at 30th September 2007 was a matter which CCC's Directors were entitled to take comfort from as supporting their own opinion, then and thereafter, that CCC was reasonably viewed as a going concern. By the same token, I am satisfied that it also provides valid objective evidence that CCC was reasonably so viewed.

2225. In all the circumstances, I therefore dismiss the wrongful trading claim with regard to October and November 2007.

2226. For completeness I make the following further incidental points and findings of fact.

2227. It does seem to me, from the evidence, that Mr Stomber regarded it as a mission to set out to persuade PwC that CCC was a going concern. This is partly just because Mr Stomber sees many business activities in a somewhat confrontational light. However, it was also because of his passionate belief that CCC really was a going concern. I find that he viewed it as a mission, not in the sense of seeking to fool or to manipulate PwC, but in the sense of ensuring that every bit of evidence which could be advanced in support of the contention that CCC was a going concern was put before PwC to full effect.

2228. I see nothing wrong with this. If the directors of a company form the view that it is a going concern, it does not seem to me that it is then their duty to remain neutrally aloof on any review of the point which may be conducted by the company's auditors, and still less to press the strength of negative factors which might support an adverse conclusion. Being of the view that the company is a going concern, they are entitled to present their reasons for this view to the auditors with all the support which they perceive can be mustered. Of course they must not mislead the auditors, but I cannot see that they are to be condemned for presenting positive arguments. It is the auditors' function, as Mr Reville stressed, to test the directors' propositions and satisfy themselves that they are justified. On the evidence, I am satisfied that PwC, in effect Mr Reville, who also brought in Mr Summa, an expert in capital markets to review the position, and the remainder of his team, did do that.

2229. Second, it was put to Mr Stomber that he had set out to mislead PwC in this respect. I make it clear that I accept that he did not set out to mislead PwC, but only, as was legitimate, to put forward the best case in support of his strongly held belief that CCC was a going concern, and of the market's current surprising failure to appreciate the intrinsic worth of CCC's assets.

2230. Third, whilst I note that the presentations made to PwC included Mr Stomber's "likely" and "downside" case scenarios containing references to CCC's selling RMBS in certain situations, I accept Mr Stomber's evidence that this was put forward as an illustration to indicate to PwC that CCC could, potentially, make such sales *at the losses there indicated* and still survive, by which I mean, remain solvent. It was a hypothetical case, and I do not find it to be evidence that Mr Stomber held a belief that such sales actually could have been made in general terms, at the particular time. This point has been considered in relation to the similar presentation made at the 13th November Board Meeting.

2231. Fourth, the Plaintiffs invite me to discount the mutually complimentary evidence between Mr Reville and the Defendants as to their respective co-operation and thoroughness. I have in fact taken no account of their respective opinions of each other at all. However, it does seem to me that if Mr Reville had not expressed confidence and appreciation of the co-operation and assistance which he received from CCC in carrying out his functions that would in all likelihood have been commented on adversely by the Plaintiffs as a significant omission.

13. The Claims: DECEMBER 2007

Did the Defendants culpably fail to review and change their strategy during December 2007?

General overview

2232. As regards December, the Plaintiffs repeat their complaint that the Defendants did nothing to protect CCC from its position of extreme vulnerability to market movements and repo financing risks, called no Board meeting to address these issues, and failed (therefore) to institute a programme of selling quantities of RMBS during this time.

2233. At the end of November, CCC's financing and liquidity positions had come under pressure with the investment banks' year end, and this was not expected to ease over the calendar year end, used by the commercial banks. However this had been catered for, to a degree, by the arrangement of some repo finance for 60 days, to straddle this period. The end of December and beginning of January are also, of course, a holiday period, during which there would normally be reduced activity in the market in any event. Indeed, there were no particularly notable matters in December 2007 except perhaps for the stalling of progress towards the ultimately ill-fated Wachovia $2Bn 364 day repo credit line.

2234. CCC's overall financial position during the month was largely flat. It worsened marginally on a comparison of month end figures, with recorded NAV going from $676,349,070 on 30th November to $667,659,278 on 31st December and liquidity down from $71Mn, including $40Mn still available from Carlyle (10.5%) to $62Mn (9.3%), but these changes are not large and, on their own, would not seem to be outside the range which might be expected from normal market fluctuation. The consensus amongst Mr Stomber and his senior management team remained that CCC's asset price ought to recover, the only disagreement being one of greater or lesser optimism as to when. During December, therefore, CCC largely marked time, pursuing the successful management of the two December repo rolls, and awaiting January, when markets would resume activity and there would be more information from which to plan the future. It was noted, however, that repo counterparties were tending to adopt even more defensive pricing marks, a tendency which now appeared to be motivated more by a self-serving desire to increase assets on their own balance sheets than any genuine perception of reduced value in the collateral.

Early December

2235. Mr Stomber was now emailing Messrs. Allardice, Conway, Hance and Loveridge with daily liquidity updates, Messrs Sarles and Zupon preferring less frequent information. On 3rd December, in reporting liquidity up by $6Mn to $77Mn million, Mr Stomber also reported small but potentially encouraging signs: that prices were improving on 5-year Agency debentures, which ought to assist CCC's asset prices by parity of reasoning, and later, that

Lehman had slightly improved their hotly disputed repo marks, because they acknowledged that there had been an improvement in market conditions in the past week.

2236. Mr Stomber also took stock of the situation, and on the same day wrote to his management team Messrs Greenwood, Trozzo, Melchior, and Ng, giving his views as to glimmers of improving signs for the prices of CCC's floater spreads – in essence, signs suggesting conditions for the hoped for flight to quality – and that a "snap back" of Agency floater prices could therefore be expected in January/February 2008, but he asked each for his own separate assessment of the Agency floater market and his opinions. They all agreed that an improvement was to be expected, although with varying expectations of when, and somewhat less optimistic views than those of Mr Stomber. They were in agreement that the key problem was lack of demand, and some pointed out that this was partly due to buyers having less access to borrowed funds, rather than having no appetite for the relevant assets. Mr Ng, from the marketplace perspective, commented that dealers were nervous about *"getting stuck with secondary inventory and limited to the amount of risk they are permitted to take"* and that the market had *"gone risk-averse for anything with a mortgage name*" regardless of the value in the Agency floater structures. Mr Trozzo said that this all pointed to the best course being to "*Let it happen. Let's get over the year end and re-assess rather than predicting the snap back to[o] early."*

2237. The Defendants submit that the recorded and reasoned views of the CCC management team at that time, as well as those of Mr Stomber himself, were cogent and reasonable as to the best course for CCC being to await the new year and then assess the situation.

2238. On the same day, though, Mr Trozzo emailed Mr Stomber to the effect that the negotiations with Wachovia for the $2Bn term repo facility were basically "dead in the water" and suggesting that CCC should be willing to take a $500Mn 364 day capped 3% haircut line from them direct, by getting them to see this as a graceful way out of their prior commitment. He made further suggestions on progressing negotiations with Lehman, Fortis, Barclays and RBS.

2239. Mr Stomber subsequently had an email exchange with another Carlyle manager, Mr Akerson, who had seen and forwarded, as relevant to CCC, an article in the Washington Post warning of the possibility that "*AAA rate[d] mortgage backed securities are not all that safe/robust.*" He explained to Mr Akerson the difference in quality, because of lack of credit risk, between CCC's Agency AAA rated floaters and other non-agency AAA rated floaters. When asked if CCC would therefore be relatively unaffected if the markets deteriorated significantly, he responded that it depended on what got worse, credit risk or liquidity risk, explaining CCC's dependence on its repo financing.

2240. On 7th December, Mr Stomber was able to report liquidity back up to $82Mn and an improved NAV, and also that Citi had said that CCC's repo lines should be steady over the year end-period. On 10th December, Morgan Stanley announced a further write down of $6.6Bn assets.

2241. CCC signed an MRA with Wachovia, but had yet to agree actual repo terms, and Wachovia seemed to be having some internal difficulties with the brokerage arrangements. On 11th December Mr Stomber proposed to Mr Burlingame that Wachovia should start with a $500Mn line, which CCC would like to have in place by 21st December, as a progress step and to save face all round. Further documents were exchanged over the next few days.

2242. Also on 11th December, the Federal Reserve cut interest rates by another 25 bps, bringing the Fed Funds rate to 4.25%. The general evidence suggests that whilst intervention from the Fed was both expected and welcome there is a consensus in hindsight, and there was a view at the time, that the Fed had been slow, and should have done more to help re-energise the markets. Mr Greenwood expressed such a view in an email to Mr Stomber.

2243. On 12th December Mr. Stomber reported to Mr. Conway that he believed that CCC would have sufficient liquidity through the year-end, but that the pressures on the banks' balance sheets were building, and he would like to line up a potential request for a further $50Mn loan from Carlyle, if necessary, whilst still confirming his view that CCC's floaters would make big price gains in 2008. He said that he believed that the Federal Reserve would have to do more to assist; he saw the market dynamics as not being about the value of the securities – there was no pressure for higher haircuts - but "*all about liquidity and fear*". He candidly said that in the circumstances he did not know what else to do but "*stick with the strategy of holding on, given we are at par on maturity*," and continue to work the repo dealers. The Plaintiffs point out that the obvious possibility of selling RMBS as an option was not mentioned or suggested for consideration here, as with his earlier reporting commentaries.

2244. The following day, the Federal Reserve announced the creation of a temporary Term Auction Facility giving banks the ability to obtain four to five week loans anonymously against a range of securities including RMBS. $40Bn was in fact injected into the markets on 17th and 20th December through this programme.

2245. On 12th December 2007, CCC Coinvest began purchasing additional shares for Mr. Conway, whose desired investment had not been fulfilled in the initial round of purchases. Ultimately, CCC Coinvest was able to purchase approximately $7Mn more in shares, bringing Mr. Conway's total further investment to approximately $7.8Mn.

2246. On 13th December, Ms Cosiol requested advice from Linklaters as to whether the additional proposed facility of $50Mn from Carlyle would require to be disclosed in a press release immediately or only if and when it was taken up. This was prompted by Mr Conway's concerned recollection of the unexpectedly adverse publicity which had been attracted by the news of Carlyle's initial $100Mn support for CCC. She was advised that this would only be necessary when the loan was executed. The correct interpretation of this is a matter of dispute between the parties, which I will have to mention later.

2247. Also on 13th December, Mr Stomber reported to Messrs Allardice, Conway, Hance and Loveridge, in advance of the 17th December repo roll, that arrangements were going well and CCC had negotiated an improved repo rate of LIBOR minus 9.5 bps, substantially lower (better) than in November. He reported that NAV had risen to $715Mn, but that the liquidity cushion had not shown proportionate improvement and stood at $69Mn. He explained that this was because "*[our cash]… is on the balance sheet of our dealers. Why? Because they can and CCC made a mistake of not having enough repo line availability to balance fear and greed".*

14th December - ALCO Meeting

2248. This meeting was attended by all the members of the ALCO committee, thus including Mr Stomber, and also by Mr Zupon and Messrs Loveridge and Sarles by telephone.

2249. Mr. Greenwood reported on market conditions. He noted that short-term rates recently had risen "*due to year-end pressures being exaggerated by the credit crunch*," but had retreated slightly following the Federal Reserve's recent rate cut. He noted that spread levels were at historic highs and that banks remained wary of lending to each other despite the encouragement of the Federal Reserve's actions. There had been a flight to quality in US Treasury Bonds, and US Agency Debentures (an even more risk free form of security than CCC's Agency RMBS capped floaters) and credit markets had reacted positively to the announcement of the Fed's TAF on 12th December. Trading in 7% floater caps was at the same prices as November, but he agreed with Mr Stomber's comment that trading was currently non-existent and everyone was simply looking to get through the year end.

2250. The various metrics in the "Risk Summary" Slide in the ALCO pack were reviewed. Mr. Trozzo gave an update on the status of repo negotiations, noting that CCC had agreed terms for 54% (roughly $11Bn) of its financing over the year end – in effect, the 26th December repo roll and beyond - and he expected the remainder to be successfully completed; CCC had completed terms for the mid-December repo roll with an average repo rate of LIBOR minus 10bps.

2251. Mr Trozzo gave an update on the status of the portfolio. He noted that there had been an "*uptick*" in CCC's NAV, which was shown in the ALCO pack to be at $712 Mn as at 11th December (as compared to $680Mn in late November). In contrast to the improvement in CCC's NAV, total liquidity had decreased from $84.4Mn (12.4 %) on 27 November to $69Mn (9.7 %) on 11th December, although Management was expecting a $6-8Mn improvement in the liquidity cushion after the next roll. Mr Zupon enquired about the reason for the disparity in the movements of NAV and liquidity and it was explained that

> "*despite improvements in CCC's mark-to-market and December estimated NAV, the liquidity cushion was still down for two reasons: 1) there is no price discovery as there is virtually no secondary trading for capped floater securities; and 2) dealers are still contending with year-end balance sheet pressures and therefore are grabbing liquidity* "*where they can because they can*", *i.e. fair and economic pricing of our capped floater securities is not their primary concern.*"

2252. On 14th December, Mr Stomber reported in a general email that the Agency floater market was effectively now frozen until, probably, mid-January. Whilst this cessation of activity over the Christmas and New Year holiday was nothing new, the appearances were that it would be particularly long that year because everyone was nervously waiting for others to buy, and by now they simply wanted to get away from it all. It did mean, however, that the repo dealers must have concluded that margin was therefore wide enough over the year end, although CCC would still have to negotiate the 26th December repo roll.

17th December - repo roll

2253. CCC rolled its repo successfully on 17th December and its liquidity rose by $5Mn, with no significant changes to its repo arrangements. Mr Stomber reported liquidity of $73Mn, and Mr Hance responded *"Nice work, next we sweat out January*". The next few days saw a modest improvement in NAV and liquidity, which naturally encouraged Mr Stomber. Concerns about the year-end pressures eased slightly. On 20th December, Mr. Stomber provided Messrs. Allardice, Conway, Nachtwey, Hance and Loveridge with another update on market conditions and CCC's liquidity, then standing at $78Mn. He observed that the spread between Agency floaters and 5-year Agency debentures, which was at an historic high, ought therefore to come

back in (he expected sometime in early 2008) and this would significantly improve the value of CCC's portfolio.

2254. At the same time, on 17th December, Mr Reilly of Wachovia was insisting that, with amendments having been made to the documents, Wachovia would need another legal review.

Mid-December 2007

2255. On 18th December, not having heard from Wachovia, Mr Stomber asked Mr Conway to call Mr Burlingame.

2256. More positively though, Mr Stomber was able to report an initiative to obtain tri-party repo, following a promising meeting with Bank of New York. Tri-party repo would involve BoNY connecting CCC with repo investors for a fee but without putting the loans on its own balance sheets. Tri-party repo would benefit CCC because it was understood to tend to be a longer tenor, with more stable terms, and because it removed the repo bank as middle-man with the potential to grab liquidity for itself by aggressive price marking. Mr Stomber explained that such arrangements had not, before August 2007, been competitive with the rates which banks were obliged to offer in the super-competitive area of 30 day repo, but by now, things had changed. CCC and BoNY signed a confidentiality agreement shortly afterwards, with a further meeting arranged for mid-January, in recognition of the realities of not being able to get much done during the Christmas holiday period.

2257. On 19th December there was another "bad news" announcement, this time with JP Morgan announcing a further write down of $5.7 Bn.

2258. On 20th December Mr Stomber, circulating his usual report, recorded liquidity up to $78Mn, good progress on securing repo finance for the final roll of the year, monthly income expected to be $21Mn or a 9% return on equity, and prices for Agency Debentures which (he estimated) made CCC's Agency capped floaters look cheap, and should therefore encourage demand.

2259. On the same day the Independent Directors approved the $50Mn increase in CCC's potential line of credit from Carlyle requested by Mr Stomber, and Ms Cosiol so informed the Board. It was stated at all points in the conversations, including where details were forwarded to the Carlyle Founders, that this was not expected to be taken up but was an insurance policy, especially in view of the imminent holiday period. It was also stated that there was to be "no disclosure". Mr Nachtwey queried that this presumably meant no press release, but there would no doubt be a footnote in TCG's audited financial statements, to which Mr Conway responded with a notably steely "*Not even that disclosure I think*".

2260. On 21st December 2007, Ms. Cosiol and CCC's Dutch counsel at Linklaters prepared a form to notify the AFM that CCC Coinvest's ownership of CCC shares had exceeded 15%. This form was submitted on 24th December 2007.

2261. Between 21st and 26th December CCC's liquidity fell once more, owing to margin calls by Citi and Lehman, made unsportingly on the morning of 24th December. These were paid.

26th December - repo roll

2262. This was completed smoothly. CCC rolled $410Mn of repo away from UBS to Bank of America, at UBS' insistence because of year end balance sheet issues. This was largely compensated by a roll of $360Mn away from Bank of America to JP Morgan, resulting in no significant overall change to arrangements.

2263. The next ALCO meeting was set for 27th December, but this does not appear to have taken place and has not been referred to in the evidence. On 28th December, CCC paid to CIM $6.3Mn for third quarter management fees and expenses and the $1Mn commitment fee for Carlyle's $100Mn line of credit. This reduced CCC's liquidity, to $56Mn. Mr Stomber reported this to Messrs Conway, Hance, Allardice, Loveridge and Nachtwey.

Position at the end of December 2007

2264. On 31st December, Mr. Stomber sent an email to the Board letting them know that CCC ended the year with $62Mn in its liquidity cushion. He also noted that CCC's "*[return on equity] for Q4 was in the slightly above 9 percent (annualized) range and we were able to weather 2007 to fight again in 2008 thanks to TCG's solid support*." He noted, though, that the first week of January would bring a distressed auction of $800Mn of Agency floaters by Citibank. In his evidence, Mr Stomber said that this auction was welcomed because of the price discovery information which it would give, as ammunition with regard to the pricing on CCC's portfolio. I suspect however, that this view owes something to hindsight, the result of the auction having turned out to be reasonably positive. To me, the tone of his note is a cautionary one, the obvious implication being that this would produce price discovery which might or might not be welcome, and would have to be coped with.

2265. The value of CCC's portfolio, according to its later Annual Report, was $21.71Bn with a NAV of $668.2Mn. The liquidity cushion then stood at 9.31% according to the 15th January 2008 ALCO pack. CCC had, $20.9Bn of repo funding rolled into January 2008 with $2.26 Bn of unused lines. Lines with Calyon, Citi, JP Morgan and Lehman (around 50%) had haircuts at least nominally lower than 3%, which was the nominal figure for all the remainder. Whilst the Defendants submit that the average repo rate was 2.6%, the Plaintiffs submit, I think more accurately and apparently taking these figures from CCC's own repo status reports that the average was 2.66% nominal, but that the effective haircut rate was 3.04%. CCC's leverage ratio, according to Professor Hubbard's calculation, was 32.5x.

The Claims - December 2007 - Summary of arguments

Plaintiffs' case

2266. The Plaintiffs rehearse the familiar complaints as before, namely that of the Defendants' not taking steps to reduce CCC's leverage and increase its liquidity by (in practice) selling large quantities of RMBS, and they argue that the need for this was so obvious as at CCC's year end, as to render the Defendants in breach of their duties.

2267. They argue first that the pressures on CCC and its asset pricing could not be dismissed for being simply and predictably caused by the passing on of the repo banks' year end pressures, because the Defendants themselves recognised, as can be seen in contemporaneous communications, that the situation was not the usual one, and was indeed very serious. The

adverse effects at this year end were significantly greater than usual and it was admittedly also not usual for the markets to completely freeze up out of "fear" at the end of a normal year. The Plaintiffs submit that this shows that the crisis was still very much brewing, and the Defendants were well aware of this, and wilfully or negligently closed their eyes to it and the need to take major steps to deal with it; this can be seen, for example, in Mr Hance's acknowledgement on 17th December that CCC would have to "*sweat out January*".

2268. They point to Mr Stomber's reference in his 13th December email to a "mistake" in not having enough repo availability to be able to move it around when repo lenders made unwarranted margin calls as another indication that CCC's parlous repo financing availability was appreciated, but nothing was done to alleviate this.

2269. They rely on the additional $50Mn loan facility requested by Mr Stomber in early December as further evidence of recognition of the gravity of the situation. They submit that Mr Conway's anxiety not to disclose this facility, and the eventual failure to do so until 28th February 2008 when it was actually used, was discreditable, and a breach of Dutch regulatory law, and that Ms Cosiol was at fault in failing to apply the advice previously given by Linklaters on 17th August 2007, that disclosure was required *"as soon as it may reasonably be assumed that the funding note will be executed*", which, they argue, was before 28th February 2008 and in fact when the availability of the facility was agreed. They also say that this reluctance to make any disclosure lends support to the view that the Defendants were fully aware of CCC's desperate and precarious position and were hiding or ignoring it.

2270. They argue that it is clear that the Defendants never compared the actual year end results of CCC with the predictions of Mr Stomber's proposed "business plan" presented at the 13th November Board Meeting. Had they done so, they would have perceived the vast divergence from his assumptions, which would in itself have suggested that Mr Stomber's predictions were not reliable. The situation was turning out to be significantly worse than he had been assuming or predicting, thus leading to the conclusion that other urgent action, namely the sale of RMBS, ought to be now considered. It was negligent not to have noted this and not to hold a further Board Meeting. This was was obviously required to be called, as a matter of good governance, to assess the situation.

2271. They point to CCC's financial performance indicators for the end of the year and that its unrealised losses on its portfolio had increased to $273Mn from $235.6Mn at the time of the November Board Meeting and $227.5Mn from even the end of September 2007. They point out that financial metrics known to reflect or affect CCC's prices (average price volatility and spreads, interest rate volatility and option adjusted spreads) had all increased, and this showed that the market, far from improving, was continuing to deteriorate. There had still been no "flight to quality" as regards CCC's assets, notwithstanding Mr Stomber's continual reference to expecting one.

2272. They repeat, therefore, their arguments with respect to November 2007 as applying to the circumstances of December.

Defendants' case

2273. The Defendants likewise repeat the arguments which they made with regard to November and earlier. They submit that nothing had materially changed; the choice facing the Defendants remained the same judgement call between adopting a strategy, on the one hand, of holding the

RMBS with a view to keeping capital losses on paper rather than crystallised and holding on long enough, with a business which was still generating profits, to get the benefit of the inevitable ultimate return to value (and as to which the risks lay in the question whether sufficient financing could be maintained), and, on the other hand, of selling RMBS with the consequence of locking in not insignificant losses for the objective of improving liquidity and reducing leverage and reliance on finance availability - as to which the risks lay in the fact that large sales would be needed to generate any worthwhile improvement in liquidity and these might unleash adverse and uncontrollable consequences by providing concrete adverse evidence of asset value, and/or laying CCC open to being seen as a vulnerable distressed seller.

2274. They submit that the calendar year end difficulties had been and were still reasonably perceived as being caused by the banks' usual year end pressures, but naturally exacerbated by current dislocated market conditions. It was reasonable to see this as has having been anticipated and to some degree forestalled by arrangements which had been made (60 day repo, etc) to ensure certainty of funding over the relevant period, and that even if the degree of exacerbation were greater than Mr Stomber and his team had anticipated, that was not of a sufficient degree to change the balance of the merits of the decision referred to above.

2275. They submit that the prompt confirmation of the availability of an additional $50Mn from Carlyle, far from being a fact which should have caused a rethink of the previously decided strategy, was plainly just a prudent fall-back, and in the event it was not even necessary to use it at this time; it is more correctly viewed as reassuring evidence of Carlyle support, making it unnecessary to take the unpalatable decision that selling RMBS was the only option. They submit that the allegation that failing to disclose this facility was a breach of Dutch regulatory law is wrong, or at least open to substantial doubt, on the Dutch lawyers' evidence - but it is in any event irrelevant, as it is not alleged to have caused any damage to CCC.

2276. They refute the submission that it was crucial that the Board compare actual results with the assumptions in Mr Stomber's proposed new business plan presented at the 13th November Board Meeting, submitting that there is no evidence that this would have made any difference to what occurred. They submit further that the virtual standstill of the markets in December was in itself a further good reason why any thoughts of selling RMBS would not have been appropriate at that time. They submit that the evidence of what was happening in the markets supported the view that on a day to day basis, so long as circumstances did not worsen significantly, CCC's financial position would gradually improve – it had done so in October and the early part of November and was therefore likely to do so again when the banks' year ends had been navigated. Discouraging figures in the present metrics being generated were, once again not of sufficiently serious practical effect that they should bring about a complete sea-change in the agreed strategy in the abnormally static state of the December 2007 financial markets. This was also a reason why it would still be premature to conclude that there was no prospect of benefitting from a flight to quality.

2277. In short, they submit that the Board and CIM were simply faced with a difficult situation. CCC needed the financing on which its portfolio had been built and well understood that it was in the midst of a period of increased stress on that financing, but which ought to be temporary - Messrs Stomber, Conway and Allardice all said as much in their evidence. It could attempt dramatic action to shift its business model in the midst of this stress, or it could do everything in its power to ride out this event, which it thought was likely to be of short duration. Had CCC's Board or Management concluded that the financing risk could not be managed, the only

course of action available at the time would have been to sell some of CCC's Agency floaters, but particularly during December 2007, when the trading markets had ground to a halt, this option was viewed as a last resort which the circumstances did not yet (at least) justify.

Discussion and conclusions – December 2007

2278. I turn as usual to the breaches of duty as alleged in the Cause against the individual Defendants in respect of this period from 1st to 31st December 2007. They are, as against the Carlyle Directors, the matters listed in Paragraphs 369T (duty of care) and 369U (fiduciary duty) of the Cause, and against the Independent Directors, the same matters using the same words *mutatis mutandis*, in Paragraphs 369V (duty of care) but (i) with the addition of an allegation at Paragraph 369W that they failed to prevent the Carlyle Directors from giving priority to Carlyle's interest over those of CCC and also including (ii) maintaining CIM's fee income, a portion of which would be distributed to the Independent Directors (Paragraph 369W). Once again these breaches are said to be as further particularised in Paragraphs 418A-N and 4124A-G, incorporated here by Paragraph 369Z.

2279. As before, the effectual breach of duty alleged against these Defendants can be distilled down to the allegations, now in Paragraph 369T.2 and 369V.2 but using the same mantra as previously, of

> *"failing to insist that CCC either (i) sell down its RMBS assets to generate liquidity and reduce leverage, and/or (ii) raise additional equity capital to reduce leverage and/or (iii) conduct a restructuring or orderly wind down".*

2280. However, the Plaintiffs' actual submissions with regard to this period, with more realism, contain no hint of any suggestion that raising equity capital was remotely feasible.

(a) Breach of fiduciary duty

2281. The allegation of breach of fiduciary duty is here confined to acting with the improper purpose of prioritising Carlyle's reputational interests in not having to disclose CCC's poor financial performance and thereby Carlyle's failure to make it a liquid investment company with a competitive dividend yield, and thus prejudice the pursuit of the "Carlyle Strategic Objectives".

2282. I can find no further evidence in relation to December 2007 which would or even might give me grounds for changing, in respect of this period, the conclusions which I have previously explained in rejecting similar allegations made with regard to earlier periods. Nothing further in the financial situation in December requires any further comment in this regard.

2283. I have also already said that I consider the allegation of an improper motive connected with bolstering the payment of fees to CIM to be unsustainable. I can see no evidence that any actions or decisions of any individual Defendant were influenced as an attempt to manipulate its affairs to enable CIM to claim fees, with or without the added allegation that a portion of these would be distributed to the Independent Directors.

2284. I therefore dismiss the claims of breach of fiduciary duty for similar reasons to those previously given.

(b) Breach of duty of care

2285. I have cited the familiar pleaded terms of the core breach of duty alleged above, and repeat the familiar points that this is the only effectual breach of duty alleged, that the matters pleaded in the remaining subparagraphs of Paragraphs 269.T and 269.V are neither alleged to, nor did, give rise to any damage to CCC, and that they can be no more than particulars of the core breach, at best.

2286. As to the core breach itself, having reviewed the parties' respective arguments and submissions, summarised above, I am not persuaded by the Plaintiffs' arguments and prefer those of the Defendants.

2287. Given that I am examining the Plaintiffs' complaints in chronological order, as I am doing in order to avoid unfairly applying hindsight, I have already found that the Defendants' reactions to the financial circumstance in which CCC found itself prior to December 2007 were not reckless or negligent. This means that the nub of the Plaintiffs' claim as regards December has to be, once again, that in the situation in which CCC then came to find itself the policy of holding RMBS and not selling was so patently the wrong course that it had *by then* become reckless or negligent. This means judging whether there was any sufficiently significant change in the general assessment of CCC's own financial situation and the impact of surrounding circumstances, which would demand a reappraisal and alteration of the capital preservation strategy. I am satisfied that they did not, whether the circumstances are looked at afresh generally, or only by looking to see if there had been any significant changes in that period.

2288. I am satisfied that there were no such changes, and that the considerations which drove the material decisions prior to December 2007 remained substantially and sufficiently the same. There was also, however, the added point that any attempt to seek to sell RMBS would have been impractical in the inactive markets of December 2007 (and indeed, that attempting to do so would in itself have appeared so remarkable, in those circumstances, as to increase the chances of causing CCC to be perceived as a distressed seller.)

2289. On the one hand, CCC had certainly not seen real evidence of any flight to quality and whilst Mr Stomber had consistently reported financial indicators which ought logically to have produced such a trend, and had reaffirmed his faith that it would occur, it had not happened. On the other hand, CCC had managed to secure affordable repo finance for that period, and was not incurring income losses. Its balance sheet position had remained relatively flat taking month end to month end, with fluctuations of value in between, but there was also the evidence that in the weeks prior to the impact of bank year ends, its balance sheet position had improved in the ways expected. Although in December conditions were difficult, this had been broadly anticipated and steps taken to meet the problems. I do not consider, therefore, that the further month with no major progress on the recovery front was a factor which ought to have caused the Board, or CIM, to reconsider the capital preservation strategy on the grounds that it was somehow not working, and it would therefore be right to consider, still less to put into effect, the alternative of selling quantities or RMBS.

2290. As regards selling RMBS, the previously appreciated disadvantages about doing so were compounded in December, I find, by the fact that there was not even a tolerably active market into which CCC could have sold RMBS. In those circumstances, even if the matter had been

actively considered, I have no doubt that a decision to defer any action into January 2008, at any rate, would have been taken, and would have been reasonable.

2291. I do find some inconsistencies in Mr Stomber's opinions as to the future of the market in his emails of early December 2007. He was not cross-examined about this, possibly because of the time constraints which his cross-examination had come up against. Looking at those emails, however, I take the view that the variations between gloom and optimism were once again Mr Stomber's personal reactions. I find that he was, at the same time, fearful of the consequences if the markets did not improve, but also quite convinced, and genuinely so, that CCC's capped floaters simply must begin to become appreciated as quality assets with a consequent recovery of their value/price. I am satisfied that this was the case even though (or perhaps because) Mr Stomber thought that market conditions might still deteriorate somewhat before they got better, a view which he certainly expressed.

2292. I do not find Mr Stomber's reference to a "mistake" in not having enough repo capacity to withstand the banks' greed and fear to be of any weight in support of the Plaintiffs. I find this to have been a throw away remark, even if somewhat bitter, as to lessons which might be learned in the future and in no way do I see it as an admission of legal fault.

2293. I do not find it lacking in due care, or even surprising, that the Defendants should not, during December, have formally re-considered Mr Stomber's business plan assumptions from the presentation to the 13th November Board Meeting. The business plan was concerned with illustrating ways and timings under which CCC might again get back to the stage of being able to reinvest. The actual events, on which they were receiving updates, were of more importance to the immediately central issue of CCC's continuing survival, and I am satisfied that, in any event, even if divergence between these presentations and reality had been focused on, and it had been concluded that Mr Stomber's illustrative predictions had been optimistic, this would not (and reasonably would not) have made a difference to the course actually taken on behalf of CCC in December, in practice.

2294. I am satisfied that Mr Stomber genuinely thought that the banks' seeking to improve their own year end positions was a temporary phenomenon, even whilst acknowledging that its effects would be more pronounced (worse) in the general background of the disturbed market. I am also satisfied that the other Board Members agreed with this view, and that it was reasonable to do so. I do not consider that the difficulties of securing further repo facilities from other lenders or obtaining significant longer term repo were such as to mean that it was only reasonable to abandon the capital preservation strategy in favour of attempting to sell RMBS. The course, once again, of seeking at least to get over December and into the new year before making any such decision was a reasonable course. CCC had managed to maintain its repo financing despite the difficult market conditions. It was reasonable still to see some hope of a line from Wachovia, even if no longer of the truly significant size originally expected.

2295. The Plaintiffs quote and stress, as they have done before, the ominous sounding metrics from amongst CCC's internal analytical papers, with the clear implication that the accumulation of these provided overwhelming evidence from which the Board should have concluded that action (implicitly, therefore, selling RMBS) should have been taken. It is, though, in my judgment, superficial to pay regard to such statistics on that basis, and I reiterate the points which I have previously made with regard to such metrics being an aid and a tool to assist managerial decisions, and requiring to be used with judgement. For example, apparent

"dramatic increases" in statistics such as APV, spreads, interest rate volatility, and OAS may show a high level pattern of increase but the significance of any such pattern requires interpretation as against other known circumstances; it is the underlying explanation for the pattern (if any) rather than the trend in the figures, which is the material which management needs to use in order to make the best judgement.

2296. As an example of this, the Plaintiffs stress that at this time the ratio of CCC's liquidity cushion to its 20 day VaR was 0.4x, the word "only" being implicit. The immediate impression is that such a small figure means that the position was extremely precarious. However, what that figure meant was that CCC's available liquidity was only 40% of the sum which CCC was calculated to lose on the assumption that it suffered the worst market conditions which had been experienced within the historic period of the data capture, and took no action to correct these effects for a period of 20 working days, or one month. Of course, *if that happened*, the metric showed that CCC was doomed, but the metric itself says nothing about the likelihood of either aspect – the degree of market disruption or the lack of any defensive action then being taken for a month – actually happening. That is a matter which obviously affects the regard which it was necessary to give to this metric, and that assessment is a matter of managerial judgement. In the circumstances, therefore, I do not find it either surprising, or evidence of culpable lack of care, either that such metrics were not the subject of any recorded close consideration amongst the Defendants or Management, or that there is no record of their affecting the decisions taken.

2297. All in all, therefore I do not find that it was a wrong decision, and therefore still less an unreasonable decision, not to make any change in the capital preservation strategy during December 2007. It would, in any event, have been reasonable to defer any such decision into the New Year.

2298. This is sufficient for me to dismiss, as I do, the Plaintiffs' allegations of breach of the individual Defendants' duty of care in respect of 2007.

(c) Contractual breach of duty by CIM

2299. For reasons previously discussed, this being a claim with regard to strategy and advice against CIM, (rather than a claim about execution of transactions) it depends materially on the selfsame facts as those alleged against Mr Stomber under the complaint with regard to his alleged breach of his duty of care as a director of CCC. For the same reasons, it therefore fails.

(d) **Wrongful trading**

2300. With regard to the wrongful trading allegation, the position up to and including December 2007 remained that at all times that CCC paid its debts (repayment of repo finance and/or margin calls), had shown a continuing ability to secure the means to do so, and was in fact otherwise making profit from the transactions which it undertook. It was therefore not insolvent. The only basis on which the Directors could therefore incur liability for wrongful trading was if they ought to have concluded that there was no reasonable prospect of CCC's avoiding going into insolvent liquidation. This depends entirely, as discussed before, on whether they ought to have concluded that there was no reasonable prospect of CCC's continuing to be granted sufficient affordable finance to be able to finance its assets, with if

necessary, the backstop support made available or likely to be made available by Carlyle in respect of resources to meet reasonably conceivable margin calls.

2301. I am quite satisfied that there was no reason to conclude that CCC had no reasonable prospect of being able to continue in "safe mode" on this basis. I therefore dismiss the wrongful trading claim as well.

14. The Claims: JANUARY AND FEBRUARY 2008 - and beyond

Did the Defendants culpably fail to review and change their strategy between 1st January and 27th February 2008?

General overview

2302. As regards January and February 2008, the Plaintiffs repeat their complaint that the Defendants did nothing to protect CCC from its position of extreme vulnerability to market movements and repo financing risks, called no Board Meeting to address these issues, and failed (therefore) to institute a programme of selling quantities of RMBS.

2303. At the end of December 2007, CCC had a net asset value of $667,659,278, much as it had been at the start of the month, although it had had better days in the second week of December, and a low point on Christmas Eve. In January there were also fluctuations, but with a rising trend, reaching a high of over $780Mn through the second week of February, which only fell significantly at the end of the month. The liquidity cushion rose from $62Mn (9.3%) at the start of January, to $112Mn (16%) on 10th January and remained at or above this level until 20th February when it fell to $104Mn (13.4%). It closed the month at $69.3Mn (10.4%). However, the figures for the last week or so of February are erratic, reflecting the beginnings of the market turbulence which was then imminently to cause CCC's collapse.

2304. None of this, though, was predicted at the beginning of the year, which started on a more positive note, with the increasing intervention of the Federal Reserve from December and continuing in January being seen as a positive measure for CCC, for reasons explained below. Once the markets got going in January, discussions and negotiations with CCC's repo lenders broadly progressed well, although there were individual ups and downs.

2305. There were no particularly noteworthy events in this two month period, a broad account of which is as follows.

Early January 2008

2306. On 3rd January, Citi auctioned approximately $800Mn of Agency floaters, another of the Westways auctions previously mentioned. It was apparently successful, and Mr Stomber viewed this with pleasure (and I am sure also relief) for the fact that it showed some liquidity in the markets, provided auction price discovery of which there had apparently been none since 4th October, and gave a positive note to the beginning of the year. He made it clear in his oral evidence, however, that this sign of liquidity was not on its own sufficient to suggest that there was now enough liquidity in the market to make it feasible or safe to sell off large quantities of CCC's RMBS. The general target which the Plaintiffs say should have been aimed at, it will be recalled, was $10Bn.

4th January - ALCO Meeting

2307. This was attended by the usual official members, and also amongst others, by Mr Zupon and Mr Rella.

2308. Mr Greenwood reviewed various aspects of the markets, including the effects and implications of the Westways auctions the previous day, analysing their results. Mr Stomber noted to the meeting that this auction might lead to an opportunity to recover margin from repo partners in the coming weeks.

2309. The importance and positive effect of reductions in interest rates, made by the Federal Reserve in December, and the anticipated beneficial effect of this in increasing prepayment speeds, which would produce both natural deleveraging for CCC and increase the investment's attraction, was noted and discussed as a positive development, with Mr Stomber explaining that this ought to result in an improvement in CCC's asset prices.

2310. As usual, the five factors which were seen as drivers of the price of CCC's securities were reviewed. Discussion of CCC's repo lines was to the effect that CCC had some headroom as regards the next repo roll ($2.3Bn) and that there were more lines expected. CCC's repo position was thus seen as currently being on a sound footing.

Early January continued

2311. On 7th January, Mr. Stomber circulated to the Board commentary from a Goldman Sachs analyst, commenting positively on the Westways auction result and opining that it was not surprising that balance sheet should be deployed in investing in Agency floaters. Indeed, this did, in the event, mark the start of an upward trend in the accepted prices of CCC's RMBS for several weeks, with a notable initial improvement in liquidity from $86Mn to $112Mn over 9th and 10th January.

2312. The scheduled meeting with BoNY as regards the potential for a tri-party repo agreement was fixed for 8th January 2008, with Mr Stomber making encouraging reports as to BoNY's willingness to assist, although he also expressed the general view that he could not see how there could be a "soft landing" in the markets.

2313. On 10th January he also reported to the Board that Calyon and ING had agreed to consider increasing the size of their repo lines, and reported a sense that, now over the year end, dealers were taking a more positive approach, recording that it was a "*good day for CCC*". Mr Conway wrote an encouraging response, commenting that they were still focused on survival, but would soon be focused on making money and paying dividends – a response which then prompted the serious Mr Stomber even to suggest some parameters for this, although agreeing *"no dividend on borrowed money".*

2314. Around this time, Management scheduled meetings with Barclays and RBS regarding the possibility of establishing repo lines with those institutions.

2315. A new "repo committee" chaired by Mr Stomber but including Mr Trozzo had been formed within management, to meet often, with its agenda being to progress negotiations with BoNY, Calyon and ING, Wachovia, RBS and Barclays. Negotiations with BoNY were continuing on this and the following day. However Wachovia at this stage formally declined to grant CCC

the $500Mn 364 day repo line which they were now seeking. Wachovia blamed balance sheet constraints and the amount of capital it would require. Mr Stomber thought they had miscalculated and sought, but unsuccessfully, to persuade them to change their position.

2316. Lehman, hitherto a main repo lender to CCC at $3Bn with a haircut nominally at 2%, but with a marked tendency to increase this by the backdoor method of aggressively low pricing, now formally demanded a haircut of 4%. They were alone in doing so, though, and Mr Stomber, Mr Hance and Mr Conway all suspected that this attitude owed something to unrevealed internal issues within Lehman itself. CCC decided that it would roll most of its repo away from Lehman rather than accede to the unacceptable 4% haircut ticket, and there was negotiation about this. Mr Stomber played the Carlyle card with Lehman, expressing willingness to go to 3% but not above. The eventual result was that it was agreed that CCC would roll its repo away from Lehman over the following two rolls, reducing the line eventually to $1Bn, to which Lehman agreed to apply a 3% haircut. CCC hoped to transfer the bulk of this funding to the apparently promising new tri-party arrangement with BoNY.

15th January - repo roll

2317. With the challenging stance of Lehman, the roll was accomplished by CCC rolling $480Mn of repo away from Lehman, principally to Citi and ING, and agreeing a 3% haircut with Lehman on the remainder, with agreement that there would be a further roll away at the next roll. Mr Stomber reported on the state of the repo lines and negotiations to Mr Conway (who was in Japan), Mr Hance and Mr Allardice, including receipt of an approach from Calyon for more business. Mr Conway, responded in his usual one-liner style, that they could use the good news but added, in a comment on which the Plaintiffs lay stress, that "*you and I knew it would get ugly, and it is. It will get worse much worse*". As his email began with the comment that he had just read the papers, I interpret that as a reference to some bad financial news in the press.

2318. That day, CCC paid back $20Mn of the Carlyle revolving credit, reducing the unused portion from $40Mn to $60Mn.

2319. On 17th January Calyon agreed to an increase in CCC's repo line by $1.3Bn, at a 2% haircut. The Defendants point out that an internal Calyon memorandum, not, of course, known to CCC at the time, shows that this was done with full knowledge of the suspension of CCC's minimum liquidity cushion requirement and its leverage ratio of 32x, and in terms which showed that this increased facility was a recognition of both the quality of CCC's RMBS assets and its support from Carlyle. It is suggested by the Defendants that this was an implicit endorsement of the capital preservation strategy.

18th January - ALCO Meeting

2320. This was attended by the formal committee Members and also, amongst others, by Mr Allardice by telephone, and Mr Rella.

2321. Mr. Greenwood and Mr Trozzo informed the committee that there was increasing talk in the market that the Federal Reserve would cut interest rates significantly in January and probably even further later on. Again, the importance of increasing prepayment speeds as a benefit for CCC's position was discussed, and the five factors which were the understood drivers of CCC's asset prices were considered, as was usually done at each meeting.

2322. On 22nd January, the Federal Reserve did cut the target federal funds rate dramatically by 75 bps to 3.5%. Mr Stomber wrote a positive email to the Board, noting that CCC now had $123 million in liquidity, and that this was expected to rise the following day in consequence.

2323. At about this time, though, Mr Conway drafted his annual memorandum to all Carlyle Investment Professionals, acknowledging the seriousness of the current financial situation generally and commenting that he thought that "*we are much nearer the beginning than we are near the end*".

2324. On 23rd January, Mr Stomber was able to report an increase in liquidity, although only of $1Mn, but also positive news for the 25th January repo roll. Morgan Stanley had agreed to provide an entirely new $600Mn line at a 3% haircut and ING had increased its line by $500Mn and UBS by $200Mn, also at 3%.

25th January - repo roll

2325. This roll was accomplished with the use of the additional repo lines just mentioned and the additional $1.3Bn from Calyon. CCC had increased its repo lines by more than $2.5Bn, and added another repo lender. This was positive. However, counterbalancing this, it had also had to complete the move away from Lehman, losing $2Bn of capacity in that direction, such that the net result was only slightly improved.

2326. On 29th January, Mr. Stomber reported to the Board that the parties were "*moving at full speed*" to get the necessary documentation in place following BoNY's resolution of a technical issue with its ability to process repo for CCC. He summarised the benefits of tri-party repo and reiterated his belief that a deal with BoNY had the potential to be "*transformational to the future of CCC.*" Board Members were seemingly impressed and delighted (though Mr Sarles, Mr Hance and Mr Allardice said in evidence that they had been sceptical about whether this repo finance would actually come to fruition). It was therefore all the more disappointing no doubt, when this initiative eventually came up against problems.

2327. On 30th January the Federal Reserve further cut the target federal funds rate by 50 bps to 3.25%.

31st January - ALCO Meeting

2328. This was attended by the usual committee members but no other Board Members.

2329. Both Mr Greenwood and Mr Stomber commented on the Federal Reserve's apparent policy and noted positively that the Fed seemed to be seeking to be proactive to stimulate the economy, and that lower rates were essential to "repair" the commercial banking system. The reduction in rates was regarded as helpful for CCC, because of its tendency to encourage prepayments. Unlike the investor who usually does not want to receive his capital back at a time when he can no longer (by definition) invest it at such beneficial interest rates, CCC, in capital preservation mode, welcomed the prospect of more capital being repaid, importantly, at par. There was general agreement amongst the Defendants (not only Mr Stomber, but also, expressly in their evidence, Mr Conway, Mr Hance, Mr Allardice, Mr Zupon, and Mr Sarles) that this was understood to be the case at the time.

2330. I understand that this positive aspect was also expected to benefit prices in the secondary market, because the securities were currently priced below par. Mr Stomber's explanation was that

> "*[i]f prepayment speeds increased, prices for these securities should increase because holders of the securities would receive principal payments more quickly and at par.*"

2331. I confess that I cannot readily see the logic of this for the general market as compared to CCC's peculiar position. It would seem to depend on how far the perceived likely percentage of prepayments at par, would make the purchase of the whole bond at a price higher than its current (below par) market price an attractive proposition. I do not think, though, that I need to explore or understand that point for my purposes here. This was the position generally understood by Mr Stomber and CCC's Management, and at the meeting it was noted that dealers were saying that they had now begun to notice an increase in floater activity, and that the effect of increased prepayment speeds would likely be felt significantly in March or April.

2332. Mr. Stomber reported these positive predictions to the Board members that same evening. He was also able to report that the liquidity cushion had risen to $127.8Mn, just less than 19%. He expressed the anticipation that it might reach $170Mn by the Board Meeting scheduled for 27th February. He and Messrs Conway and Hance considered that this was positive evidence that, now that the pressures associated with the banks' year ends had been withstood, CCC was back on the track towards the recovery which it had shown from September through to early November 2007.

Early February 2008

2333. At the start of February, CCC's NAV had risen to $682Mn (Mr Stomber reported $686Mn, but this difference is immaterial) and its liquidity to $127Mn, (18.8%), and CCC's repo capacity, marginally improved over January, showed prospects of further improvement with the anticipation of the tri-party arrangement with BoNY.

2334. On 6th February Management met with BoNY representatives to work on the project, with Mr Stomber reporting to the Board that evening that the talks had been very constructive and CCC was sending to BoNY a letter of intent with regard both to the tri-party repo arrangement (yet another advantage of which was that BoNY would use IDP pricing, which would reduce difficulties with unmatched values as regards margin calls) and also to moving CCC's clearing business to BoNY, and away from Lehman who, it will be recalled, had been being somewhat "difficult". BoNY would apparently welcome CCC's Agency floaters as good collateral for "*these difficult times*". Mr. Stomber said that he expected to contact the first 15 investors within 48 hours. Mr Hance, perhaps with a note of caution, replied that the "*conversations directly with the investors will tell you if this is for real*".

2335. In the light of positive developments, Mr. Stomber, always anxious to move quickly and impress his superiors that he was thinking ahead, recorded in an email of 8th February to Mr Conway his thoughts as to when CCC might be in a position to start making new investments again, though noting that CCC did not yet have the capital to do so, and also as to dividend policy. He recognised the major risk of starting to buy assets too early, before fundamental economic issues had resolved themselves, and noted that the banking system was still "fragile". He stated that no matter what the state of CCC's liquidity, management would not recommend a dividend payout of more than 50% (presumably of net income) and maybe zero.

Whilst this is, of course, evidence of the consideration of potential dividend payments which the Plaintiffs have roundly criticised for even existing in this case, I find this email to show Mr Stomber balancing the need to impress Mr Conway that he was conscious of the imperative to pay dividends which is what would make CCC a successful entity, against also impressing him that he (Mr Stomber) would be very responsibly cautious. The reference to "whatever" was CCC's liquidity reflected, I find, an anticipation that the figure would be high rather than low.

2336. On 8th February Mr Stomber reported an increase in CCC's NAV by $98Mn in two days to a total of $788Mn, attributing this to rises in price because of the effect of higher prepayment speeds. Mr Stomber says, and I accept this, that this improvement was all in line with the effects which he and his team had predicted in December and January would arise from reduced interest rates, and this gave him encouragement and confidence. By this date, CCC had also reduced the used amount of the Carlyle revolving credit to $10Mn.

2337. On 11th February, Mr. Stomber made his first five calls to the investors on BoNY's list, but from this point matters began to unravel. His reception was such that he concluded it was "*not a good start*" because BoNY had not forewarned the investors of CCC's potential call to them. The following five calls were slightly more positive.

2338. Mr Burns of BoNY left a voicemail message for Mr Trozzo, saying that such arrangements did have to be lined up, whilst understanding Mr Stomber's anxiety, and offering to come and talk the following day, to discuss. He followed up with an email the next day warning that the process was sometimes a negotiation with the investor, who would have to carry out its own due diligence and suchlike, and whose parameters for an acceptable counterparty might have changed in the environment of the times. He specifically warned that

> *"…An investor that would accept non-rated companies a few months ago may have changed their requirement so you may run into a name that we think is OK but later find out its an issue*."

2339. By 13th February CCC's liquidity had increased steadily, almost day by day, from $134Mn on 6th February to $151Mn on 13th February, reflecting return of margin on increases in repo price marks. In an email to Mr Stomber of that day Mr Hance said that "*[b]oth liquidity and NAV are improving as you predicted*." Mr. Stomber responded that "*[h]ope is not a plan, but it occasionally works.*"

2340. The Plaintiffs have lighted on this comment as a recognition that CCC had not really had any proper plan at all, and had been operating haphazardly and with reckless disregard of the factors which ought to have driven it to a different and positive course of action, namely selling RMBS. I do not read it as such however. The Defendants submit that it was just a response of modesty, and I accept this. For perhaps the first time in several months, Mr Stomber had seen significant movements in CCC's position which bore out the opinions and predictions on which he had based his advice to others, and had probably received, for the first time, a complimentary acknowledgement which he actually felt he deserved, rather than just someone being encouraging. I am quite satisfied that this was just a response covering awkwardly felt gratification, and nothing to do with any admission that previous policy had been irresponsibly based on nothing but hope.

14th February – ALCO Meeting

2341. On 14th February 2008, there was an ALCO meeting at 9.30 am, attended by Messrs Trozzo, Stomber, Greenwood, Melchior and Buser as members, and also, amongst others, Mr Ng and Mr Rella, and with Mr Allardice and Ms Cosiol in attendance by telephone. The Minutes suggest a more up-beat tone to the meeting as participants discussed the economic indicators affected by the Federal Reserve's intervention, and implications for the future. The Committee discussed the reasons for CCC's increasing NAV and liquidity, which by then stood at $785Mn and nearly 20%, respectively. Mr. Greenwood explained that CCC's pricing service, IDP, had factored the increasing prepayment projections into its pricing model, leading to the rapid and significant increase in Agency floater prices at around 8th February, and that as a result as at 12th February, the RMBS portfolio's year-to-date unrealised gains were up to nearly $107 Mn. This explained why margin had been returning to CCC in substantial amounts. It was confirmed that repo financing for the next roll was secure with rates locked in for one month, and that there would be no room for rate negotiation because the Federal Reserve was not due to meet again until 18th March.

2342. However, that same day, there was something of a reverse in the positive signs in the market, with traders reporting adverse market conditions and volatility suggestive of more problems to come. Significantly for present purposes, there was a surge in selling in the RMBS sector without adequate corresponding demand. This drove down prices, although it does not appear to have affected CCC's NAV figures, which were based on IDP pricing, for another few days. IDP pricing inevitably tended to lag behind actual transactional evidence.

2343. Analysts' comments at the time are written in the usual jargon of the markets, but the fundamental problem appears to have been recognised as being that banks were not able or willing to lend, owing to pressures on their own balance sheets and capital ratios, arising because so much of their assets were in practice turning out to be "toxic waste". This would, on the evidence, be the notorious sub-prime derivative bonds - debt obligations which were increasingly going bad, and the full extent of which, as part of the wider ABS market, had still not yet really emerged.

2344. Mr. Stomber now wrote an email to Mr. Conway with some general thoughts on market conditions, now rather pessimistic and with a lugubrious reference to this not being the first quarter of 2008 but the fifth quarter of 2007. He commented that he saw "*nothing positive*" for the US economy as a whole, and that the signs of economic deterioration made him "*worried about repo line availability".*

2345. On 14th and 15th February, CCC received substantial margin calls totalling $39Mn from Bank of America and Deutsche Bank, supposedly due to a dispute about pricing, but interpreted by the cynical Mr Stomber, in a reporting email to Mr Conway, as likely to be "*a new wave of collateral grab",* given that further write downs from the financial institutions were expected. He described credit issues as holding down prices in market sectors other than just risky sub-prime and expressed the laconic doomsday view that *"the financial system is crippled*". Later he remarked *"I think the near term makes or breaks us*".

2346. The dispute with the banks about pricing was plainly compromised in some way, as CCC's liquidity only dropped from $159Mn to $127Mn, but Mr Stomber saw the following week as likely to be crucial.

15th February – repo roll

2347. The 15th February repo roll was nonetheless accomplished with little change, CCC rolling just under $500Mn away from Morgan Stanley to Deutsche Bank.

17th – 24th February

2348. In an email of 17th February, as the markets deteriorated further, Mr. Stomber wrote to Mr. Conway commenting that the economy appeared to be "*near or at bottom*." When Mr. Conway asked, on 18th February, how Mr. Stomber thought that might affect the pricing of CCC's assets and its access to repo lines, Mr. Stomber acknowledged that the pressure on banks could affect availability of financing, but he thought that further government intervention to stabilise the markets was likely, and that CCC's repo lines would hold. His belief was that CCC would be "OK" because of its association with Carlyle, and if it survived through the quarter year end for the banks, then it would have "*made it*."

2349. On 20th February Mr Conway had an exchange with Mr Duffy of Bank of America, in which the latter commented on the poor markets and lack of interest in even Agency RMBS, and observed that he had commented a week or so ago to one of CCC/CIM's team that *"the best hedge [was] to sell, and it [made] sense to do so now*." Mr Conway's response was "*Hear you, but. . .*" .

2350. The Plaintiffs rely on this email as evidence that at that time the general wise view was to sell, and CCC ignored it. Mr Conway explained his response as meaning that it was easy to suggest selling, but another thing to find a buyer at a reasonable price and to sell in a market where prices were declining without triggering further declines or margin calls; in other words his response had been a coded reference to the various difficulties perceived about CCC's selling RMBS which had affected its decision not to do so before.

2351. Mr Stomber updated his liquidity report to Messrs. Conway, Hance, Allardice, and Loveridge, noting that Deutsche Bank and Bank of America had generated margin calls which had reduced CCC's liquidity to $104Mn, down $23Mn from the previous day, and repeating the *"fifth quarter of 07*," quip. CCC now began to draw funds back down under the Carlyle revolving loan facility. As ever, though, Mr Stomber added a brighter comment that margin calls and CCC's liquidity position "*could all reverse in the next 5 days*," and that he thought this was a real possibility given how quickly market conditions had shifted in the last few weeks.

2352. Mr. Hance was surprised at these sudden adverse market developments, and could not understand why there was not a flight to quality and/or an improvement in prepayment speeds, asking how far apart the repo lenders' marks were from CCC's own FT pricing. Mr Stomber replied that this was, collectively, about $100Mn.

2353. Mr Conway says that although he felt similarly unsettled about the worsening market, he believed that CCC was then in a better position to withstand adverse market conditions than it had been in late 2007 and did not think it was facing an imminent threat to its survival. Comments about "*the world … coming to an end"* are quoted from this exchange of emails by the Plaintiffs, but read in context, they seem to me to have been ironic.

25th February – repo roll

2354. CCC completed the 25th February Fannie Mae repo roll with no significant changes to its repo arrangements or sources, the only feature being the familiar one of unfavourable dealers' marks.

2355. On 25th February, spreads continued to widen in the light of banks' balance sheet constraints and the growing supply of Agency RMBS in the market. Mr Stomber reported on the still deteriorating market conditions to Messrs. Conway and Allardice. Mr. Conway responded that, given these developments, he did "*not see how we can pay a dividend*," and that he thought Carlyle should not take any incentive fee, despite the hard work everyone had done. Mr Stomber replied that CCC was objecting to what he saw as unjustifiably low pricing by some repo lenders, but that it was likely to take two weeks to address the issue effectively with them.

2356. Also on 25th February, Mr. Stomber wrote to Messrs. Conway, Hance, Allardice and Loveridge reporting that CCC's liquidity had now fallen to $88Mn, based on the perception that repo dealers were very nervous and were therefore operating "*herd fashion*". Reiterating his concerns in a further email that day, he nonetheless said that these were tempered because of small signs of "*repair*", and indications that the Federal Reserve was now more attuned to the issues in the repo market.

2357. Up to the end of February, BoNY and CCC were still working on documentation for the tri-party agreement, and were making plans to contact another round of investors, although this project did not survive the adverse events of the very end of February itself.

26th February - Audit Committee Meeting.

2358. The Audit Committee met on 26th February 2008 to review CCC's 2007 year-end financial statements, including the MD&A and CEO letter, in order to ensure that those documents accurately described CCC's financial condition. Mr Stomber, Mr Conway, the members of the ALCO committee and Mr Reville of PwC, together with others, also attended.

2359. After lengthy, and I think anxious, review and discussion, the Audit Committee ultimately approved the financial statements, CEO letter, and related disclosures, including representations about Management's expectations for increased prepayment speeds and recent actions by the repo counterparties that had reduced CCC's liquidity.

2360. Mr. Reville reported that PwC was prepared to issue an "*unqualified*" audit opinion, meaning that there were "*no uncorrected misstatements and no audit adjustments*." Mr Reville confirmed that, owing to the continuation of the general liquidity crisis since the events of August, PwC had once more independently confirmed Management's pricing of CCC's securities and found the result to be virtually identical. In this instance the final discrepancy over the whole portfolio was $154.

2361. The Committee discussed Carlyle's decision to waive its entitlement to incentive fees for the fourth quarter of 2007, in the light of the anticipated decision by the Board not to pay a dividend. The Committee concluded that CCC "*had 'sufficient' liquidity to pay a dividend*" but that it "*wasn't prudent to do so because of the volatile markets*." It did so after weighing the effects of not paying a dividend on the stock price as against the effects of paying a dividend on the attitudes of CCC's repo counterparties.

26th February - Informal voting directors' meeting

2362. Later that night, before the Board meeting the next morning, Messrs. Conway, Hance, Allardice, Sarles, and Loveridge—CCC's voting directors—met for dinner to have a high-level discussion about CCC's future. This meeting had been planned and proposed by Mr Allardice at the time when it seemed that the situation had turned somewhat for the better and the capital preservation strategy was working, such that it now appeared to be the time to discuss views about the future of CCC.

2363. Messrs. Stomber and Zupon, were not present. It is suggested by the Defendants that this was because they each had managerial responsibility for, and thus had vested interests in, particular components of CCC's portfolio, and it had therefore been decided that the voting directors should meet alone to allow them to discuss candidly matters such as a potential change of asset mix and general investment strategy, which might well have consequences for whether CCC's then current Management would be retained. However, I think that is not the whole story. I find that this was really aimed at Mr Stomber, and that Mr Zupon was excluded for presentational purposes. I find this, first, because Mr Zupon's position in Carlyle was clearly secure on any basis; only Mr Stomber's position was dependent on CCC. Second, Mr Stomber had shown himself to be a prickly personality, especially when he felt threatened (as had happened, for example, at the 13th November Board Meeting). It would not have been presentationally possible to hold an informal meeting excluding only Mr Stomber and it was therefore more diplomatic to exclude Mr Zupon as well, on the basis that this could then be portrayed as simply a discussion of the voting directors, who were, at least in theory, those more distanced from CCCs every day affairs.

2364. The ever blunt and to the point Mr Sarles had prepared a list of points which he wanted to see discussed, and he took this with him. Amongst these was the issue of financing; it was his view that if CCC were continuing to finance mortgages then there had to be a better way than using 30 day repo. The evidence is that at the dinner, the group discussed financing options for Agency RMBS (as Mr Sarles recollected), the credit business, dividends, when CCC might begin investing again, and whether to shift the business model away from an RMBS-focused portfolio. In response to questions from the Independent Directors, the Defendants say that Mr. Conway reiterated that Carlyle would continue to support CCC, both from a financial and operational perspective, as it had since CCC's inception. The Plaintiffs say that, on examination, the evidence is more equivocal; Mr Conway was reluctant or avoided committing such support to an actual figure, and it was obvious that the accounts consolidation issue was going to be a potential stumbling block. They say that the other voting directors should have taken no comfort from Mr Conway's affirmation, even if it was given.

2365. The outcome of the dinner was a decision that, for the short term, CCC should continue with the capital preservation strategy, and the company would revisit the question of a long-term investment strategy after it had accumulated sufficient resources to start buying new assets. I am told that it was agreed that Mr Stomber and his team had been doing a good job managing CCC through difficult circumstances, and the directors retained full confidence in him, but that if CCC pursued a substantially different investment strategy in the future "*Mr. Stomber might not be the right person to lead the company*." In the meantime, Mr. Hance was to speak with Mr. Stomber to ask him to prepare specific proposals for the Board's consideration about the future direction of CCC.

27th February – BOARD MEETING

2366. CCC's Board met the next day, 27th February 2008. The Plaintiffs invite me to note (as I do) that the Minutes in the bundle are a version which went through many amendments by both the Directors and their lawyers. I have therefore looked also, and primarily, at the redoubtable Ms Cosiol's handwritten notes.

2367. After opening the meeting and making certain formal appointments, the Board discussed the documents to be included in the Annual Report and Accounts, and especially the need for updating information to reflect the situation up to the moment of its release. The general concern of the meeting was to ensure that, with the changes in circumstances over the previous two weeks, all the material contained in these documents was fully accurate and presented clearly for investors. The discussion began with a review of the proposed CEO letter, and moved on to the MD&A, and then to the Financial Statements themselves and the Annual Report incorporating PwC's review as auditors.

2368. Amongst matters recorded as discussed, points of particular relevance are that in the light of the worsening market conditions Mr. Conway informed the Board that Carlyle was amenable to increasing the size of the revolving credit facility by $50Mn, if needed. This was a repeat of the increase lined up but not used in December 2007 because it was not needed. The December authorisation was then reaffirmed by resolutions of the Independent Directors and the Board. The availability was also extended to 1st July 2009.

2369. In line with the prior day's discussion at the Audit Committee meeting, and in conjunction with CIM's waiver of its incentive fee for the fourth quarter of 2007, the Board approved a proposed amendment to the IMA whereby CIM would not earn an incentive fee for any period in which the Board did not declare a dividend. The Board believed this change would benefit shareholders and Mr Conway commented that he thought this change was fair; if investors were not getting a dividend, then CIM had not really earned an incentive fee. In conjunction with this the Board discussed CCC's dividend policy and reaffirmed that whilst they believed CCC had sufficient liquidity to pay a dividend, they did not feel that it was prudent to do so and would not declare a dividend for the fourth quarter of 2007.

2370. The MD&A recorded that Management and the Board were continuing to analyse the appropriate liquidity cushion. The reason for this was that one could not determine an appropriate liquidity cushion until one had both analysed the liquidity crisis which had required its use originally and determined an appropriate prospective business model, both of which were not yet possible because markets had still not shown signs of being settled into a state which could be treated as normal. The Board also discussed the recent cut in interest rates by the Federal Reserve and how CCC might be affected as a result.

2371. Moving to the financial statements themselves, Mr Reville presented PwC's findings upon its review of the Fourth Quarter financial statements and recorded that PwC did not find any material weaknesses in CCC's financial reporting, that PwC had (again) independently evaluated the prices used by Management and come up with essentially identical results, and that it had been a clean audit with full cooperation from management. He later confirmed that PwC was satisfied that CCC was to be regarded as a going concern, commenting that the increase in the potential Carlyle loan facility would be "*extremely helpful*" in this regard. He said in his oral evidence, though, that he had already formed that view the previous evening

having considered the matter and all the materials to be presented at the Board meeting, and that this increased facility was not decisive but simply bolstered his view.

2372. Mr Stomber commented that the markets had deteriorated "*markedly, rapidly and unpredictably*" since 14th February, and these developments had caused banks and securities firms to mark CCC's securities at lower prices compared to newly issued Agency floaters. Members of the Audit Committee confirmed that this pricing was not rationally explicable and suggested that factors beyond the intrinsic value of the securities must be affecting price - by which Mr Allardice explained he was thinking of internal pressures within the banks themselves.

2373. After approving the formal year end documents, the meeting then turned to the business model and related materials presented to the Board, with updated projections that Management had prepared, showing how CCC would be positioned throughout 2008 if Management's assumptions about market conditions were borne out. Mr. Trozzo explained to the Board that CCC's portfolio had "*begun to stabilize"* in the fourth quarter of 2007 after the third quarter's *"unanticipated volatility*," and this had reduced CCC's need to draw on liquidity to meet haircuts and margin call demands. He then explained CCC's basic financial model, called the "*Static Case*," was an updated version of the projections provided to PwC in October 2007 and to the Board in November 2007. It assumed that there would be no new investments in RMBS or credit products, no sales of RMBS, no dividend payments, and that repo haircuts would remain at a weighted average of 2.74% (as at present), throughout 2008. It further assumed that LIBOR would move down to 2.25% and that the pricing of Agency floaters would recover by 1% per month during 2008, Management's most conservative prediction. The *Static Case* was also referred to as the *Downside Case*, because it assumed a repayment rate on RMBS held at a mere 1% per month, even though expectations were that prepayment speeds would increase notably in 2008 because of the lower interest rate environment.

2374. Based on these assumptions, the *Static Case* projected that: (1) liquidity would improve by over $40Mn per quarter throughout 2008; (2) leverage would reduce from about 33x to 25x by the end of 2008; (3) NAV would increase by around $25Mn in each quarter in 2008 because of asset price recovery; (4) the book value of CCC's shares would improve to $15 by year-end; and (5) CCC would earn a net annual return of 7.25% (but would not pay a dividend).

2375. The "*Likely Case*" also contained in the Board Pack, made more favourable projections based on assumptions of faster paydowns, quicker recovery of prices in 2008, repayment of the revolving loan by the end of the first quarter of 2008 and payment of a dividend. It is of course fair to say that the events of the immediately preceding fortnight must have cast some doubts on the attainment of these predictions, especially as regards recovery of asset price and repayment of the Carlyle loan facility. Asked whether the earnings reflected in these projections were sustainable, Mr Trozzo responded to the effect that whilst CCC's underlying cash flows were substantial, its liquidity was being unfavourably affected by repo counterparties' tightening credit in response to unstable market conditions.

2376. As a result, CCC's Board concluded at this 27th February meeting, that the better course was to remain on the same track as had been pursued since August 2007, namely the capital preservation strategy, which was now embodied in the *Static Case*. Once again, the risks of selling as an alternative arose from effects of low or unpredictable price. Nonetheless, the Board urged Management to begin preparing for a situation in which the projections in the

Static Case were realised, such that CCC's liquidity improved over the next several quarters, as CCC would then need to have a plan for how its capital and cash would be deployed, and to do some strategic thinking for presentation at the next Board Meeting. Various options were thrown up as thoughts, including, from the notes: staying in mortgages with varying degrees of leverage, a portfolio of diversified fixed income products, or buying another company. Mr. Stomber explained that it would be difficult to formulate a plan as to the appropriate asset mix without making a market forecast, which remained difficult, but his view was that when the market recovered, CCC should diversify into credit products though he could not yet suggest when or what would be appropriate.

2377. Ms Cosiol's notes record that, at one point, Mr. Sarles made the statement, "*if we can't get comfortable [with] anything, figure out how to gracefully exit*." Mr. Sarles explained that he meant that Management and Board should consider a variety of options including a future orderly wind down if a future trading strategy could not be agreed. Bearing in mind the Defendants' consciousness of the fact that CCC's investors were expecting a strategy to return attractively high dividends, it appears very plausible that this comment was looking to the eventual future, generally.

2378. The Board discussed a recent New York Times article, which described the steps that three of CCC's competitors were taking in reaction to market conditions. The Board also discussed CCC's plans to switch its clearing agent to BoNY and its continued pursuit of tri-party financing arrangements. Management explained the perceived benefits of tri-party financing to the Board and the Board approved the resolutions necessary to set up such a facility with BoNY, although in the end nothing came of this before CCC collapsed.

2379. Because of the increased signs of market volatility over the preceding two weeks, Management also recommended, and the Independent Directors unanimously approved, a resolution extending suspensions of the liquidity cushion, repo line capacity and portfolio composition Investment Guidelines through to 30 September 2008, in order to give management the desirable flexibility in its actions.

2380. After the Board meeting adjourned the Independent Directors, Messrs. Loveridge, Sarles and Allardice, met in an executive session of their own, without Management present, to discuss the challenges for CCC and the need for Management's input regarding its longer term strategic direction. The meeting apparently confirmed the general points highlighted at the previous evening's dinner and the Board meeting itself, although there seems to have been stress on the fact that Management needed to prioritise planning for CCC's future.

2381. CCC later released its 2007 Annual Report, including the CEO Letter to Shareholders. With PwC's clean audit and favourable going concern conclusion, the Annual Report did not contain any disclosures or cautionary language about CCC's ability to continue as a going concern for at least another year.

Financial position at the end of February

2382. CCC's financial condition had deteriorated by this time, and substantially. The ALCO pack documents showed that in roughly two weeks, $106Mn in unrealised gains since the year commenced had become $17Mn in losses. Between the 12th and 27th February, liquidity had been cut in half from $151Mn (19.3%) to $75Mn (11.3%). The NAV had also fallen, although superficially less dramatically, from $679Mn to $664Mn. Haircuts had, though, remained

reasonably steady at a weighted average of 2.7 % and now among 14 repo lenders. This aspect of CCC's financial position was therefore seen as having been managed successfully, and being apparently stable. An intimation that Deutsche Bank was going to propose a haircut of 4% was only to come later.

The subsequent history

2383. The Plaintiffs' claims do not rely on any acts of the Defendants after 27th February 2008, but it is convenient to continue to set out here the final short chapter of CCC's existence, before considering those claims, because it provides some evidence and context.

2384. On 28th February 2008, a press release was issued, recording the main figures and features of CCC's results for the fourth quarter and year end to 31st December 2007.

2385. Mr Trozzo had put forward to Mr Stomber the names of six banks which it was suggested be approached with regard to establishing new repo lines, the goal being a further $3Bn of funds, seen as providing defensive flexibility of funding and a bridge until the still expected tri-party repo could become established.

29th February - ALCO meeting

2386. CCC's ALCO met two days after the Board meeting, on the afternoon of 29th February, but it was a deliberately brief affair. It included the formal Committee members, together with Mr Zupon and also Ms Cosiol by telephone, so there were no handwritten notes. The record is very short, no doubt reflecting that other more pressing matters took over in priority from around this time from tasks such as drafting minutes. The meeting covered only a review of the markets, which consisted of Mr Greenwood explaining, in essence, that RMBS spreads had widened rapidly.

2387. During the evening of 29th February (a Friday), Mr. Stomber sent emails to Messrs. Conway, Allardice, Hance, Loveridge and Sarles, reporting that it was a "*[r]ough day on margin calls despite market fundamentals going our way*." Whilst CCC made successful return margin calls ($9.1Mn) on Lehman and Bank of America, it had also received margin calls from other repo counterparties, notably ING ($2.1Mn), JP Morgan ($28.3Mn) and Deutsche Bank ($28.5Mn) which it paid, reducing CCC's liquidity on that day from about $120Mn to $70Mn, (both these figures being bolstered, though, by having now included the $50Mn promised increase in the Carlyle credit facility). On that day, also, Deutsche Bank intimated that they would be imposing a 4% haircut for the next repo roll.

2388. Mr. Stomber explained to the Board that Management was following up with the major lenders on Monday, to dispute the prices on which the margin calls had been made; he observed that there had been a trade that day by Bank of America for $60Mn in capped floaters at a price nearly 30% better than the prices being used by JP Morgan and Deutsche.

2389. Mr Conway replied supportively, though fearing that the markets would get worse. Mr Stomber was still hopeful that prices for CCC's securities would improve because interest rates had to go lower and prepayment speeds therefore increase, but that the US economy was clearly *"in for a long problem".*

2390. Also on 29th February, Mr Gehring of Credit Suisse noted in a Bloomberg Message, that Peleton Partners, who had won an award as "best credit fund" only a month previously, had been forced into liquidation, blaming the withdrawal of credit lines by its prime broker, which had then caused a *"funding issue"* and thence the liquidation. On Saturday 1st March 2008, the Wall Street Journal reported the collapse of Peleton Partners, and Mr Stomber emailed Deutsche Bank to request a review of the decision to increase haircuts to 4%, since CCC had never had a 4% haircut with any of its lenders. Mr Stomber believed that this request was out of line and in fact being driven by a particular employee of Deutsche Bank with a grudge.

3rd - 6th March

2391. On Monday 3rd March, at 10 am, Mr Stomber, Mr Hance and Mr Rella held an Analysts' conference call to review CCC's 2007 Annual Report. The transcript of this call shows them broadly reiterating the points made at the Board Meeting and the contents of the CEO Letter and MD&A. As regards haircuts, Mr Stomber says he had not taken the Deutsche Bank comment seriously at that time, and was therefore quite genuine when he said that increases were *"not happening today".* I accept this only in the sense that, having requested a review of Deutsche Bank's decision and not agreed to it, Mr Stomber felt he could, at that time say that such an increase was not happening; I think that Mr Stomber had indeed taken the request seriously, albeit he was determined to resist it. Mr Hance did record that CCC was receiving margin calls, which was the reason why it was retaining its cash.

2392. That day, though, turbulence began to spread in the markets in earnest. Thornburg Mortgage, a large US residential mortgage originator, reportedly got "crushed" in the markets, having previously issued warnings of difficulties meeting margin calls because of the reduction in the price of home loans tied to bonds in February. There were reports of some sort of meltdown going on in the repo loan market in general. Mr Nachtwey, who investigated and reported on what he was hearing in the markets to Messrs Conway, Hance and Zupon, says that his recollection is that what he was being told was that there was a market wide contraction of repo lines, seemingly in response to a panic among banks who were looking to reduce their exposure and hold on to as much liquidity as possible.

2393. CCC had met all its margin calls up to this time. However on 3rd March Mr Stomber learned that Citi was also now demanding a 4% haircut (although it would limit it to 3% if CCC would reduce the size of its line) and Deutsche Bank was now set to demand a 5% haircut at the next repo roll.

2394. At this point, on the morning of 4th March, Mr Stomber informed Mr Conway and Mr Hance that he felt that boldness was required, in order to break the cycle with the banks, (they were simply demanding collateral because they could, and it kept being forthcoming). He proposed that CCC should seek a standstill agreement with CCC's repo lenders as to haircuts, and an agreement with them to abide by external pricing services in exchange for Carlyle lending another $100Mn to CCC, and at the same time, also put a rights offer to CCC's shareholders requiring them to contribute additional share capital to CCC or else have it sell securities at a loss. He considered that major investors in particular were likely to want to help CCC hold on in order to realise par value on its securities at maturity.

2395. Mr Hance reacted that an immediate sale to try to recoup net asset value and thereby give investors a 30% loss might be a better option, because trying to fend off ever increasing haircuts prompted by banks' desires to gather liquidity for themselves would not work, but Mr

Stomber responded that such a sale could mean a much greater loss than Mr Hance suggested. He did a calculation of the level of losses which would be occasioned by selling $2Bn or $10Bn at CCC's marks, or at those being used by JP Morgan, which showed doubt about whether a substantial part of net asset value would be recovered, and there was also, he pointed out, the further prospect of the liquidity spiral effect. The sight of a large sale of Agency floaters by CCC could cause the repo banks to have fears about price trends and demand yet more margin, or fears about CCC's health and retract finance still further.

2396. Whilst the situation was obviously bad, it was also somewhat uncertain; on 4th March, CCC succeed in recovering $10Mn of margin, including $4.4Mn from JP Morgan.

2397. However, on Wednesday 5th March, matters worsened again when JP Morgan now issued a margin call against CCC for $14Mn and Lehman for $3Mn, and a further substantial call from Deutsche Bank was expected. Mr Stomber noted that, having received $47Mn in margin from CCC over the previous seven days, JP Morgan now had an advantage over CCC's other repo lenders. He stated to Messrs Conway and Hance that "*Today will have to be the day we stop paying margin*". He proposed a meeting with CCC's repo lending banks to agree a standstill whilst the matter was *"work[ed] through".*

2398. Mr Conway informed his Carlyle Co-Founders of the position, commenting that such a standstill might enable CCC to get through, but that even then a 1% change in haircut levels was worth $200Mn and whilst this would have been unthinkable until recently, it was now no longer.

2399. Mr Stomber emailed all CCC's repo lenders, copied to CCC's Board, advising them of the margin demands which CCC was receiving, the request for higher haircuts and the backdoor lower pricing, and inviting them all to a meeting on the following Monday (10th March) to discuss the situation in a coordinated way, reminding them that Carlyle had always supported CCC where necessary, but that every time CCC obtained additional resources, "*one of our repo parties has moved the goalposts.*" Mr Stomber and Mr Nachtwey then made a telephone call to Mr Black of JP Morgan, to try to persuade him not to call default on JP Morgan's margin call until after the Monday meeting. However, they met a complete lack of co-operation and stone-wall intransigence. They therefore predicted that JP Morgan would call default, seize assets and sell, unless JP Morgan heard from the Founders that Carlyle was willing to support CCC, effectively without limit.

2400. In fact, the first notice of default was received that evening from Deutsche Bank. JP Morgan declared default the following morning, despite an intervening telephone call from Mr Conway to Mr Black to attempt to persuade it to hold off. CCC, as it was no doubt obliged to do, issued a press release that night, announcing that it had received demands for margin and additional collateral totalling more than $60Mn which it had not met, and that it had received a notice of default and expected more, although management was still actively working with CCC's repo counterparties to develop more stable financing terms.

2401. This was not, of course, enough and on the morning of 6th March, CCC received an avalanche of further margin calls from other repo lenders, totalling over $400Mn.

2402. CCC therefore accelerated the meeting with lenders from 10th March to that afternoon, 6th March. However, four of CCC's repo lenders declined to attend, and neither did JP Morgan or Deutsche Bank. The meeting was attended by Mr Conway as well as Mr Stomber and

Management, with representatives from Citi, Bear Stearns, Lehman, Calyon, ING and UBS. A term sheet had been circulated for a proposed co-ordinated agreement which would guarantee haircuts and agree to use independent pricing, in return for an infusion of capital from Carlyle, and an issue of equity to the banks was proposed. However no commitments from the banks were obtained, although Calyon and ING appeared to be interested in working out a deal. This was against the background that on that same day the stock prices of companies in the Agency REIT sector suffered extraordinary one-day drops of between 18% and 31%.

6th March – BOARD MEETING

2403. An emergency Board Meeting was convened by telephone that evening. Mr Hance outlined what had happened since the beginning of the month and at the meeting that afternoon. It was agreed that the scale of any standstill agreement required was very large and also that Citi, as the largest lender was key to this. However, Citi had intimated at the meeting that it would require Carlyle to provide at least another $800Mn in capital or collateral. Mr Buser reported that Mr Reville of PwC, was surprised at the sudden downturn of events but remained comfortable with the opinion that he had expressed as regards CCC's having been fairly seen as a going concern at the previous year end.

2404. That evening, Mr Stomber sent a contrite email to the Founders, apologising for any "*collateral damage*" to the Group, stating that CCC had been killed by the worst market since the depression, and recognising that his employment would have to be terminated. Mr Conway responded, assuring him that it was not his fault, that they still needed to work to do what was best for the company, and that he was not throwing him (Mr Stomber) overboard.

7th - 16th March - More BOARD MEETINGS

2405. I do not need to recite all the detail of what occurred over the following few days. In summary, Carlyle devoted a great deal of time, effort and resources to trying to work out a way forward to salvage value in CCC, bringing in a skilled crisis negotiator, Mr Bruce Rosenblum, enlisting the help of outside counsel and other investment banks, and being, Mr Conway said, willing to put up large further sums if the repo lenders would hold off and avoid selling CCC's securities at firesale prices (although it is not clear that this proposed support was as much as the $800Mn that Citi had intimated). However, it proved impossible to obtain any sufficiently co-ordinated response from the repo lenders who each had their own individual issues or agendas. Certain repo lenders broke ranks and started selling CCC's securities which they had seized - by 10th March, over $5.7Bn of CCC's securities had already been seized and sold – and that fuelled the incentive for others to sell, to minimise the effects on them of prices falling as more such assets came on the market.

2406. CCC made almost daily press releases as to the state of its affairs, on 5th, 7th, 9th, 10th, 12th , 13th and 16th March. Further Board Meetings were held on 7th, 10th and 12th March, but by then CCC was compelled to announce that it had been unable to reach agreement with its lenders for continued financing, and that it therefore expected that CCC's lenders would proceed to take possession of substantially all of its remaining assets. Unsurprisingly that occurred. The collapse was by then inevitable, and further Board Meetings on 14th and 16th March merely discussed and then took the necessary steps to put CCC into liquidation.

2407. Market commentary during these few days first focused on CCC's leverage (of 28x – 32x) as being the fundamental distinguishing feature between CCC and its suggested peers, (citing Prodesse, Annaly Capital Management and MFA Mortgage Investments) and latterly came to identify this as the cause of CCC's collapse for being unsustainable in the current turmoil of the mortgage markets. The Defendants, though, point to a contemporaneous summary set out on 10th March itself, in comments to the US Federal Open Market Committee (the "FOMC") by William Dudley, then Manager of the Federal Reserve's System Open Market Account, recognising the "liquidity spiral" pattern of events, and describing the further consequence of such financial instability having started in the more risky subprime areas but then spilling over into and through the more solid AltA and Jumbo prime markets, and ultimately even to Agency mortgage backed securities.

17th March 2008 – CCC is wound up

2408. On 16th March, both the Board and the A shareholders resolved to apply to this Court for the compulsory winding up of CCC, and an Order was made, on 17th March 2008, as noted at the start of this judgment, a long time ago.

2409. Of course, CCC was not the only entity suffering from the contraction of funding in the financial markets at the time, and the banks' reactions to it. Other entities also failed, in the end, the most well-known being Bear Stearns and later Lehman themselves. Bear Stearns, collapsed at the same time and speed as CCC, on 13th March 2008, with its cash reserves wiped out in three days.

The claims: JANUARY and FEBRUARY 2008 – Summary of arguments.

Plaintiffs' case

2410. For present purposes, the assertions in the Plaintiffs' case must focus on what the Defendants did in January and up to 27th February 2008, being the period expressly referred to in the Cause as the reference point for their claims.

2411. The Plaintiffs' submissions in relation to this period start from the assertion that the Defendants had already been in breach of their duties for many months, which I have found not to be the case. However, they maintain that, during this period, the Defendants' continued running of CCC as before, holding a $23Bn [sic] portfolio levered at more than 30x and funded exclusively by 30 day repo, was an independent breach of the Defendants' duties at this time. They repeat their general criticism of continuing this course and taking no steps to deleverage, by selling or otherwise, but they focus particularly on the deterioration in market conditions in February 2008, causing CCC, with its cash reserves nearly exhausted, then to run out of repo capacity and collapse into insolvent liquidation. They urge that this situation was, in reality, a continuum of the financial crisis which had begun in August 2007, and that CCC's collapse therefore cannot be attributed to some claimed new cause of a supposedly freak market event in March but was the inevitable consequence of the Defendants' failure to take the now familiar "required action" from August 2007 onwards, but independently including in this period. They point out for example that the sudden drop in IDP prices for CCC's RMBS is shown in the graph evidence as occurring only on 11th March 2008, when CCC's actual collapse occurred a few days earlier.

2412. The Plaintiffs invite me to find that the economic conditions relevant to CCC were no better in the first quarter of 2008 than at the end of 2007, (as witnessed by the "fifth quarter of 2007" comments at the time), that nothing happened in that first quarter which justified the Defendants' having any optimism for the future, but that, on the contrary, CCC's funding position became incrementally worse, as it struggled to maintain affordable repo lines. They point to recognition in the emails between Mr Stomber and Mr Conway in early January (2nd and 8th) that market conditions remained worryingly bad. They point out that "most" (they in fact cite six) of CCC's repo lenders had 31st December year ends, and would be publishing at least preliminary results in late January or early February with the expectation that they would show large losses incurred - indeed Mr Hance had alluded to this expectation in November - and they remind me that Mr Stomber had also anticipated the spillover of market difficulties from the struggling sub-prime sector to other areas in one of his emails of 13th November 2007, where he referred to spread to the "Muni" (Municipal loans) market.

2413. They argue that the emails of 12th-15th February 2008, which I described above, show that it was generally recognised (including within CCC) that this contagion had happened, and these were just the latest in a progression of worsening circumstances which made it perfectly obvious that it was not reasonable to expect any easing of difficult market conditions, and Mr Conway, they suggest, had clearly recognised this in his draft annual circular memorandum to Carlyle employees of 22nd January 2008.

2414. Reviewing CCC's repo availability, they submit that it could clearly be seen to be deteriorating: Deutsche Bank had reduced the tenor of CCC's repo to one week in September 2007 and had broadly kept it there. The Plaintiffs say this was due to fears about CCC as a credit risk, and suggest that Mr Stomber accepted this (although on examining the evidence they refer to, I think that all Mr Stomber was accepting was the general point that one week repo was intrinsically "less risk" for the lender than was 30 day repo). The Plaintiffs cite the sequence of events with Lehman, in which CCC was forced to move its repo away from them – CCC's second largest repo lender - in the midst of escalating tensions with them after Lehman had demanded a 4% haircut. Previously the haircut had been a nominal 2%, although in practice more like 2.5% owing to aggressive pricing. They point out that CCC then acknowledged internally that even a staggered move through a 3.5% haircut was a "*ticket we cannot print"*. This illustrates, they submit, the obvious precarious footing of CCC's financing; it could not afford even its current repo at a modest haircut increase across the board, and this was known to those in charge.

2415. They submit that no comfort could be taken from the negotiated increased line with Calyon because the latter was courting Carlyle business and was in any event a "*very small and unsophisticated"* dealer (this was Mr Welles' evidence) with the implication that they did not really know what they were doing, and obviously could not be relied on as representative. They point to the foundering of the negotiations with Wachovia in mid-January, even after the proposal was reduced from a $2Bn line to a relatively insignificant $500Mn. They rely on the acknowledgements by all the main Defendant witnesses, in oral evidence, that they were worried about CCC's repo capacity.

2416. They pour scorn on any supposed comfort being taken from the tri-party repo project with BoNY, describing it as a mirage. They say that it should never have been relied on; it was a sign of Mr Stomber's incompetence that he ever pursued it, and it would not have made any real difference to CCC's position anyway. They point out that Messrs Allardice, Sarles and

Hance all admitted to scepticism about tri-party repo in oral evidence. Relying on Mr Welles' evidence they submit that Mr Stomber fundamentally misunderstood the nature of tri-party repo, in that all the tri-party agent did was act as custodian and facilitator, and took no part in the negotiation of the repo terms, which had to be done directly with the ultimate lender. This would be a more difficult negotiation than with seasoned repo lending banks, because such lenders were risk averse, and would never be prepared to lend to an entity with CCC's profile. Whilst accepting that BoNY was the largest and best known provider of tri-party repo arrangements, they point out that BoNY was looking to gain CCC's prime brokerage business from Lehman, and suggest that BoNY may have been leading CCC on with regard to tri-party repo, and that if tri-party repo had been so obviously feasible, CCC could and presumably would have lighted upon such arrangements with JP Morgan, the second such well-recognised intermediary, who also had existing connections with CCC. They add finally that tri-party was never, in any event going to be the great panacea for CCC which Mr Stomber apparently thought when he described its apparent potential as a "breakthrough", because placing tri-party repo arrangements would have been a protracted business, and they were also, typically, say the Plaintiffs, of even shorter duration than 30 days, and indeed mostly overnight.

2417. Focussing then on the second half of February 2008, the Plaintiffs emphasise the worsening market conditions, and that Mr Stomber was noting and even predicting (on 14th February) that problems in the "Muni" market would spread to affect CCC, going so far as to comment, the next day, that "*the financial system is crippled*". They quote a set of Bloomberg messages from various banks commenting on worsening market conditions between 13th and 15th February. They submit that Mr Stomber's protestations that the eventual fall of CCC was the result of unpredicted and unpredictable market conditions is at odds with his contemporaneous comments.

2418. They observe that around 20th February Mr Conway pointed out to Mr Stomber that price indicators (spreads) were currently at 170 bps, when they had only been at 56 bps three months earlier, at the time the previous crisis had set in. They also point to the advice from Mr Duffy of Bank of America to Mr Conway on 20th February, noting that this had been first delivered a week previously, and criticise Mr Conway for being unwilling to heed a friendly warning (again), citing this this as evidence of an unreasonably intransigent attitude to holding RMBS.

2419. They point to the fall in the IDP average prices for CCC's RMBS, between 12th and 27th February, creating a total fall in the value of the portfolio of $120Mn, which had cancelled out the much welcomed price rise (from $98.80 to $99.26) on 7th February 2008. Consistently with this, CCC had started to receive margin calls from about 14th February onwards, and between 13th February 2008 and the 27th February Board Meeting CCC's liquidity cushion was reduced from $152Mn (19.3%) to $75Mn (11.3%), a net cash out-flow of $76Mn, which wiped out all liquidity improvement since the beginning of the year. Whilst CCC acknowledged that its weighted average nominal haircuts had increased since 31st December from 2.66% to 2.72%, it could be seen on careful examination, that three counterparties, (Bank of America, Lehman and Credit Suisse) were operating effective haircuts in excess of 3% and even 4%. In addition, the interest rate spread to one month LIBOR had increased by 6 bps, which increased the annualised costs of CCC's borrowings by $15Mn.

2420. They point further to the figures and graphs included in the papers for CCC's ALCO meeting on 29th February, which showed worsening volatility metrics (cap volatility and average price

volatility) since the year end, and a liquidity to 20 day VaR ratio continuing at the portentous level of less than 1. All this (they submit) showed that CCC had insufficient liquidity to operate within the risk parameters which had been considered appropriate when its original business model had been devised.

2421. Overall, therefore, the Plaintiffs submit that the Defendants' suggestion that the first quarter of 2008 was an improvement for CCC does not stand scrutiny. The reality was that there had been no material improvement, even since August 2007, and even if the first few weeks of 2008 might have given hope (although they should not have done) that CCC had turned the corner towards improvement, the events from 14th February onwards showed that this was not the case.

2422. The Plaintiffs next say that it was plain from the Audit Committee Meeting of 26th February that further support from Carlyle could not be relied on; it can be inferred from the notes of the meeting that any further support was likely to mean that Carlyle would have to consolidate CCC's operation into its own accounts, and Mr Conway stated quite clearly at that meeting that Carlyle did not want that to happen. It should be inferred that this was a red line matter, and this would have been apparent to those involved.

2423. They submit that the calling of the informal Dinner Meeting of 26th February, with its organiser, Mr Allardice, referring to the stress of CCC's living "roll to roll" as the impetus for organising a "*sit down in a calm and relaxed setting*", and with Mr Sarles bluntly saying that it had been an opportunity to have a frank and open discussion and find out whether Mr Conway was interested in continuing to support CCC, itself demonstrates how inadequate the engagement of the Board with the company's business had been before this point in time – far too late - and in particular the failures of the Independent Directors.

2424. Turning to the 27th February Board Meeting, the Plaintiffs submit that it then was (or should have been) obvious from comparison of Board materials supplied that CCC's position had not improved from the 13th November Meeting, and had even worsened. They suggest that the Defendants' appreciation of this is shown by an extract from the draft minutes of this meeting, which was excised from the final official version, but which Mr Sarles accepted was something he had said, that

> *"[a]ll acknowledged that it was the Company's primary goal to be in diversified fixed income, but if it could not get comfortable with any future operating strategy, the Company would have to figure out <u>how to exit gracefully"</u>* (emphasis added).

2425. The Plaintiffs submit that this shows that the Defendants were, at the time, questioning whether CCC had a viable future (although they deny it now) but that they ignored the obvious signs and recklessly continued with the same policy, without giving consideration to reducing leverage through asset sales or other means. In addition, they (in particular the Independent Directors) extended the suspension of the Investment Guidelines until September 2008, without any deliberation, improperly treating it as a mere formality. The Plaintiffs submit that the proper course was to reinstate and enhance them, in the light of the more volatile market conditions.

2426. The Plaintiffs criticise the fact that no new business model was proposed at this Board Meeting, and that the Board does not appear to have even compared actual results with the projections which had been advanced at the 13th November Board Meeting and which showed

how adrift from reality the latter had been. They criticise the Board's giving no "meaningful" consideration to selling RMBS to generate liquidity. The Plaintiffs point to various performance statistics (though derived mainly from the ALCO papers for the 29th February meeting, tabulated against the same statistics for 31st December 2007 and not being any document actually presented to the 27th February Board Meeting) and they submit that this demonstrates that CCC's position had steadily worsened over time; there had been no sign of any "flight to quality", and CCC was plainly insolvent or on the brink of insolvency, as witness the fact that within mere days of this Board Meeting CCC's repo lenders had served notice of default, and CCC had collapsed into insolvent liquidation. This was as a result, they submit, of the very risk to which CCC had been increasingly exposed since July 2007.

2427. They observe that the statements in the Annual Report, no doubt aimed at trying to reassure investors, in fact painted a far from positive outlook, and the Plaintiffs submit that they were also misleading in some respects - in particular as to statements that CCC's Board was continuing to analyse the appropriate size of a liquidity cushion, when it was not, and announcing an increase in one of CCC's repo lines in late 2007, without also mentioning the virtually corresponding decrease, in early 2008, in respect of Lehman.

2428. Based on the above, the Plaintiffs argue that the Defendants were guilty of the core breach of duty (failing to sell RMBS or raise capital to increase liquidity) during the period from January to 27th February 2008. They also add that it was a breach of duty not to bring about the reinstatement and enhancement of the Investment Guidelines, and not to convene a Board Meeting before 27th February 2008. They assert generally that CCC was cash flow insolvent or near insolvent, that the Defendants had no regard for the interests of CCC's creditors and that they are therefore guilty of breach of duty (knowing, reckless, or negligent to the point of grossly negligent) and also misfeasance.

2429. Having recited the subsequent events of CCC's collapse, they lastly add three further submissions of a more general nature with regard to matters taking place after 27th February 2008 and inferences which they say can be drawn from these.

2430. First, they refer to the urgent steps which the Defendants began to take from about 5th March onwards, seeking to make a standstill and a combined agreement with their repo lenders, and say that this is illustrative of what they could and should have done in the second half of 2007.

2431. Next, they suggest that the Founders of Carlyle (including therefore Mr Conway) tried to distance Carlyle from CCC's failure and blame it on adverse market conditions, and that Mr Rubenstein, in particular, disseminated a series of false and misleading statements in an effort to protect Carlyle. They suggest that this is illustrative of the standards of honesty of senior Carlyle personnel when damage to the Carlyle Group was feared, implying that general inferences as to credit and motivation can be drawn from this. Similarly, the Plaintiffs cited an email of 15th March 2008 by Mr Nachtwey, Carlyle's chief accountant, to a Mr Walsh at Evercore, an investment manager, on which the postscript includes that "we" (not defined) *"ignored the canaries in the coal mine for too long. We should have done a more substantial fix last fall",* and in effect the Plaintiffs invite me to view this as an admission.

2432. Last, they refer at length to events by which amendments were made between March and June 2008 to the then draft Minutes of, in particular, the 27th February and 12th March Board Meetings, long after CCC had been wound up, and including by several sets of external lawyers, and, particularly those acting for the Independent Directors. The Plaintiffs assert that

this process amounted to creating a false record, an attempt to thwart the investigation of CCC's affairs, and an attempt to avoid blame for CCC's collapse by manipulating these to emphasise, and seek to attribute that collapse simply to, the claimed sudden deterioration in market conditions. As with their previously noted criticism of amendments to the draft minutes of the Audit Committee's meeting of 13th November made by Mr Allardice in February 2008, they submit that these went too far to be proper. They rely on these matters as a general attack on the integrity and evidential credit of the Defendants, and in particular the Independent Directors.

Defendants' case

2433. The Defendants' response is relatively short, because they repeat the arguments made previously, generally submitting that when the actions of the Defendants are considered and evaluated in the circumstances at the time, and without the infection of hindsight, what they did was fair and reasonable in those circumstances, and that the decisions they made and the actions they took were within the range of reasonable and proper decisions or actions which an ordinary and competent director (or investment manager), even with any relevant applicable degree of additional expertise, could reasonably have made.

2434. In particular, they submit that nothing in either CCC's circumstances or external market conditions had changed, or did change, sufficiently during this period to mean that the capital preservation strategy ought to be abandoned in favour of selling RMBS before or on 27th February 2008. The gains in RMBS prices in the first six weeks of 2008 reasonably suggested that the difficulties of December and late November had indeed been the product of the banks' year end pressures; results showed that there was an improvement in CCC's general financial position for several weeks from early January to mid-February, which supported the perception that the capital preservation strategy was working as anticipated, even though the improvement was not sufficient to mean that CCC could yet begin to make moves towards a different business model and starting to invest again. The available options and considerations, however, remained those which had previously informed the decision that the balance of benefit and risk attaching to holding on to the RMBS portfolio was better for CCC than the balance of benefit and risk attaching to attempting to sell.

2435. The Defendants dispute the Plaintiffs' assertions that CCC's repo position was such as to make it obvious that failure was inevitable. They point out, once again, that CCC had consistently managed to obtain necessary repo financing, even if work and persistence had been required to achieve this. Whilst greater unused capacity would obviously have been comforting, it was not necessary, and the amount of excess - $2.3Bn beyond a requirement of around $21Bn - could be worked with. Efforts were constantly being made to increase this, and even if difficult, they had in fact borne enough fruit, until then, to keep the business going. They submit that, at the start of 2008, it was reasonable still to expect something from Wachovia, even though this came to nothing during the period as Wachovia began to experience its own pressures.

2436. They equally submit, contesting the further evidence from Mr Welles on this point which was only introduced late and during the trial, that it was not unreasonable for Mr Stomber to believe that a tri-party line through the BoNY connection remained a possibility; even by the end of February some contacts for this project still remained to be approached. They point out that BoNY itself gave the appearance of believing that there was indeed such possibility, relying on the tenor of communications between Mr Burns of BoNY and Mr Stomber, which

(they submit) contradict Mr Welles' suggestion that BoNY was likely to have been leading CCC on in order to gain their prime brokerage business. This, they point out, is an entirely speculative suggestion, and outside either Mr Welles' knowledge or his field of expertise.

2437. They submit that there was no need, practical or otherwise, for any further Board Meeting between 1st January and 27th February. The regular meetings had been timed sensibly to coincide with the next Audit Committee meeting, and to review the preparation and approval of CCC's year-end financial statements. In the interim, Board Members were being kept abreast of the every day position and any material developments, including by updating emails and through receipt of ALCO papers. Nothing of sufficiently obvious and grave moment at the time occurred to require an extraordinary meeting to be called before the meeting scheduled for 27th February 2008.

2438. Whilst acknowledging that Mr Stomber and Mr Conway, and the other Defendants who were kept in the email loop, recognised that economic conditions were still worryingly bad, the Defendants dispute the Plaintiffs' assertion that these were in effect recognised as being terminal. Although Mr Stomber made many negative comments about financial market conditions, he also noted positive developments such as Federal Reserve interventions, and remained clearly (and, they submit, genuinely and reasonably) of the view that both market conditions and logic pointed to the likelihood of recovery in the value of CCC's assets. The drivers of a flight to quality phenomenon even meant that a worsening of some market conditions ought to benefit CCC in this regard, thus going against any broad general negative trend.

2439. With regard to the second half of February, whilst it was of course apparent that market conditions and indicators were then worsening again, and even that they had eliminated earlier gains, this was still something that might be part of ordinary and usual general market fluctuations for a few days. It was too early to see that it was going to turn into the completely seismic shift in markets which started right at the end of February.

2440. The Defendants refute the Plaintiffs' suggestion that the sudden drop in IDP prices for CCC's RMBS occurring on 11th March 2008 must show that CCC's actual collapse had not been triggered by any precipitous change in the market, but was just the inevitable result of generally deteriorating market conditions since the previous August which should have been recognised in this period, if not earlier. They point out that the alleged implications of these IDP prices was only put - they say remarkably and inappropriately - to the Defendants' insolvency expert, Mr Shaw, and not to experts with more relevant knowledge and experience.

2441. They dispute that the potential availability of additional emergency finance from Carlyle was illusory. They submit that it was real, and reasonably so regarded, based on both previous experience and Carlyle's interest in CCC's success. The Plaintiffs try to attribute too much significance to Mr Conway's remark at the 26th February Audit Meeting, that Carlyle "did not want to consolidate CCC" into its own accounts, this being a general remark, made in the context of CIM's likely waiving of the incentive fee and pointing out the problem of indirect support having hidden consequences in this regard.

2442. They reject the Plaintiffs' criticisms of both the course and the content of the 27th February Board Meeting. They submit that on examining the evidence, it can be seen that full discussion and appropriate consideration was given to all of CCC's financial circumstances, including the metrics and the results to which the Plaintiffs point and to current market factors,

noting that the materials in the Board Pack had been circulated for consideration beforehand. They object that the Plaintiffs' criticisms go to details of form (such as whether a "new business plan" was formally presented, or whether a formal comparison with previous projections was made), and miss the real point, which is what actually was discussed and whether these would reasonably have appeared to be the most crucial points, and what was perceived to be CCC's best course in all the current circumstances. They place reliance on the fact that, at the meeting, PwC repeated its confirmation that it considered that CCC could be properly regarded as a going concern, both with regard to the assessment at the end of year Annual Report, and still with regard to the date of signing off its own auditors' report, as at 27th February. This view was, they also submit, not dependent on the offer, confirmed by Mr Conway, that Carlyle was ready to provide another $50Mn of liquidity for CCC if needed, but was only reinforced by that offer. PwC's opinion was a considered, informed and external general view.

2443. They submit finally that the event which did bring CCC down was indeed, on the evidence in the case, a second financial crisis of even greater magnitude than that of eight months previously. It was not a mere credit event, but a wholesale liquidity crisis, causing a "systemic run on repo", the likes of which Professor Hubbard said had never been seen before. In support of their proposition that the eventual March 2008 crisis was recognised as not being a foreseen and foreseeable event, the Defendants cite the comments, not long afterwards, of high ranking officials such as Janet Yellen (current Chairman of the US Federal Reserve), that the acute liquidity crisis of March 2008 was devastating, unprecedented and not predicted even by astute followers of the financial market. The Defendants submit that this all chimes with the evidence of the financially experienced Defendants in this case, that they themselves did not foresee such a market shock materialising. They submit that since it can be seen that the great majority of knowledgeable and experienced market participants did not predict such a second shock, it cannot be said that it was negligent or culpable for the Defendants not to have done so - even if there had then been anything practical which CCC could have done, having survived the first crisis of August 2008 but being left in a weakened state, to avert or lessen its impact if they had foreseen it.

2444. With regard to the three general allegations made by the Plaintiffs based on matters occurring after 27th February 2008, they submit that the first – the claim that CCC ought to have sought a moratorium with its repo lenders earlier than at the last minute in March - is not a claim which was made until the trial and ought not to be permitted, even if it could have been a sensible option, which it was not. They submit that the further materials referred to - subsequent comments by Carlyle personnel, and amendments made to draft minutes - even if taken at face value, do not support the adverse inferences which the Plaintiffs invite to be drawn.

Discussion and conclusions – January and February 2008

2445. Following the usual pattern in respect of this period, the operative claims in the action are, as against the Carlyle Directors, the matters listed in Paragraphs 390B.1-3 (duty of care) and 390C.1-2 (fiduciary duty) and against the Independent Directors, they are in materially identical terms at Paragraphs in 390D.1-3 and 390E, as always, all as further particularised in Paragraphs 418A-N and 4124A-G incorporated here by Paragraph 391.

2446. The upshot with regard to the duty of care is that, apart from the core breach of

"failing to cause CCC to either (i) sell down its RMBS assets to generate liquidity and reduce leverage, and/or (ii) raise additional equity capital to reduce leverage and/or (iii) conduct a restructuring or orderly wind down"

(Paragraphs 390B.2 and 390D.2), the express allegations of breach of duty of skill and care with regard to this period are pleaded as (i) extending the suspension of the Investment Guidelines rather than reinstating them, (ii) failing to convene any Board Meeting before 27th February 2008 even though CCC had failed to meet the liquidity and leverage projections presented to the 13th November 2007 Meeting and "*Carlyle[sic] and CIM*" had done nothing to raise liquidity and reduce leverage despite (asserted) representations to the September Investors' conference that this was "*necessary and would occur*", and (iii) not presenting a viable business plan to CCC's Board since *"admit[ting]"* that the original plan was no longer viable in August 2007.

2447. The claimed breaches of fiduciary duty made against the Carlyle Directors incorporate the same breaches, but with their commission being attributed, once again, to prioritising Carlyle's corporate and reputational interests over CCC to the latter's detriment because to sell RMBS would have locked losses into CCC's financial statements, impairing its ability to pay dividends, and would also (as would seeking to raise further equity capital) have exposed Carlyle to reputational damage, negative publicity and loss of fee income, and jeopardised the pursuit of Carlyle's alleged Strategic Objectives. The allegations against the Independent Directors are effectively the same, with the addition of the improper motivation of pursuing alleged personal benefit through thereby maintaining CIM's fee income, a portion of which would be distributed to the Independent Directors.

2448. Once again, the core breach is the only breach of duty which is capable (or in fact even asserted, see Paragraph 392 of the Cause) to have caused any actual damage to CCC, and the other factual allegations are variously in the nature of particulars, or of evidence, or just irrelevant.

2449. The allegation of breach of contract or tort against CIM (Paragraph 390F) again in practice rests on the same facts as the above allegations insofar as they relate to Mr Stomber, whose monitoring, advisory and supervisory duties to CCC as an employee of CIM and therefore owed under the IMA really coincide with his similar duties as a non-voting director of CCC. I can see no matter which could constitute a breach of contract or tortious negligence by CIM which is independent of Mr Stomber's role and involvement also as a Director of CCC.

2450. I observe that there is no allegation of wrongful trading in respect of this period.

Specific points of procedure and credit

2451. Before discussing the breaches of duty which are alleged, it is convenient to deal with the last three points of argument made by the Plaintiffs, and mentioned above, which are evidential or procedural in nature.

(i) Standstill agreement

2452. As to the allegation that the Defendants were negligent because they ought to have ensured (but did not) much earlier in the history ie in the last quarter of 2007, that CCC took steps to enter into a standstill arrangement with its repo creditors, as it eventually tried to do on about

10th March 2008, this does not appear in the pleaded Cause, either directly or even by reasonable implication. It was first raised only in Advocate Wessels' opening submissions. This is not a claimed cause of action which falls under the general formulation of the core breach. I therefore accept the Defendants' submission that, absent a successful application to amend the pleadings, this is not a claim which the Plaintiffs are entitled to rely on at this juncture.

2453. That is sufficient to dispose of the point, but I add that I would also reject it as a matter of substance in any event. First, I can see no actual evidence to support the argument that the Defendants ought to have perceived an imperative need for this course at an earlier time. Second, and more important, I also accept the argument that, once the general importance of CCC's avoiding any appearance of being in financial trouble is accepted, it follows that asking repo lenders for some kind of concerted favourable treatment was not a practical possibility; it would be too easily perceived as a request for a moratorium. The important point for CCC throughout this delicate period was not to be seen to be doing anything unusual.

(ii) Subsequent "admissions"

2454. The second point is the lengthily pleaded and pursued allegations of Carlyle's attempting to distance itself from the failure of CCC, and of Mr Rubenstein, in particular, by spreading untrue statements with this objective (or true statements which amount to admissions) which, it is suggested, should cause me to draw adverse inferences, or at least to proceed with caution, with regard to the honesty and integrity of the actions of senior Carlyle personnel where the interests of Carlyle are concerned and where this consideration is material for my deliberations.

2455. Plainly, again, none of the particular instances cited forms any part of the factual matrix of the effectual allegations of breach of duty which are made. This is not least for the obvious reason that they all post-date the time period in which those breaches are alleged. They could only, therefore, have any relevance if they provided evidence from which I could properly draw inferences, either directly as to what did happen earlier with regard to the substantive claims, or indirectly as affecting my assessment of the evidence of witnesses to such matters.

2456. In fact, I have not found any of this material to be of even indirect relevance or assistance on the matters which I have to determine.

2457. The Plaintiffs have highlighted certain recorded comments of Mr Rubenstein and Mr Nachtwey during early March 2008. They appear to rely on these, for as much as they can persuade me they are worth, as evidence, or even admissions, that there was negligence in handling CCC's affairs, in particular in not deleveraging "*months ago*". The first significant such comment is contained in an email from Mr Rubenstein to Mr Conway on 6th March 2008, reporting that Jamie Dimon of JP Morgan had told him (Mr Rubenstein) that "*Stomber is an idiot - was told to deleverage months ago and did not*". The second is an internal JP Morgan email of 10th March 2008, which the liquidators obtained from that firm, in which James Lee of JP Morgan reported to Mr Black on a conversation he had had with Mr Rubenstein in which he reports Mr Rubenstein as saying that "*we hired the wrong guy (who will be pushed out), we didn't deleverage when we should have and now we are paying the price*".

2458. Even leaving aside the far from clear evidential question of whom the latter comment (second hand hearsay at best) could be evidence *against*, I do not find these email statements of any

relevance to my own examination of what actually happened, and whether or not it was negligence, for the following reasons.

2459. Mr Rubenstein was the "rainmaker" for the Carlyle Group, concerned principally with external relations with both counterparties and clients, and with bringing in business. Clearly, from the overall evidence, he had an exceedingly poor opinion of Mr Stomber's interpersonal skills, and I have the firm sense that he did not like Mr Stomber, probably because Mr Stomber's lack of interpersonal skills both grated with Mr Rubenstein and sometimes made his role more difficult.

2460. When CCC's difficulties became public in March 2008, one of Mr Rubenstein's functions was obviously to try to contain the fallout damage for the Carlyle Group. To this end he identified, in an internal email to Mr D'Aniello of 6th March 2008, that the impact of CCC *"will be worse than anything that has happened to us in twenty years by far. Investors are unable to understand why this happened so quickly and why it will not infect the rest of our business"*. This perception was no doubt correct; investors were obviously likely to have an alarmed, hasty, angry and initially uninformed reaction to what was unfolding. It was thus this perception that Mr Rubenstein would have been setting out to allay. He would therefore, I have no doubt, have been looking for every opportunity, fortuitous or created, to distance the Group, and its other businesses from CCC, and to play down the importance of CCC to the Group, because this importance was seemingly magnified to the outside world because of CCC's name.

2461. There are further comments by Mr Rubenstein in the documentary evidence, which the Plaintiffs also cite, which were obviously made to this end, and which, in pursing it, were not scrupulously accurate. An example is an email to the President of John Hopkins University of 9th March 2008 in which Mr Rubenstein stressed that Carlyle owned "*less than eight per cent of it and did not control the Board.*" I am not sure that either assertion was literally true, but the latter was certainly not true in practical terms. These statements were made for reputational and PR purposes.

2462. Mr Rubenstein was not, of course, involved in the actual running of either CCC's business or of any entities in the same market. The only Founder with the kind of financial skills which approached understanding this market was Mr Conway, and it is quite apparent that even he did not have (and recognised that he did not have) the very specialist knowledge and skills needed to understand this particular sector of the bond market. Any comments about the merits or timing of deleveraging which Mr Rubenstein may have either received and passed on, or made on his own initiative, are therefore certainly not, I find, expressions of expert opinion, even if they did express a view held by Mr Rubenstein. Returning to the two initial statements, being those between Mr Rubenstein and JP Morgan, it is perfectly plain that Mr Rubenstein's first concern was to rehabilitate Carlyle in the eyes of JP Morgan, and I am quite satisfied that his manner and his comments would have been geared to saying what would be most impressive or ingratiating for Carlyle as regards his interlocutor at JP Morgan. The reported comments have, to my mind, just that air, and I am quite sure that whether or not such a criticism of Mr Stomber was truly justified would not have been playing much, if indeed any, part in Mr Rubenstein's thinking at the time.

2463. In short, I would not, and do not, find Mr Rubenstein's reported opinion on whether or when CCC should have deleveraged, or even his opinion of Mr Stomber's competence, of any

weight or significance in this matter. Nor do I find extravagant comments made for PR purposes to carry the significance of solemn representations.

2464. Similarly, although the Plaintiffs cite the email of 15th March from Mr Nachtwey to Mr Walsh at Evecore, the comment relied upon (*"[we]ignored the canaries in the coal mine for too long. We should have done a more substantial fix last fall")* was in the postscript to what was quite obviously a personal and social email. Mr Nachtwey explained in his witness statement that he was talking with the benefit of hindsight, and that in any event he had no idea what measures CCC's own Management had been taking or what they could or would have done if they had known that the second crisis of 2008 was about to happen, and he certainly had not given it any thought when he wrote what he did. Mr Nachtwey was not called for cross-examination. Given his distance from the actual running of CCC's business, and the casual context of the comment, I dismiss this apparent admission as likely to have been unconsidered chat. It is also, similarly, far from clear that it could be regarded as evidence against any of the actual Defendants, in any event.

(iii) Amendment of Minutes

2465. The third point is that of the inferences which might be drawn from the amendments which it can be shown were made to the draft minutes of meetings. This is not the place to examine in depth the underlying question of the proper principles of recording minutes, and the proper limits of such amendments, for the main reason that the issue itself is so peripheral to the essence of this case that it would be quite disproportionate to do so. I have already made some comments on this when considering the allegations against Mr Allardice and his amendments to the minutes of the Audit Committee meeting of 13th November, but I will make the following further general points.

2466. The point of meeting minutes is, obviously, to provide an accurate and sufficient record of the business of the meeting for whatever purpose such record is required, but what that requires as to the minutes themselves can vary hugely, depending on the purpose and function of the body concerned. In addition, styles of minute taking can, in my view quite legitimately, vary enormously, from a detailed record of the entire course of discussion, to the style which records only that discussion took place and what was ultimately resolved. Whilst recording elements of the discussion can provide a helpful record of the ideas and views which were aired, the recording of too much such detail and the attribution of views to individuals can inhibit discussion and become invidious, even in a body which continues in existence with no pressures. When the possibility of later recriminations, or investigation by hostile outsiders, is added into the equation, the laconic style of minute taking, leaving no hostages to fortune, may reasonably appear to be preferable.

2467. As far as I can see (I was not specifically addressed on this topic, but I make no complaint about this) the only legal requirement as to what is to be recorded in the Minutes of Directors' Meetings of a Guernsey company at the time was that it should be minutes of "all proceedings" at the meeting; see s. 53 of the 1994 Companies Law. This was re-enacted in s.154(1) of the 2008 Companies Law, but has been subsequently amended to merely "<u>the</u> proceedings" by the Companies (Guernsey) Amendment) Law 2015, an amendment which would seem to encourage a more succinct style of minuting.

2468. What this must mean is that all formal elements of the business of the meeting (items of business, presentations, proposals, motions, appointments, resolutions etc) would need to be

recorded, but I doubt whether the content of a discussion, as contrasted with its fact, would be within the concept of a "proceeding", even in the context of the phrase "all proceedings". It follows that the Plaintiffs' submissions as to the significance of amendments to draft minutes going to the content of discussions can carry no more than the ordinary evidential implications of the making of such amendments, ie what they may indicate as to the facts of what did occur at the meeting, the attitude of those who make the amendments to having the original statements stand as a supposed record of what occurred, and inferences as to the possible reasons for this. That exercise only has to be stated for the likely disproportionality of undertaking it to emerge, and that is all the more so where, as here, there are in fact contemporaneous handwritten notes of the meeting in existence in any event.

2469. As regards the copious amendments to the draft minutes of Board Meetings from 27th February 2008 onwards, it is quite obvious, taking a realistic view, that when a company has just collapsed spectacularly with an immediately clear deficiency of somewhere between $350Mn and $950Mn, those who may feel themselves vulnerable to attack as a result will, whether or not they are actually guilty of negligence or malpractice, prefer it that there are no unnecessary hostages to fortune contained in the minutes of any relevant recent meetings, whether these be matters of substance or of infelicitous expression. It is also quite likely that they or their insurers will immediately involve lawyers, and that the lawyers will have different ideas as to the desirability or felicitousness of what is said in as yet unfinalised minutes of recent meetings.

2470. I therefore find it quite unsurprising that these draft minutes should bear the stamp of having been combed through and amended by lawyers. I also find it unsurprising and not unreasonable that lay persons whose lawyers, acting on their behalf, are examining proposed minutes of meetings, should accept the advice or guidance of those lawyers as to what it is either correct, necessary or appropriate to include in such minutes, and that they would therefore tend to accept lawyers' amendments without demur. I see no reason why they should not do so, so long as these still appear fairly and reasonably to represent what did occur at the meeting. Only, it seems to me, if lawyers were to propose amendments which the lay person who was actually present could see were actually false as to what happened at the meeting (as contrasted with merely pruning what was included, or expressing it in more accurately chosen words) does it seem to me that the lay person could be expected to refuse to sanction lawyers' amendments for not being an appropriate record of the "proceedings" of the meeting.

2471. On this broad basis I am far from satisfied that any material criticism of any of the Defendants can be made on the above score. I also do not think it appropriate to consider this point in any more detail than broad impression, because I do not find these copious amendments to be of any sufficient relevance to the material facts of the case to make such an exercise of any value. Making comparisons of what was initially thought appropriate by the first draftsman (I think, Ms Cosiol) and how the Defendants or numerous other persons, especially those with a lawyer's training, may have subsequently thought it appropriate to re-cast this out of fear of its being (mis)construed against them, tells me nothing much about what actually happened. Even innocent people can behave in ways which might look suspicious, and the real question is the direct one, whether they are, or are not, guilty. Even what happened later is of limited value, and examining how or whether what happened later at a meeting might have been subject to re-presentation because of later circumstance is of even less value.

2472. However, I do not feel able to leave this point without giving some warning as to the part which lawyers can properly play in such a matter. Where the lawyer has been present at the meeting, then he is obviously in a position to judge whether proposed minutes do fairly represent what occurred at the meeting, and he can legitimately advise or comment on their form from that background. It strikes me as being a rather different matter, though, when the lawyer has not been present at the meeting. A lawyer who then embarks on an exercise of editing or proposing amendments to draft minutes is treading on exceedingly dangerous ground, because only those who were actually at the meeting are in a position to say whether minutes do fairly record what took place. The function of a lawyer who has not been present is therefore, it seems to me, extremely limited as a matter of proper conduct. He may just about properly be able to suggest that recording certain points is not necessary (although he would have to satisfy himself that the apparent balance of the record was not being affected by this), or query whether the impression conveyed by the drafting is really what is intended, or does accurately reflect what took place, but this kind of review can only properly involve raising such suggestions. Even then, the lawyer's involvement can all too easily cross the line from assisting those who were present to compose a proper and correct record, into the lawyer's actually composing the supposed record, such that it would be a false record. That would be highly improper.

2473. I note that no lawyers were present at the 27th February Board Meeting, and that whilst representatives of Linklaters, Skaddens, Carey Olsen and Togut, Segal are recorded as being present at later meetings, in particular that of 12th March 2008, representatives of Stroocks, consulted on behalf of the Independent Directors, were apparently not. Because of my views as to the lack of any real materiality in these amendments for my purposes, I have not had to investigate exactly who made the amendments, or the precise process by which they came to be proposed and considered, or their precise effects on the end result. It would have been disproportionate to do so, but all of this would be necessary in order to decide whether such process was proper or whether the ultimate record really was, as the Plaintiffs assert, a false record.

2474. I am therefore making no finding one way or the other about those points. For present purposes, I record simply that the process of amendment to the draft Minutes of the Board Meetings from 27th February 2008 onwards is not a matter which either needs to or does play any part in my determination of the material issues in this case.

2475. I would in principle pay more regard to the amendments to the draft minutes of the Audit Committee meeting of 13th November 2007 made by Mr Allardice in February 2008, because they were entirely internal. I have, though, considered the implications of these when discussing the events of November 2007, and for reasons there given, I have found that they are not in fact of any weight or significance.

2476. Moving back now, therefore, to the substance of the matter, and the effectual allegations of breach of duty in the Cause I turn to the Plaintiffs' claim, first of all as against the individual Defendants and then the contractual/tortious claim against CIM.

(a) Breach of fiduciary duty

2477. The allegation of breach of fiduciary duty here is once again that of acting with the improper purpose of prioritising Carlyle's reputational interests and commercial interests over those of CCC, to its detriment, as described above.

2478. I have already dismissed these allegations for reasons given in relation to earlier periods. I found no evidence sufficient to support them then, and I can see no further or other evidence in the period between 1st January and 27th February 2008 which might give these allegations any more substance here than previously. Expressly, I make it clear that I am satisfied that neither the decision not to embark on generally selling RMBS, nor the broader decision to continue keeping CCC's business alive during this, or any previous, period was owed to any aspect of prioritising either the interests of "Carlyle" or the personal interests of any Defendant over the perceived interests of CCC as a discrete company. I therefore dismiss these allegations with regard to all individual Defendants.

(b) Breach of duty of care

2479. I have quoted above the familiar pleaded terms of the core breach of duty. Once again, this is the only effectual breach of duty alleged, and I treat the other matters pleaded in Paragraphs 390B and 390D as particulars, or evidence of that central complaint. I will say, though, that I regard the allegation of breach by "*failing to reinstate or even enhance, the Investment Guidelines ….in the light of more volatile market conditions*" as showing just how rigid, and consequently absurdly unreal, these allegations have by now become, because this submission takes no account of the obvious question how CCC was then supposed to *comply* with any such guidelines, enhanced or not. The reality was that CCC's Investment Guidelines were now to hold on to the present investments, concentrating simply on refinancing them until their value was restored sufficiently to enable other steps to be taken, and to be very cautious about possible uncontrollable consequences of simply selling without thought. The issue is whether doing this was reckless or negligent. The existence or the formal status of any Investment Guidelines is an irrelevant diversion.

2480. The allegation of culpable failure to convene another Board Meeting before 27th February 2008 likewise appears to have no practical function in the Cause, other than to provide an opportunity for the Plaintiffs to repeat previous criticisms by introducing them with the word "despite".

2481. Similarly, the Plaintiffs' criticism, regarded as sufficiently substantial to merit inclusion in written submissions, that CCC *"had insufficient liquidity to operate within the risk parameters considered appropriate when its original business model had been devised*" verges on the fatuous. CCC was not, and had not since August 2007, been operating that business model, which included a set of credit product investments with risks negatively correlated with those of RMBS, for the very purpose of providing protection against the kind of problem which was in fact sustained in August 2007. After that time, CCC was operating willy nilly with a different business model, and also operating in very different business conditions and for a very different purpose – the preservation and recovery, as far as possible, of the value of investor capital. It is bizarre to suggest that judging the state of its liquidity by what was considered appropriate under its original but now inapplicable business model has any meaning.

2482. The core breach, the breach which is alleged to have caused damage to CCC, raises the issue whether it was reckless or negligent of the Defendants to continue with the strategy of holding rather than selling RMBS, previously embarked upon during the relevant period. Again, the essential question is whether there was any sufficiently apparent and significant change in CCC's own financial situation, or factors or events affecting it, which ought to have prompted,

not only a reconsideration of the capital preservation strategy, but a decision to change it to one of selling, whether in order to remain in business or (but it amounts to the same actions in practice) in order to conduct an orderly winding down of the company. The Plaintiffs fail to satisfy me that this was the case. I prefer the Defendants' submissions.

2483. This period in practice divides into two, being the period up to about 14th February, and the period from 14th - 27th February. There are also two aspects to considering the relevant circumstances apparent to the Defendants. The first is CCC's own individual circumstances and results, and the second is the wider market circumstances, which would affect the business environment in which CCC would be operating. The latter would of course, come to affect the former.

2484. In the first few days of January the markets were returning to operation after Christmas and the New Year. Little therefore happened immediately, the only matter of note being the last of the Westways auctions of Agency RMBS, on 3rd January 2008. The results of this were apparently encouraging, although the quantity ($800Mn) of RMBS in question was obviously nothing like the amount which CCC would put into the market if it were to sell in earnest, as the Plaintiffs advocate. This auction, I find, certainly did not show that CCC would be able to dispose of half its portfolio at satisfactory prices, ie near to its own pricing marks. This I think is all the more the case because CCC's own portfolio was composed of 6½ %, 6.75% and 7% capped floaters and the former were less attractive assets. The real importance of this auction event was its assistance with regard to price and providing material for negotiating more favourable repo marks with lenders. It was therefore, I find, quite reasonable to view the results of this auction as a factor which supported the continued holding of RMBS, certainly as against any serious selling.

2485. Thereafter, during the following five weeks up to mid-February, I find on the evidence that CCC's financial position did reasonably seem generally to improve. Liquidity certainly improved. Prices did not show clear improvement, somewhat, I infer, to Mr Stomber's surprise, because he expected new lower interest rates to improve prepayment speeds which would in turn improve prices. During January it is apparent from the evidence that this improvement was simply anticipated and awaited.

2486. It is further apparent that prepayment speeds did not increase as expected by Mr Stomber, (and indeed others in the Management team, although his views naturally have most prominence in the evidence), but the realisation and appreciation that this was happening only set in gradually over February. It appears from the expert evidence that this was because, even though the logic is sound, in practice, the banks' liquidity constraints which were operating at the time and beginning to bite were such that homeowners could not actually obtain offers of finance at the lower interest rates which might then be applicable. Thus, however much they might want to refinance at a cheaper (for them) rate, they simply could not do so. That, though, is a factor which I am satisfied, had not percolated through to the perception of the market place at the time, so as to be apparent to operators like Mr Stomber, and I therefore discount it for having the benefit of hindsight.

2487. In the circumstances, I do not find it unreasonable for Mr Stomber and the other Defendants to have attributed CCC's improved position to a recovery from the banks' year end pressures, and, at least before mid-February, to have anticipated that further improvement based on increased prepayment speeds was likely, that it was slightly puzzling that it had not yet

materialised very much, but that it was nonetheless something as to which it was appropriate to await expected developments.

2488. In this context, I note and accept Dr Niculescu's broad comment that the price declines in Agency RMBS of early March 2008 were unforeseen and not reasonably foreseeable, because they flew in the face of conventional economic wisdom; they were divorced from the intrinsic value of Agency RMBS and did not react consistently with market events, such as changing interest rates, which historically had been associated with the fall or rise of such prices. This is the kind of fact which can only be seen in retrospect. At the time, and with an unusual market phenomenon, there is insufficient evidence to draw such a conclusion, and awaiting further clarification of puzzling events is not unreasonable.

2489. I also find no significance in the fact that the recorded steep fall in IDP prices for RMBS took place only on 11th March 2008 and not earlier. This is because the evidence throughout the case has suggested that IDP prices lagged behind the timing of actual market transactions. I infer that this is because the pricing agencies were slower to gather the information than were participants in the market, or alternatively would wait to ensure that it was a solid trend. I am therefore satisfied that this fall actually reflected transactional information from some days earlier.

2490. I have noted that Mr Stomber's comments and emails during this period vary from reporting positive developments with somewhat upbeat assertions of confidence that the specific RMBS market would move as predicted, to expressing fear and trepidation about underlying trends in the market, comments which, at the time, Mr Conway – looking at a wider picture – rather endorsed. This, though, has been a feature of much of Mr Stomber's communications and I do not place great weight on such changes in his apparent mood. First, this is his style and personality. Second, I do not find it surprising in the light of the pressures which he no doubt felt himself under. The real issue is whether those negative features, which he obviously perceived, ought to have caused him to advise a change of strategy for CCC's business. This seems to me to depend on when it might appear that indications of a state of affairs which could or would lead either to some major market shock, or to an inexorable and terminal downturn in CCC's fortunes, became sufficiently salient that any reasonable director or manager in Mr Stomber's position should have seen this and reacted in that way. Tracing through the evidence, I find nothing which seems to me arguably to be so sufficiently notable or prominent, before what turned out to be the sea-change in market conditions which began around 14th February 2008, as ever more gloomy analysts' comments were promulgated. Even then, however, I am satisfied that these gloom stories did not become so prominent as to demand more than monitoring and keeping careful and (obviously) concerned watch on them for the moment, to see what developed. I note, for example, that CCC managed to negotiate both the 15th February and even the 25th February repo rolls with no significant change in its repo arrangements or sources, and no increased demands for haircuts or other features sufficiently notable to have been remarked upon.

2491. What developed was, of course, the actual market crisis which really set in a fortnight later, and of which CCC began to feel the effects as panic and defensive tactics began to pervade the banks, apparently some time between 29th February and 3rd March. I am not satisfied, though, that the imminence of this was sufficiently apparent during the period from 14th February to 27th February and specifically at the CCC Board Meeting, so as to mean that the Defendants culpably failed to appreciate or act on the significance of any indications at the time. Such a

finding would require me to find that no reasonably competent and careful director in the position of the Defendants at that time could have failed to appreciate the implications of such indications and to take some action in consequence. Looking at the evidence I find that that would be to require an unreal and unreasonable degree of perspicacity in such a director. In other words, it would be requiring the wisdom of hindsight.

2492. The Board Meeting of 27th February was, not surprisingly, focused very much on reviewing and approving the Annual Report and Year End financial statements, in particular for accuracy and clarity to investors. However, it is apparent from the notes of the meeting that the deteriorating market conditions since 14th February were pointed out by Mr Stomber and were discussed. Indeed the fact that something unusual, and probably the effect of internal pressures at the banks, was affecting the position was noted by Mr Sarles, and Mr Zupon expressed concerns as well. Comments which turned out to be prescient were made, such as that lower interest rates were not helping liquidity but helping the economy, and that banking ability to borrow and lend had not been "fixed", but the surrounding notes tend to suggest that this was in the context of ensuring that the risks of credit, liquidity and financing were all disclosed and sufficiently highlighted in the financial statements. All in all, the notes convey the impression that these factors were perceived, but in a matter of fact way, rather than as significant indicators of a deepening crisis to come.

2493. I have therefore asked myself whether this was culpably paying too little attention to those factors, which were indeed harbingers of the cataclysmic changes to come, but I am not satisfied that it was. To hold so would be to apply too much hindsight. My overall impression, having had regard to all the evidence, including both CCC's recorded results, and the metrics noted in the ALCO pack of 29th February (even assuming, in the Plaintiffs' favour, that these figures had all been available as background information to a Board Meeting on 27th February, when they clearly were not) is that the Defendants' appreciation of and reaction to the facts which were unfolding was not outside the range of reasonable appreciation or conduct of directors in their position, with such knowledge both of history and of current facts as they possessed at the time.

2494. The true extent of the loss and damage inflicted and spilling over from the sub-prime mortgage bond market into the underlying financial systems was not then fully apparent, and it was not culpable of the Defendants not to perceive this, nor to anticipate its ultimate effects. It seems apparent from the expert evidence that by then, in managing their reverse repo business, the banks were not reacting solely to factors within this sector of the market, but more and more to credit risk in other, more diverse sectors of the market to which they were exposed, depending, of course, on the areas into which they were individually diversified and which were affecting their overall financial position. This was further complicating the position, but in ways which the Defendants had no real means of appreciating.

2495. For completeness, although I only regard it as a small point, I consider that the Defendants' submissions do derive some small support from the attitude of PwC (Mr Reville) at the Board Meeting of 27th February, and indeed of the fact that in the run up to this meeting and the formal signing off of CCC's Annual Report, Mr Reville and his team had expressed no qualms to CCC or to its Management, about CCC's position as a going concern, or the good sense of continuing with the capital preservation strategy.

2496. At this point in the history though, close to the end of the story, another factor also becomes particularly pertinent, and it is the practicalities and practical effects of what the Defendants actually could and should have done, even if they had then appreciated the enormity of a likely market crash. Even if the factors which the Plaintiffs rely on were indeed to be viewed as warning signals of impending disaster which could not be ignored, by the time of mid-February 2008 it seems to me that practical considerations strongly suggest that this could have made no difference to CCC's eventual fate. If Mr Stomber or another of the Defendants had, in fact taken the view even as early as 14th February that deteriorating market conditions were so ominous that they demanded that CCC should change its capital preservation strategy to a strategy of selling, it would have taken at least a few days to organise formal consideration of such a strategy change by the Board. I am not fully persuaded that, had such consideration taken place, the conclusion would then necessarily have been that attempting to make major sales, was a worthwhile strategy in CCCs' interests even; I think it is speculative as to what would have been decided. However, assuming that a process of selling would have been decided on, it also seems to me in all the circumstances (although this is inference as I have had no direct evidence on this) that it would in all likelihood still have required another few days to make organised arrangements for actually trying to do so. On any basis, therefore, I think it is highly doubtful whether any such change of strategy could in practice have been implemented effectively before the events which brought about CCC's collapse in reality, even assuming that it was implemented at the earliest time at which I think it might even be arguable that it was incumbent on the Defendants to consider making some such change. That is a point which I consider more widely later, in relation to causation and quantification.

2497. In summary, therefore, I am satisfied that it was reasonable for the Defendants, in particular Mr Stomber and Mr Conway, to continue proceeding during this period on the basis that there was no good reason to think that market conditions, or any other consideration, had changed or were about to change so significantly that CCC's capital preservation strategy approach ought to be reconsidered, still less so far that it was only reasonable actually to change it. The factors which had driven this strategy up to 1st January 2008 remained substantially the same during the following eight weeks. The only superficially obvious point was that a further period of time, up to two months, was elapsing, without CCC's asset prices having risen as the strategy anticipated. This was noted, as was the associated surprising absence of increased prepayment speeds; however, I find that, viewed at the time, there was no reason to endow that with huge significance such as to demand some immediate reaction; it was treated, and in my view reasonably, as another apparent quirk of the unusual and unsettled market, appropriate to monitor for developments, and gave no reason to doubt the logic behind the capital preservation strategy.

2498. For completeness, I add the following points. I am satisfied that CCC's non-selling of RMBS during this period owed itself to the general capital preservation strategy, coupled with the situation not providing any obvious and sufficiently safe opportunity to conduct any sales, and not to any unreasonably intransigent refusal to countenance such sales. The Plaintiffs continue to contend that the Defendants had all along adopted a recklessly rigid attitude to the possibility of selling any RMBS at all, and that this was their real (and indefensible) policy, rather than the more flexible one that would permit sales as a last resort or in case of opportunity, which the Defendants claimed (the Plaintiffs say only after the event) to have always adopted.

2499. I had already been disinclined to accept the Plaintiffs' submission based on my general perceptions of the evidence. However, I also note that on 10th January 2008, Mr Trozzo sent an email to Mr Thierry of Lehman which shows that, in answer to a direct enquiry from Mr Thierry, made on 3rd January 2008, as to what CCC would do if market conditions further deteriorated to a level where the liquidity cushion proved insufficient, Mr Trozzo had replied to the effect that (with the use of the Carlyle funding note programme not being an available option), the first course of action would likely be to engage TCG's assistance, but *"Secondly, we would consider voluntarily liquidating a portion of our RMBS"*. This statement is completely consistent with the Defendants' position that the capital preservation strategy was only to sell RMBS as a last resort, but that sales were not completely ruled out. I find this alluded to expressly here in the papers, and I am satisfied that this had been and remained the general philosophy all along.

2500. I am satisfied that the Defendants' reaction, in particular Mr Stomber's, to the way in which repo funding was developing and evolving at all times up to the end of February was reasonable. The prospect of "working" the repo lines had always been accepted as necessary, but achievable with effort, persistence and perhaps ingenuity, ever since the crisis of August 2007. By the time of the new year, this was a routine part of keeping CCC's capital afloat, and I do not see that any events in this period were a major change of circumstance. Weighted average haircuts remained, overall, in the range which CCC had calculated it could accommodate, and repo availability, whilst tight (111%) still had some headroom, and CCC had in fact come closer to having insufficient capability to make a roll during pressures in the previous August and September but had survived.

2501. As regards the tri-party repo project with BoNY, I find that it was not unreasonable for Mr Stomber to take the view that this remained a possibility. I suspect there was initially a misunderstanding between Mr Stomber and Mr Burns of BoNY, with the latter imagining that setting up arrangements was going to proceed at a more leisurely pace than did Mr Stomber, who rushed straight ahead in making his telephone calls. The subsequent correspondence seems to me to have the air of Mr Burns repairing the position. I reject the Plaintiffs' submission, in effect, that it was negligent and incompetent of Mr Stomber to imagine that any such arrangement would ever be possible. This suggestion was based on the evidence of Mr Welles, which, whilst I am satisfied it was given in good faith, was nonetheless first given 10 weeks into the trial and in "response" to Mr Stomber's oral evidence, even though he had mentioned tri-party repo in his original witness statement; it thus apparently did not occur to Mr Welles to make these far-reaching criticisms before the trial, and Mr Stomber could not be further examined in answer to Mr Welles' point, as a result. Whatever Mr Welles' evidence that the usual circumstances of such repo arrangements were very different from CCC's perceptions, and even if Mr Stomber had succumbed to a degree of wishful thinking in his pursuit of it, I find it implausible that BoNY would have comprehensively misled CCC over such a possibility, not least because a future banking relationship would have required the nurturing of trust. Whilst I note the contemporaneously expressed scepticism of Messrs Hance, Allardice and Sarles about the likelihood of obtaining tri-party repo, I do not read this as anything more than caution about counting chickens before they hatched.

2502. In any event, in the position in which CCC found itself, in early 2008, it seems to me that it had no sensible alternative but to continue making ceaseless efforts in any possible direction to obtain necessary funding for its RMBS portfolio, insofar as there might be any possibility of

their bearing fruit. This is what it in fact did. I do not find that continuing to do so was reckless or negligent.

2503. I am therefore satisfied that it is fair to say that the immediate cause of CCC's collapse in early March 2008 was the unforeseen systemic liquidity crisis among the banks, and the "run on repo" which this caused.

2504. I have not mentioned the alternative allegation of breach of duty as regards not attempting to raise additional equity capital to reduce leverage as this was not seriously argued. For completeness, though, I have previously considered the extent to which this was a practical possibility, and concluded that it was not. No factors which might have made it any more practical are revealed during this period.

2505. It was suggested in cross-examination of both Mr Conway and Mr Stomber that certain amongst CCC's self-admitted group of "peers" had attempted to raise capital, whereas CCC had not. The explanation given was that they, and in particular Annaly, were in a significantly different position because they were established companies with a track record which made raising more equity capital feasible. I accept that proposition and justification. I do not find it particularly helpful to compare what allegedly "peer" companies of CCC's might or might not have decided to do, because no such entities were precisely comparable to CCC, and in any event, the competence of a decision depends on whether it was within the range of possible reasonably competent decisions for CCC, and not whether it coincided with the thinking of some other group of directors of a different company.

2506. Mr Zupon seems to have been the director of CCC who was particularly aware of the possibility of seeking to raise more capital. I rejected the Plaintiffs' criticism that in November 2007 he accepted the other Defendants' views that it was impractical, but they have further criticised the fact that he raised the point again in January 2008, following the apparent passing of the "year end" constraints, but then only to Mr Hance, and did not insist on obtaining further analysis. I disagree that this response was "*inadequate given that CCC would have benefitted from additional capital*", as the Plaintiffs submit. Mr Hance was the Chairman of CCC, with an overarching role of ensuring that appropriate consideration was given to material matters. He was also closer to CCC's everyday operations than was Mr Zupon. Raising the point with him seems to me to be eminently appropriate, in the circumstances, and I do not find Mr Zupon's consequent reliance on Mr Hance to pursue the point further if, and when he thought it appropriate or worthwhile doing so, to have been unreasonable or negligent. Given that I am satisfied that it would not have been a practical approach, or indeed sufficient to make any ultimate difference if it had been attempted in any event, I do not take this any further.

(c) Breach of contract/tort by CIM

2507. Once again, this is a claim in effect based on alleged negligent advice by CIM, and therefore rests on the same facts as those alleged against Mr Stomber with regard to the claim of his alleged breach of his duty of care as a director of CCC. For the same reasons as lead me to dismiss that claim, the claim against CIM as investment manager, in contract or tort, also fails.

(d) Wrongful trading

2508. As already observed there is no claim in wrongful trading with regard to this period. However, in my judgment, CCC never reached a point where it was unable to meet its debts, even as "they fell due", before the time of the sudden avalanche of margin calls which were prompted by the brewing liquidity crisis of March 2008. Carlyle was not pressing for payment of the loans it had made. CCC always succeeded in obtaining financing as required up to that time and it paid all margin calls up to that date. Also, in my judgment, there was no point prior to the point when they actually did so that the Directors of CCC ought to have concluded that CCC stood no reasonable prospect of continuing to do so and thus avoiding insolvent liquidation. Whilst this may be a very sudden change of fortune, the evidence shows that, in the financial markets, fortunes can indeed change that quickly.

Final Conclusions as regards the individual Defendants and CIM as investment manager

2509. It follows from the above that, in dismissing the Plaintiffs' claims against the individual Defendants for breaches of duty and in relation to CIM for breach of contract/tort in this period, I have now dismissed all such claims in the action.

15. The Claims: Liability of the Entity Defendants as de facto or shadow directors.

2510. I have so far not considered at all the allegations of liability made against the Eighth to Tenth Defendants other than to dismiss the claims of breach of contract or negligence *qua* investment manager against CIM, and I now turn to these.

Preliminary – limits of case

2511. Paragraph 80 of the Cause is the foundation paragraph for the Plaintiffs' claims against the Entity Defendants. Within it, though, the Plaintiffs asserted, not just a claim founded on allegations of *de facto* and/or shadow directorship, but also (it appeared) an additional basis of claim, namely that the matters complained of amounted to breaches of "*other duties*" owed to CCC arising out of the nature of the relationship between the Entity Defendants and CCC, as asserted in paragraphs 76 and 77 of the Cause. Those paragraphs contained allegations, first of "*pervasive control*" of CCC by the Entity Defendants and second of a "relationship of trust and confidence" between CCC and the Entity Defendants. From this, it appeared that the Plaintiffs might be intending to argue some other grounds for imposing liability on one or other of the Entity Defendants outside the two recognised concepts of *de facto* or shadow directorship; the second phrase, in particular, is usually found in the pleading of a cause of action based on undue influence.

2512. However, in answer to a specific query from the bench as to whether this was so, Advocate Wessels confirmed that it was not. Following their closing submissions, the Plaintiffs expressly confirmed in writing that as against the Entity Defendants, their claims against TCG and Holdings rested entirely on the allegation that those Defendants were either *de facto* or shadow directors of CCC and thus themselves owed to CCC the various duties of directors. They alleged no other grounds of claim against TCG and Holdings, although as against CIM, they alleged both those bases of claim and also the further or alternative claims of breach of contract and/or non-contractual negligence.

2513. Turning, therefore to the claims based on *de facto* or shadow directorship, in my judgment these claims fail against each of these Entity Defendants *in limine*. The factual requirements

for such liability are simply not made out on the evidence before me, and are scarcely even pleaded.

The pleaded claims of de facto and shadow directorship

2514. The basic pleading of the Plaintiffs' case appears at Paragraph 80 of the Amended Cause:

> "80. *Carlyle each controlled the affairs of CCC and performed functions properly discharged by a director of CCC and/or was part of CCC's corporate governing structure, such that each of Carlyle and CIM was a de facto director under Guernsey Law. Further or alternatively, the majority of the directors of CCC took direction from and were accustomed to act in accordance with the directions of Carlyle and CIM such that each of Carlyle and CIM was a shadow director of CCC under Guernsey Law."*

2515. The authorities show that the "*and/or*" in the first sentence above cannot stand except as "*and*". The test for *de facto* directorship is emphatically what the defendant actually did, and merely "being" part of the corporate governing structure is not enough.

2516. A more technical point is that the term "Carlyle" as used in the Cause is stated to be a "*collective*" reference to Holdings and TCG. I doubt whether a joint directorship is possible even in theory. In my judgment a cause of action alleging either shadow or *de facto* directorship has to be made against a single individual. I will, though, benevolently treat the "collective" definition as being disjunctive, and the allegations of *de facto* or shadow directorship as being made separately against each of TCG and Holdings.

2517. I have already referred to the pattern of the Cause in making the same general allegations against groups of Defendants in respect of the times in point, but in places with further elaborations particularly relevant to that group. In the case of the Entity Defendants (referred to in the Cause as "*Carlyle and CIM*") the extra allegation is generally a reference to the claim of the "pervasive control" of CCC exercised by Carlyle and/or CIM. These allegations are ultimately found in Paragraphs 412R to 412ZF of the Amended Cause, where the complaints against CIM, TCG and Holdings are collected under the side heading "*Carlyle and CIM's pervasive control of CCC*". Attempting brevity, I summarise these paragraphs here.

2518. The Plaintiffs initially recite the ownership relations between the Founders and the Entity Defendants, and set out the circumstances of the appointment of the various personnel who actually conducted CCC's affairs day to day, in particular Mr Stomber and Messrs Greenwood, Trozzo, Rella and Green. They stress the instrumentality of "the Founders" (in places "*on behalf of"* Carlyle and/or CIM) in setting up these structures. They also stress the practical power of the Founders over the employment position of each of such senior personnel.

2519. A specific allegation of the shadow directorship of the Entity Defendants is made at Paragraph 412Z, and matters relied on for this then follow. First, at paragraph 412ZA, the Plaintiffs plead 14 individual written statements made by Mr Stomber between November 2006 and 14th March 2008, which they say show that Mr Stomber *"at all material times"* acted "*in accordance with Carlyle's wishes and its interests and …primarily to protect and advance the interests and reputation of Carlyle*". These might be argued to show a mindset of servility, or even sycophancy, on Mr Stomber's part, but they do not even mention any directions or instructions from an Entity Defendant.

2520. The Plaintiffs next plead the provisions in CCC's Articles of Association which confide special powers of approval to a majority of the Independent Directors as previously noted, and they plead in Paragraph 412ZD that in exercising those powers, rather than exercising their own independent judgement and responsibility the three Independent Directors were instead

> *"accustomed to act in accordance with the directions and instructions of Carlyle, expressed through communications made by persons acting for and on behalf of, or alternatively in the interests of, Carlyle".*

2521. One can just about extract from this an assertion of the giving of instructions or directions (to the Independent Directors, therefore) by a person acting on the authority of TCG or Holdings, but it does not condescend to the necessary identification of the giver of the instructions or the alleged material instructions themselves. This could, though, be remedied by the four matters which are then pleaded as founding this allegation. They are

i. *"as a consistent course of conduct …acceding unquestioningly to requests*" (maker not specified) for approval to reductions/suspensions in CCC's key risk management measures (including the minimum liquidity cushion),

ii. "*acceding unquestioningly"* to Mr Conway's alleged "*decision"* to refrain from selling RMBS,

iii. "*acceding unquestioningly"* to Mr Conway's alleged "*decision*" and/or Mr Stomber's "*recommendation"* not to seek to raise additional equity capital,

and lastly

iv. refraining from requiring more frequent Board meetings and instead simply *"permitting Carlyle and CIM to operate CCC as they saw fit"* - particularly as regards continuing to operate without maintaining a minimum liquidity cushion as a known "*fundamental*" element of CCC's business model.

None of the above however is an allegation of a direction or instruction from TCG or Holdings being followed, whether customarily or otherwise, by Messrs Allardice, Sarles and Loveridge.

2522. The Plaintiffs next plead (Paragraph 412ZE) that "*Carlyle and CIM, through the Founders and Senior Carlyle Personnel, controlled and directed the affairs of CCC"* in that they

> *"1. regularly undertook functions in relation to CCC which could only be properly discharged by a director, and formed part of CCC's corporate governance structure; and/or*
>
> *2. exercised a degree of control over the business and affairs of CCC that was at least on an equal footing with that exercised by its de jure directors; and/or*
>
> *3. were held out to, and regarded by, CCC's shareholders and creditors as part of the corporate governance structure of CCC, and responsible for its success; and/or*
>
> *4. were the substantial or predominant influence in directing the affairs of CCC."*

2523. Although sounding initially like an allegation of shadow directorship, the details only mention aspects of *de facto* directorship in (1) and (3), but even none of these allegations is specific; they ring more of a submission than statements of fact and are mostly mere assertion. They do not plead specifically any fact capable of bringing home liability to any of the Entity Defendants arising from having acted as either a shadow or *de facto* director of CCC in any material respect in this action. A finding of *de facto* directorship has to be founded on proof of the doing of a specific (offending) "directorial act" by the relevant defendant, and a finding of shadow directorship has to be based on proof of actual directions or instructions given by the defendant.

2524. This could, again, be cured by further particulars, and the Plaintiffs do indeed go on to plead further matters at Paragraph 412 ZF, although they do this as "*further or alternatively"* rather than as particulars of Paragraph 412E. They plead here that Carlyle and CIM

> "*through the Founders and Senior Carlyle Personnel, controlled and directed the affairs of CCC",*

listing 16 individual occasions of such alleged control or direction between the inception and the demise of CCC, in which Messrs Rubenstein, Mayrhof, Buser, Nachtwey, Harris, Ms Cosiol or unspecified senior Carlyle personnel, sometimes in conjunction with Mr Conway, took some step in relation to CCC's affairs. There is no need to recite all of them, but as a flavour, they include matters as diverse as seeking investment in CCC, forming plans in case its IPO did not proceed, overseeing CCC's publicity materials, dealing with CCC's funding counterparties and auditors, and receiving or making reports on CCC's affairs. However, only one such allegation is in respect of a matter which is alleged to have caused loss to CCC. This is at Paragraph 412ZF.5, which cites the familiar decision not to sell RMBS (etc) in August 2007, and the potential provision of a further loan from Carlyle to CCC in September 2007, but pleads that these were decisions of Mr Conway, acquiesced in by the other *de iure* directors of CCC. Mr Conway was, of course, a *de iure* director of CCC. Thus, this allegation neither alleges any "directorial acts" of CCC effected by personnel who were agents of an Entity Defendant, nor the communication of any "direction or instruction" to a *de iure* director of CCC by an Entity Defendant.

2525. The next material Paragraphs of the Cause are those at 419 – 421, in a section headed "*CIM's wrongful conduct"*. There is first pleaded against CIM, 21 matters of conduct each said to be reckless, grossly negligent (or negligent), wilful misconduct, and a breach of the fiduciary "*or other"* obligations owed by it to CCC, and then, at Paragraph 420, it is pleaded that

> *"as a shadow and/or de facto director of CCC… , CIM owed the same fiduciary duties to CCC…"*

as its actual directors owed, and that CIM breached these, through the conduct pleaded, not (oddly enough) in para 419, but in Paragraphs 417.4 -417.24 and 418A- 418N - even though these are allegations of misconduct by the individual directors, of whom at least three, the Independent Directors, had nothing to do with CIM. On close and laborious examination, none of these alleged facts is anything which could be argued to have been done by CIM otherwise than as part of its functions as CCC's investment manager, or amounted to "directions or instructions" to the directors of CCC rather than being professional advice.

2526. In Paragraphs 422 - 424, the Plaintiffs then plead exactly the same matters as those previously pleaded in Paragraphs 419-421 against CIM, but now against "*Carlyle*", and the same points arise.

2527. In Paragraphs 424A –G, under the heading "*Additional particulars of breach by Carlyle and CIM"* the Plaintiffs then repeat a large number of earlier paragraphs of the Cause and allege, at intricate length, that the breaches of various fiduciary duties and duties of skill and care pleaded previously in those paragraphs were also breaches of such duties owed by CIM and "Carlyle". Again, it does not seem to me that these paragraphs contain allegations of the facts necessary to constitute either *de facto* or shadow directorship, as recognised in law.

2528. It thus seems to me that the Cause barely pleads a sustainable basis for a claim that the Entity Defendants incurred liability as either *de facto* or shadow directors of CCC for the breaches of duty alleged to have caused CCC loss. However, as the nature of the claim is reasonably apparent, I go on to consider what are the requirements for any such claim, and whether these can be made out on the evidence in the trial.

***De facto* directorship – discussion and conclusion**

2529. This is not a case of acting under an invalid appointment: none of the Entity Defendants was purportedly appointed a director of CCC.

2530. Nor is it a case of CCC having held out TCG or Holdings (or CIM) as a director despite the fact that they were not, with TCG or Holdings or CIM having joined in and purported to act as a director. Although such holding out is pleaded in respect of TCG and Holdings, there is no evidence of this even on a general basis, and certainly none in respect of the only material allegations of breach of duty, ie those alleged to give rise to the loss suffered by CCC.

2531. The type of *de facto* directorship alleged here is the third category of *de facto* directorship, identified above under Legal Principles, ie that of interference. It requires that the Entity Defendants can be shown to have meddled in the affairs of CCC by themselves carrying out acts which only a director of CCC had power to carry out, and which were culpable on the part of a director of CCC in the ways pleaded. To be a qualifying act, for the purpose of founding proof of *de facto* directorship in this case, the relevant act must satisfy four criteria. It must be

(i) an act carried out on behalf of CCC, that only a *de iure* director of CCC could perform,

(ii) an act carried out by the relevant entity sought to be fixed with liability (ie by a human actor who is either an empowered officer, or the duly authorised agent, of that entity, and for that purpose),

(iii) an act which the relevant actor could not be legitimately doing in a capacity other than that of a director of CCC,

and, in addition, in order to give rise to liability

(iv) an act which was in some way causative of the damage to CCC of which complaint is made.

2532. Leaving aside the fourth requirement for the moment, as regards TCG and Holdings, there is no acknowledgment of the first three criteria in the pleading, and there is neither pleading, nor evidence, to show how it is maintained that the only actions which are claimed to have caused actual loss to CCC, namely the decisions not to sell RMBS or seek to raise further equity capital from July 2007 onwards, were carried out by TCG or Holdings, as a matter of fact. Certainly facts demonstrating the necessary authority from TCG or Holdings to the person(s) who actually did any such material acts would have be pleaded and proved. There is nothing approaching this.

2533. Even overlooking the absence of a properly pleaded case on the pleadings, but applying the correct legal principles to the evidence in this case, I find the allegations of the *de facto* directorship of CCC, whether by CIM, TCG or Holdings to be unsubstantiated. The allegation is little more than assertion, founded totally on the argument that the relationship of TCG and Holdings (or CIM) to CCC should be characterised as one of "control", and arguing that "therefore" any material decision or act of CCC or its Board can be regarded as being "really" that of TCG or Holdings (or CIM). That is neither principled, nor is it the law.

2534. The short point is that the only decisions which are alleged to have caused loss to CCC are the decisions made at various points between July 2007 and March 2008 not to sell RMBS (or not to try to raise equity capital) but instead to hold on to those assets and to continue the necessary borrowings to do so, and, on the evidence, those decisions were taken or endorsed, and the implementation of those acts was authorised, by the *de iure* directors of CCC. Even if the scope of relevant decisions is extended to include such ancillary matters as authorising the suspension of the Investment Guidelines, those decisions were also still taken by the *de iure* directors of CCC.

2535. There is no evidence of any such decision being taken by anyone in the capacity of agent for TCG or Holdings. Whilst it might be argued that some such decisions were taken or implemented by CIM, such acts were properly done in CIM's capacity as investment manager for CCC, appointed under the IMA. They are plainly referable to that status; they are not CIM's officiously assuming the functions of a director of CCC.

2536. Even where distinctions in capacity might begin to become blurred in practice (I note, for example, that Mr Green resigned from CIM, and thus what was effectively his position as CFO of CCC at the end of January 2008 shortly before the end of the material time, and the result was that Mr Buser of TCG rendered more assistance to the operations of CCC in his place), that makes no difference to the fundamental point that to make out *de facto* director liability it would be necessary to prove that an individual acting on behalf of TCG or Holdings did material acts on behalf of CCC which could only have been done by a director of CCC. I was in fact not even addressed on the basis that there were any such examples in the evidence. The whole pattern of the Plaintiffs' submissions in this regard was simply reliance and emphasis on the strength of the alleged "pervasiveness" of the Carlyle ethos and influence in the running of CCC's affairs, and that this somehow made TCG or Holdings tantamount to directors of CCC, such that they could be called *de facto* directors of CCC. An alternative submission was that as Mr Stomber and Mr Conway, in particular, failed themselves (it is said), to distinguish the capacities in which they might be acting, that opened up the door to treat their acts as being carried out on behalf of TCG, or Holdings (or I think, CIM), simply because they had authority to act on behalf of those entities (Mr Conway) or were effectively employed by those entities

(Mr Stomber, even though that proposition is not really accurate as he was employed by CGEC). In my judgment that simply is not enough.

2537. In their closing submissions, the Plaintiffs argue that "*the appropriate inference to be drawn*" from the evidence (including, they say, the absence of any evidence given by any other Carlyle/CIM personnel who had involvement in CCC's affairs beyond those called by the Defendants) is that

> "*…the Defendants, the Senior Carlyle Personnel and CCC's authorised Officers were acting concurrently on behalf of Carlyle, CIM and CCC at all relevant times*".

2538. This vague and broad brush approach is neither correct as a matter of legal analysis of the facts, nor is it a permissible basis of liability. I unhesitatingly reject it.

2539. Thus the allegation of *de facto* directorship of CCC made against the Entity Defendants, in respect of the acts which are material to the alleged causing of damage to CCC therefore fails on this fundamental point of evidence.

Shadow directorship – discussion and conclusions

2540. As regards the allegation that CIM, TCG or Holdings was a shadow director of CCC in respect of any material decision, I find that the Plaintiffs' case also fails.

2541. The key point here, in my judgment, is that the Plaintiffs must identify some "directions or instructions" emanating from the relevant entity and in accordance with which the actual directors of CCC (or, if applicable, the relevant voting majority of such directors) was "accustomed to act". As the entities sought to be made liable are corporate entities, CIM, TCG or Holdings, it is therefore <u>their</u> directions or instructions which have to be proved. This requires a finding against either CIM, TCG or Holdings that <u>that entity</u> gave directions or instructions to the directors of CCC, or the relevant majority of them, in respect of any relevant act and such that there is a discernible pattern of those directors "doing as they were told" by CIM, TCG or Holdings rather than exercising their own judgment in respect of the relevant act or aspect of CCC's business. This in turn means proving the communication of relevant "directions or instructions" by some person who was doing so in the capacity of either the appropriate organ or a duly authorised officer or agent of the entity (CIM, TCG or Holdings) in question.

2542. Again, taking TCG and Holdings first, the Plaintiffs have not, it seems to me, even focused on making out this requirement as a matter of evidence. No evidence has been adduced or elicited, of any material "directions or instructions" being given to the Directors of CCC with regard to any of the decisions or failings complained of by any person, let alone any person shown to be acting in that regard on behalf of and with the authority of TCG or Holdings. Neither is there any evidence of conduct from which it might be properly inferred as a fact that directions or instructions were being given by either TCG or Holdings to CCC's directors (or to any material group of them such as "Allardice, Sarles and Loveridge"), and in accordance with which they were "accustomed to act". Indeed, I do not think that it was ever suggested to any of the last three directors that they were acting on directions or instructions at all, as contrasted with it being suggested that they exercised no independent judgement and unquestioningly did what either Mr Stomber or (as the allegation more often is) Mr Conway requested, proposed or recommended. That is not the same thing.

2543. I have already noted when considering legal principles that the authorities show that the mere fact of holding a company's shares, or a majority of them, is insufficient to constitute an entity a shadow director of the relevant company. Thus, even if the voting shares in CCC were to be treated as held by either TCG or Holdings, that would not justify a finding of shadow directorship.

2544. There is, I find, no evidence sufficient to found a conclusion that the *de iure* Directors of CCC (or a relevant majority of them) were accustomed to act in accordance with instructions or directions given by TCG or Holdings, let alone that they did so act in the respects which are alleged to have caused CCC loss. There is no evidence of actual directions or instructions. Mere influence is insufficient, even if it is considerable, and "control" would likewise only be sufficient if it manifested itself in the form of the necessary pattern of instructions given and customary compliance. None of that is made out here.

2545. Moving to CIM, since CIM was CCC's investment adviser, it is necessary to consider in what capacity any communications to CCC's directors which are established as being from CIM were given and whether they were, in substance, advice being given in a professional capacity or, rather, "directions or instructions" as to how to act. I have no hesitation in finding that any such communications were the former. Even assuming that communications from Mr Stomber to the other directors of CCC were to be treated as coming from CIM, rather than (as I would have thought more reasonable) from CCC's own CEO director, there is, once again, simply no evidence to support the proposition that Mr Stomber was conveying CIM's "directions or instructions" to the directors of CCC, as contrasted with CIM's investment advice.

Final Conclusions as regards the Entity Defendants as directors

2546. For all the above reasons, therefore, the claims against the Entity Defendants based on allegations of their *de facto* or shadow directorships of CCC fail completely.

2547. As the Plaintiffs' claims against the Entity Defendants have now become defined, my conclusions on this aspect of the claim are sufficient to dispose of all claims which have been maintained against TCG and Holdings. The Plaintiffs' action against those entities will therefore be dismissed. As regards CIM, they dispose of the claims founded on *de facto* or shadow directorship. The Claims against CIM made on the basis of breach of contract or negligence have been considered above.

16. Causation and Quantum

Preliminary

2548. The arguments in this case have never got as far as any detailed consideration of damages calculations. It has not been worth doing so in advance of findings of fact which would enable a properly focused exercise to take place.

2549. Because I have held that the Defendants committed no breach of duty (and nor, consequently, misfeasance) and were not guilty of wrongful trading, it is strictly unnecessary for me to deal with issues of damage and quantum. The question is therefore whether I should nonetheless consider these points in case this matter goes further (to use the traditional phrase).

2550. Doing so raises some difficulties. Whilst it is often possible to postulate a different legal conclusion and state what consequent alternative outcome the court would find on that basis, it is not easy to do so in this case. This is because assuming a different result on liability here is to assume not simply a different judgment on legal principle, but a different judgment on a matter of mixed law and fact. A major part of my reasons for holding that the Defendants did not commit breaches of duty has been the highly doubtful prospects of making worthwhile sales of RMBS at the relevant times – worthwhile in terms of both quantity but also, and in particular, in terms of likely price. Those are findings of fact. To assume, therefore, that failing to sell was a breach of duty involves the assumption that it was grossly negligent or a breach of fiduciary duty not to sell despite those factual circumstances.

2551. All of this makes my views on the isolated effects of causation and quantum highly unnatural and very much more hypothetical. I have therefore been uncertain as to whether I ought to include the following conclusions in my judgment at all. However, given the enormity of the case and the resources which have been invested in it, including argument on this topic, I have concluded that on balance I should.

2552. My conclusion, in short, is that even if the Plaintiffs had satisfied me that the Defendants' failure to sell significant quantities of RMBS was a breach of duty, or that they were guilty of wrongful trading at any of the points in the history on which they focus, their evidence entirely fails to satisfy me that it can be established on balance of probability that CCC did suffer any identifiably worse financial outcome as a result. Therefore, this action fails for that reason as well.

Principles

2553. It is appropriate to start by identifying the principles governing an award of financial compensation in each of the cases of breach of duty of skill and care, breach of fiduciary duty and wrongful trading alleged, so as to determine what requires to be proved with regard to loss and damage, and how an appropriate award would be quantified or calculated.

(a) Breach of duty of care

2554. As regards breach of the duty of skill and care, the principles are those which apply in the general case of negligence.

2555. In *Bristol and West Building Society v Mothew* [1998] Ch 1, Millett LJ, distinguished the principles of causation, remoteness of damage and measure of damage applicable in the case of an "equitable" duty of skill and care from equitable compensation for "*breach of a fiduciary duty which may be awarded in lieu of rescission or specific restitution*". He held that the former loss was recoverable on the same basis as damages for common law negligence.

2556. It is the former with which I am here concerned. I have already pointed out that the concept of a fiduciary (or equitable) duty of care is no different a concept from the ordinary duty of care, but simply such a duty owed in the context of a fiduciary relationship. This does not affect the dictum above, and if anything reinforces it. The contrast referred to by Millett LJ makes no difference on this point either. The breaches of fiduciary duty alleged here are of a different kind from those giving rise to a claim for rescission or restitution. The Plaintiffs claim compensation for loss – more accurately, for failure to avoid loss, but it amounts to the same thing.

2557. In this context therefore the starting point is the ordinary starting point with regard to establishing causation in negligence. Subject to rules as to remoteness, the defendant is liable for all losses which flow directly from the breach of duty, and this is initially proved by the test that "but for" the breach of duty complained of, the loss which is being considered as the candidate for compensatory recovery would not have occurred.

2558. There may then be a subsequent question as to whether the breach has to be "the effective or dominant" cause, or merely "an effective" cause, of the actual loss. A distinction may also be drawn between whether the wrongful act caused the loss, or merely provided the occasion for it to occur: see *Galoo Ltd v Bright Grahame Murray* [1994] 2 BCLC 492, in which it was held that an auditor's negligence in overvaluing the company's stock, which thus hid the fact that the company was valueless and enabled it to continue trading and incur further losses, did not "cause" those losses.

2559. These are expressions by which the courts seek to describe the line between what is perceived as a cause, or merely as a circumstance. It may be a difficult conceptual line to draw at times, and with regard to these limiting distinctions it has been observed that

> *"Ultimately, all of them depend on a developed judicial instinct about the nature or extent of the duty which the wrongdoer has broken*"

per Lord Neuberger, in the recent case of *BPE Solicitors vs Hughes-Holland* [2017] UKSC 21 at [20]). However the broad initial qualifying test remains that of "but for" causation, which is a necessary, although not necessarily sufficient, test for liability. There must be a discernible direct causal link between the breach complained of and the loss in question.

2560. Once causation is established by this test, the quantum of recoverable loss then has to be calculated or assessed, according to the rules relating to remoteness of damage and any other principles applicable to that second stage, although these assessments may themselves be affected by the perception of the nature of the duty of care in question: see the *BPE Solicitors* case, above.

2561. In general in negligence, the doctrine of remoteness limits recovery on the basis of whether the particular loss was a reasonably foreseeable consequence of the relevant breach of duty, or not. This depends on the facts and circumstances. Where the loss results from some supervening and unexpected occurrence it will probably be excluded for being too remote from the breach of duty. However, where the loss results from the very matter from which the defendant was under a duty to protect the plaintiff, it will be obvious that the test is met. In a sense that simply re-states the question, ie was it the very matter from which the defendant was under a duty to protect the plaintiff? It redirects attention, once again, to the nature or scope of the duty of care. A more constructive test will often be: for what consequences does it appear that the defendant ought to be held responsible? (cf: Lord Hoffmann's article on *Causation* (2005) 123 LQR 592 at 595). This will again depend on the circumstances.

2562. In my judgment it is very important, though, to keep in mind that the process of assessing causation and quantum is not a single process but a two stage process: see *Parabola Investment Ltd v Browallia Cal Ltd* [2011] QB 477 at [23]:

> *"The claimant has first to establish an actionable head of loss. …….The next task is to quantify the loss. Where that involves a hypothetical exercise, the court does not apply the same balance of probability approach as it would to the proof of past facts. Rather, it estimates the loss by making the best attempt it can to evaluate the chances, great or*

small (unless those chances amount to no more than remote speculation) taking all significant factors into account…" (emphasis added).

2563. Thus, the first stage is to decide whether the defendant is liable for having sufficiently caused loss by conduct which was a breach of the duty in question. The second stage is to quantify the recoverable loss which the plaintiff suffered as a result of the identified breach of duty, rather than some extraneous matter.

2564. The former stage, that of causation, is a finding of fact which, in common with all findings of fact has to be proved on the basis of the ordinary civil standard of proof, ie the balance of probabilities. The latter, that of quantification, is not. The Plaintiffs cite the following helpful passage from Patten LJ in *Vasiliou v Hajigeorgiou* [2010] EWCA Civ 1475 at [25]

> "*Where the quantification of loss depends upon an assessment of events which did not happen the judge is left to assess the chances of the alternative scenario he is presented with. This has nothing to do with the loss of chance as such. It is simply the judge making a realistic and reasoned assessment of a variety of circumstances in order to determine what the level of loss has been".*

2565. Although the Plaintiffs cite the above two cases in relation to assessing equitable compensation because their case lays more stress on this, the basic approach is, in my judgment, the same in negligence, and these dicta apply just as much to causation and damages with regard to the duty of care. There are, though, aspects in which the assessment of equitable compensation does differ from that in relation to duty of care, as mentioned below. It will depend on the facts whether these make any difference to the end result.

2566. Lastly under this head, the Defendants submit that if the Plaintiffs cannot show that <u>any</u> loss has been caused to CCC by the Defendants' alleged breaches of duty on this "but for" test and the balance of probability, then that is certainly an end to the Plaintiffs' claim based on breach of the duty of skill and care. This is because proof of loss is a required ingredient of the cause of action itself. I think this is correct. A claim for breach of the duty of skill and care is a claim in negligence and the fact that it arises out of the relationship of company and director does not make any difference to the principles.

(b) Breach of fiduciary duty

2567. As regards the principles for recovery of equitable compensation for loss caused by breach of fiduciary duty, the Plaintiffs accept that, as its title suggests, the principle is that such an award is compensatory and, again, a "but for" test of causation is to be applied.

2568. However, they argue that the principles differ as to what is to be treated as compensatory, in other words, it seems to me, as to quantification. They cite Snell's ***<u>Equity</u>*** (Cumulative Supplement to the 33rd Edition, 2015, at 20-028), stating that

> *"In every case equitable compensation may only be awarded in respect of losses the claimant can show would not have occurred but for the breach in question. Such losses are to be assessed as at the time of trial using the full benefit of hindsight."*

This latter, they then submit, applies a stricter test of liability in the case of a fiduciary, justified as a matter of policy, to encourage fiduciaries to fulfil their duties.

2569. Both Plaintiffs and Defendants rely on the Supreme Court case of *AIB Group (UK) plc v Mark Redler & Co Solicitors* [2015] AC 1503, recently approved as representing the law of Guernsey by McMahon DB in *Romain Zaleski v GM Trustees Ltd* (1st September 2015: Guernsey Judgment 42/2015), for the principles governing equitable compensation.

2570. The Defendants submit that this case is really the last word on the matter, overriding any earlier authority, which therefore really does not need to be looked at. They submit that the key points to be derived from the *AIB* case are that

(i) the purpose of equitable compensation is to compensate (Lord Reed at [2015] AC 1503 at [136]), not to punish;

(ii) the award is again limited by a "but for" test of causation, being confined to losses which would not have been suffered "but for" the relevant breach, and

(iii) awarding compensation for a loss which would have been suffered even if the relevant duty had been performed is not permissible, because it would be penal (Lord Toulson at [62] – [64].

However they accept that

(iv) there is a difference in that foreseeability as a test of whether loss is recoverable under the principles of remoteness of damage which apply in the assessment of damages for negligence does not apply; the test is simply the test of direct consequence, ie whether the breach in fact caused the loss in question, whether it was foreseeable or not (Lord Reed at [135]).

2571. I do not understand the Plaintiffs to dissent from this. However, and relying on the proposition that foreseeability is immaterial (*Zaleski* (above) at [124]) the Plaintiffs then construct from this a proposition that the court can and should approach issues of proof of damage on a "broad brush" basis.

2572. They first advance the proposition that in the case of a delinquent fiduciary, the burden of proof shifts from the plaintiff having to prove that the loss was caused by the breach, to the defendant having to prove that it was not. As authority for this proposition they rely first on a citation from Snell's ***Equity*** 33rd Edition 2015 at [7-059], and second on dicta from the case of *Libertarian Investments Ltd v Hall* (2013) HKFCAR 681 in the Hong Kong Court of Final Appeal, where Ribeiro PJ stated at [138]) that

> "…*where there is (as in the present case) evidence of a breach of fiduciary duty causing loss, equity places the onus on a defaulting fiduciary to prove that such loss would have occurred in any event even if no breach had occurred"* .

2573. The citation from Snell's ***Equity*** summarises a dictum of Blackburne J in *Nationwide Building Society v Balmer Radmore (a firm)* [1999] Lloyds Rep PN 241 at 278-9, regarding the principles of causation and quantum in the case of a fiduciary (a solicitor) making misrepresentations or non-disclosures to a beneficiary (a mortgage lender) which caused the beneficiary to act in a particular way (granting the mortgage), and concluding that the court was entitled to assume that the beneficiary would have acted in the manner most beneficial to it

unless the fiduciary proved – as it was entitled to try to do in cases other than where it had acted dishonestly – that the beneficiary would not have acted in that way.

2574. The Plaintiffs submit that where the matter goes even further and it is the very nature of the defendant's breaches which causes the difficulty in quantifying the loss sustained, the above principle entitles the plaintiff to the benefit of the approach that the court will

> *"resolve uncertainties about what would have happened but for the defendant's wrongdoing by making reasonable assumptions which err, if anything, on the side of generosity to the [plaintiffs]"*

see *Yam Seng Pte Ltd v International Trade Corpn Ltd* [2013] 1 Lloyds Rep 526 at [188]. Put more trenchantly, the plaintiff will be entitled to the benefit of "a fair wind" in establishing the quantum of its losses (per Jonathan Parker in *Browning v Brachers* [2005] PNLR 44 at [210]).

2575. The Plaintiffs therefore submit that, applying this principle here, the Defendants' breach of duty lay in not selling RMBS when they should have done. The Defendants cannot, therefore, take advantage of any argument that it is impossible to quantify CCC's loss because of a lack of evidence of the price at which RMBS would have been sold, because it is the Defendants' very breach which has prevented the evidence of the price at which such sales would have taken place from being available. The court therefore can, and should, assume against the Defendants, if they are liable for breach of fiduciary duty, that sales would have been effected at the prices which the Plaintiffs now suggest were possible.

2576. In support of this proposition they rely on *Armory v Delamirie,* (1722) 93 ER 664. There, a goldsmith kept a jewel which a chimney sweep had found and taken to him to value, forcing a mere nominal payment on to the sweep. In an action in trover, the goldsmith was found liable in damages, but sought to argue that there was no evidence of the quality of the jewel, which should therefore be taken to be average. The court held, however, that since it was the goldsmith's conduct which meant that the jewel could not be examined to ascertain its true value, it must be assumed against him that the jewel was of the finest quality, and damages should be awarded on that basis. The Plaintiffs cite this as an example of the right approach where it is "*the actions of the wrongdoer which have made an accurate determination so problematic*" (Handley JA in *Houghton v Immer (No 155) Pty Ltd* [1997] 44 NSWLR 46 at 59) and they submit that this is precisely the situation here.

2577. With the Plaintiffs having relied heavily on the *Libertarian* case in their opening, the Carlyle Defendants, in their opening response, argued comprehensively that their submission as to shifting the burden of proof was misconceived. They elaborated further on this in their written closing submissions, no doubt expecting major reliance on this case again from the Plaintiffs, although in the event it was merely cited as indicated above.

2578. Apart from submitting that the *Libertarian* case was in a different jurisdiction, and in any event preceded the *AIB* case which should now be regarded as the comprehensive relevant authority, the Defendants argue that *Libertarian* was a decision in a very different context. It was concerned with a breach of fiduciary duty by actual misappropriation of trust monies by the defendant. What was in fact held was that once it was established (as it was) that the defendant had misappropriated trust money, then all reasonable assumptions would be made against him

as regards what was required in order to restore the trust fund to the position it should have been in - unless he was able to disprove the likelihood of those assumptions.

2579. In that case, the defendant had received $5.5Mn with a mandate to purchase certain shares, but had failed to purchase them and had stolen the money. The award of equitable compensation was made on the basis, not only of the restoration of the funds, but of the loss of potential profits on an onward sale, as the evidence suggested the shares could have been sold on. The defendant tried to argue that the plaintiffs had not proved that the shares could, in fact, have been purchased in the first place, thus limiting compensation to the sum which had been misappropriated. This argument was rejected on several grounds (not least because it had never been pleaded or put to relevant witnesses), but these included that it would have been for the defendant to prove that proposition, and he had not done so. The *Libertarian* case, say the Defendants, was thus an entirely different situation from the present, the principle of making assumptions against the defendant was not even determinative of the decision, and the point was, in any event, concerned with quantification of loss, and not with causation.

2580. With regard to *Armory v Delamirie*, they submit that this is an example, not of a factual evidential presumption against the defendant as regards causation, but a procedural evidential presumption as regards quantum. In *Armory v Delamirie*, it lay within the power of the Defendant to produce the jewel, as it was in his possession (or, presumably, evidence of its actual value was, if he had sold it) but he had failed to do so. On that basis the adverse assumption as to value made against him was justified because of his conduct in not providing evidence and trying to take advantage of this; it was not because of his wrongdoing in keeping the jewel. A similar principle may apply where the breach of fiduciary duty lies, for example, in not keeping records which ought to have been kept and which would disclose the values of transactions necessary for taking a proper account.

2581. The key, though, lies in the fact that the material evidence is something which it would be in the defendant's control to provide directly, and which he ought to provide, but which he does not. It does not extend to making an assumption as to what evidence would exist if the defendant were not in breach of duty as claimed in the action, when what that evidence would be is the very thing which the plaintiff is required to prove to establish that there is liability at all. In the case, such as the *Libertarian*, of misappropriation of trust funds rather than merely a breach of fiduciary duty alleged to have caused damage, the basic proposition that loss has been caused is met automatically by proving the act of breach of trust, ie the misappropriation or misapplication of trust money. That deals with the initial issue of causation. The further dicta in the case are then concerned with the appropriate principles with regard to assessing quantum, ie what is required to restore the beneficiary to the position that he would have been in if the breach had not occurred.

2582. I broadly prefer the arguments of the Defendants; in my judgment the principle of *Armory v Delamirie* should be regarded as a principle of evidence regarding quantification of loss.

2583. However, even if it could also be applied in the context of causation, it is not, in my judgment, a rule of inflexible application, and it does not or should not apply in the circumstances of this case. I reach these conclusions as follows.

2584. First, I think there are significant limits on the assistance to be derived from the authorities, and they require careful examination and comparison with the nature of the present case. For example, *Nationwide Building Society v Balmer Radmore (a firm)* [1999] Lloyds Rep PN 241

at 278-9, paraphrased in Snell's Equity at [7-059] in the passage on which the Plaintiffs rely, is a complex case, because it was a test case on issues of principle in twelve cases concerning the liability of solicitors in the context of various cases of mortgage fraud. It takes careful reading to appreciate that the reason why this is a case of breach of fiduciary duty rather than a straightforward negligence case is that the solicitors were acting for several parties and were therefore subject to undisclosed conflicts of interest. It is thus a very different situation from the present case, and one cannot safely transpose dicta from one commercial situation and apply them in another.

2585. Second, the Plaintiffs' approach simply assumes causation of loss at the outset, and then, by concentrating on arguments of equitable generosity as regards to assessment of loss, seeks to justify a "broad brush" approach being read back into the requirement for proof of causation of loss, as if such a generous approach makes the question whether loss was actually caused more readily decidable in favour of the Plaintiffs. This, though, removes the essential need for loss to be proved rather than simply assumed. In my judgment, this approach is back-to-front, incorrect and to be resisted. I do not find it to be supported in the authorities. The Plaintiffs' citations are all in the area of quantification rather than causation. The dicta in each case are on the basis that some loss has been proved, and they then suggest that the making of "all reasonable presumptions" can be applied to the estimation of the loss actually suffered. I cannot see that the principle relied on by the Plaintiffs has in practice been treated as applying to the issue whether there was actual proof of any loss in the first place, so as to enable that to be assumed.

2586. In my judgment, the Plaintiffs' arguments on this basis fall into the trap which was identified, albeit in the different context of the contractual liability of a valuer to a lender for a negligently high property valuation, by Lord Hoffmann in the House of Lords in *South Australia Asset Management Corporation v York Montague Ltd* [1997] AC 191 at [16]- [17]

> "*Much of the discussion … has assumed that the case is about the correct measure of damages for the loss which the lender has suffered. The Court of Appeal began its judgment [by]…..stating the principle that where an injury is to be compensated by damages, the damages should be as nearly as possible the sum which would put the plaintiff in the position in which he would have been if he had not been injured. It described this principle… as " the necessary point of departure."*
>
> *I think that this was the wrong place to begin. Before one can consider the principle on which one should calculate the damages to which a plaintiff is entitled as compensation for loss, it is necessary to decide for what kind of loss he is entitled to compensation. A correct description of the loss for which the [defendant] is liable must precede any consideration of the measure of damages…..".*

2587. In any event, insofar as such a principle might be invoked in the context of considering causation itself, it seems to me that it is confined to cases where the culpable conduct of the defendant which has prevented relevant evidence which might favour the plaintiff from being available has been wilful and deliberate to the extent of being dishonest, in bad faith or, at least, in cynical disregard for the interests of the plaintiff. That element appears to me to be present in all the cases cited by the Plaintiffs. It is easy to understand the court's natural reaction that in a contest between a wronged beneficiary and a fiduciary who acted in bad faith, material doubts should be resolved in favour of the innocent wronged beneficiary rather than

the reprehensible wrongdoer. This may come close to transgressing the principle that an award of equitable compensation is compensatory and not penal, but, in my judgment, it remains on the right side of the line and is justified as an application of appropriate evidential presumptions against a deliberate wrongdoer. The ethos is similar to the presumptions of causation generally made against a fraudster, against whom it will be conclusively presumed, for example, that a fraudulent misrepresentation induced the plaintiff to act upon it.

2588. If I am right about this, then the Plaintiffs would not, in my judgment, be entitled to invoke any such principle here in any event, because they have, in the end, expressly disavowed any allegation of dishonesty or bad faith against the Defendants.

2589. Lastly, whatever the scope of its application, the principle only permits the making of all reasonable assumptions against the relevant defendant. It thus falls short of permitting merely speculative assumptions to prevail over the broadly obvious inferences from facts, just because they are conceivable. Whether this is analysed as the principle not applying in the first place, or as the defendant in fact negativing the presumption, does not seem to me to matter.

2590. It means, though, that the approach which the Plaintiffs seek to invoke, even if it could as a matter of law be applied in their favour in this situation, is of more limited application than they suggest. If I am only obliged to make all reasonable assumptions against the Defendants, I would need to be satisfied that the assumption that the Defendants could have made sales of RMBS in the amounts and at the prices contended for by the Plaintiffs is a reasonable one. The assumption as to value made against the goldsmith in *Armory v Delamirie* was far from unlikely or implausible, and was not unreasonable on the facts of that case, as was the assumption in the *Libertarian* case as to the likelihood of the shares being sold on at a profit.

2591. To apply the *Armory v Delamirie* principle on any basis therefore seems to me to require that I first be satisfied that the assumption I am being asked to make is a reasonably likely one, even if it might be described as generous. It does not justify making a generous assumption which is improbable.

(c) Misfeasance and wrongful trading

2592. Both of these matters, as grounds for financial redress, are based on the principle of compensation, with the further gloss that the award depends on the court's assessment of an appropriate contribution which the guilty defendant ought to make to the assets of the company in liquidation. As such, it can therefore be lower than the assessed quantum of loss, if in the court's estimation, the facts justify this, but it cannot exceed a compensatory figure. No more therefore needs to be said about this.

Application to the facts of this case, assuming liability had been found

2593. Applying the above principles, in order to succeed in recovering damages the Plaintiffs have to satisfy me not only that there was a breach or breaches of duty (whether of skill and care or fiduciary) which I am here assuming, but also that it/they caused a loss to CCC.

2594. This is fundamental to the very cause of action in the case of the duty of care. In the case of the claim for breach of fiduciary duty, it becomes fundamental as a practical matter because the claim is for equitable compensation, and one cannot have compensation without some loss to

be compensated. At any rate, this is the basis on which the case was argued before me; it was not suggested that there could be nominal liability separately from the causation of loss, as may be possible, for example, in contract.

2595. This means that the Plaintiffs have to establish on the balance of probability that what they say that the Defendants ought to have done would have resulted in a better financial outcome for CCC than that which actually occurred when CCC ultimately collapsed. If the Plaintiffs cannot establish that, then they do not establish liability. The first stage is therefore to consider whether the Plaintiffs do establish that proposition.

2596. It is not, however, sufficient that one can speculate that CCC could have got a better outcome, or that one can envisage a series of events in which it might have done so. The test is whether, on the totality of evidence, it is more likely than not that the course which it is claimed CCC should have taken would have achieved a better outcome, ie avoided some, or all, of its eventual losses.

2597. The Plaintiffs' primary submission with regard to damages was the suggested "*straightforward*" one that the (here assumed) breaches of duty committed by the Defendants caused loss to CCC, "*in particular …the loss of CCC's entire capital*". Put another way, they submitted,

> *"If the Defendants had……undertaken an orderly winding down of CCC those losses would have been avoided. In particular creditor losses would have been avoided and CCC's capital would have been preserved"*.

As such, this submission entirely begs the question; it has to be proved. The Plaintiffs' approach to this depends on the evidence of Dr Carron.

2598. Dr Carron's evidence, in simple terms, is to assume that CCC would have sold the whole, or some proportion (chosen, as one example, as an amount which would have restored its liquidity cushion to 20%), of its portfolio of RMBS starting at one of the dates which have been the basis of examining the claim for breaches of duty, and done so either at IDP prices or (as an alternative measure) at secondary market prices then pertaining, and then to carry the figures for these realisations through to the actual date of CCC's collapse in March 2008 and aggregate them with the putative proceeds of selling the remainder of CCC's portfolio at that date at the prices then obtained, with adjustments to allow for diminished income from the sold investments in the meantime. The result is then compared with the actual deficit figure ultimately at that time, and the difference is presented as the logically consequent measure of CCC's damage, (ie, its "unavoided" losses) at that time. Interest is then added to finalise the sum claimed as damages.

2599. The form of the exercise really only has to be stated to reveal how theoretical it is, rather than attempting to replicate what the actual effects of implementing a sales programme would have been in practice. I return to this later.

2600. Returning to the theory, as previously noted, the Plaintiffs ultimately narrowed their argument to being that the Defendants should have embarked on a programmed disposal of $10Bn worth of RMBS over a period of a few months, at an appropriate date in the second half of 2007. When challenged on the grounds that they were not specifying what prices they were alleging the sales should have been effected at, they first suggested an indeterminate "modest" discount

from IDP prices. When challenged as to the imprecision of this, and the consequent impossibility of examining their case adequately, they finally, in closing submissions, based their case on the proposition that sales at a discount of 11 bps from IDP prices could have been achieved.

2601. I considered the evidence with regard to achievable prices above, in relation to the claims advanced as at September 2007. I rejected the submission of the Plaintiffs that CCC could reasonably have expected to be able to achieve sales for significant quantities of RMBS at prices at or around 11 bps below current IDP prices as utterly unrealistic, looking at the evidence as a whole. I preferred Dr Niculescu's opinion that prices would not have been higher than secondary market prices of about 44 – 48 bps below IDP prices, and very probably even lower than this, in particular for large tranches. I found this view far more credible, as it fitted with my perceptions from surrounding circumstances.

2602. I made that assessment about prices specifically in considering the position as at the end of September 2007 but I find it also to be a reasonable starting point for likely price levels if sales had actually been attempted throughout the relevant period from about 9th August 2007 to the end of February 2008. At the end of August, the market had been in more of a turbulent state than in September, so it was certainly no better. As regards November 2007, the market was a little recovered but very much the same as in September, and as regards December 2007, it was not only generally lacklustre as to prices, but in a state of stagnation such that sales prospects would have been even worse. At that date, therefore, the likely level of prices if sales had been pursued willy nilly would, I find, have been significantly worse. Improvements in early 2008 had not really got underway to a great extent before the second crisis came.

2603. As regards the earliest time when a breach of duty is alleged, ie the 26th July 2007 Board Meeting, although it would seem technically possible that there was a short period of time before the onset of the August 2007 crisis during which the somewhat better prices of earlier times might have been obtained, it seems to me that this would have made no real difference for two reasons. First there is no reason to suppose that CCC should have embarked immediately and urgently on such a selling programme (as previously mentioned, even Dr Carron argued that the process of selling need not have been urgent) and it is therefore not likely that any significant amount of RMBS would have been sold in those few days. Second, even if some tranche of RMBS had been sold at better prices in this short period, the suggested quantity would have been small in the scheme of things - certainly no more than $1Bn – and the remainder of any such selling programme would then still have encountered the adverse market conditions and potentially depressed prices which predominated from around 9th August 2007 onwards.

2604. From the above, it follows that my conclusion on the evidence is that any sales transactions which had been executed by CCC as the start of a sales programme as proposed by the Plaintiffs could and would have been achieved only at prices which were well below IDP prices (even if not quite as low as the abortive JP Morgan offer), even for relatively small quantities. I am quite satisfied that these would have been no higher than the then evidenced secondary market prices.

2605. I should mention here that, even if I were considering this point in the context of a breach of fiduciary duty by the Defendants which was of such an improper nature as possibly to justify

the Plaintiffs' inviting the court to apply the *Armory v Delamirie* principle, I would decline to do so. This is because the evidence of the disrupted and depressed state of the market, and the consequent obvious and total unlikelihood, to my mind, that sales of significant quantities of RMBS at prices a mere 11bps below CCC's marks could have been achieved, is so clear that I would not regard the assumption of that possibility as being a "reasonable" assumption, even applying a suitable degree of generosity to the Plaintiffs.

2606. However, even an assumption that initially sales could have been made at the level I have indicated, ie no higher than that indicated by evidence of secondary market prices, would not suffice to justify an assumption that the sales programme proposed by the Plaintiffs could have been continued on the same basis and at the same price levels, and at this point, the facts which it is appropriate to posit as the continuation of any such sales strategy become, to my mind, a matter of complete speculation.

2607. The enormous difficulty which I see as facing the Plaintiffs with regard to proving any claimed quantum of loss, even in general principle, is that this is not a case where they can point to the terms of a single sales transaction which they argue should have occurred and from which a comparison with the ultimate financial outcome for CCC could readily be made, but that they have been obliged to accept that sales would have had to be effected through a series of many transactions. The difficulty is then that not only would the circumstances and detail of any one transaction be different, but that the earliest sale or sales would affect the likely circumstances of later such sales in this counter-factual world, and that what the potential effects of this would be is neither obvious nor reasonably predictable.

2608. The Plaintiffs' argument has tried to conceal this problem by pointing to a global result which they say could and should have been achieved - namely the ultimate sale of $10Bn worth of RMBS between about September (or whenever) and December 2007 (or February 2008) - and arguing that taking this course of action would have achieved a better outcome for CCC when the collapse came in March 2008. But the difficulty comes when one examines what would be the effects of "this" course of action in practice. On any basis, it involves a large array of possible component sales transactions, as to which they invite the court to assume that the details do not matter, as the final outcome of any such sequence of transactions can safely be assumed to have been better for CCC than what happened in reality.

2609. I simply cannot accept this proposition. This is because the evidence shows that the financial results of such series of transactions are neither generally obvious nor effectively predictable. The prices of later sales transactions would, I am satisfied, be sensitive to circumstances created by the earlier (counterfactual) transactions, first affecting their likely achievable prices, and second, generating other matters material to CCC's finances, namely potentially lower repo marks and margin calls. The consequence of all this is that I consider it well nigh impossible to predict the likely outcome of any sequence of such transactions with any reliability. Certainly I do not think that it can be done sufficiently clearly as to even general terms, to enable it to be concluded that CCC would, even on balance of probability, have been better off when the market collapse of March 2008 occurred if such a sales programme had been commenced at some material time as suggested. The possibility that this would have been the case is, in my judgment, total speculation.

2610. The Plaintiffs' invitation to me is to leave aside all the evidence of unpredictability about the way in which such a series of transactions might work out in practice and instead make some

general assumptions and come to an overall impression that loss to some degree was suffered. That, though, is, in my judgment, moving a very long way from a principled determination of whether any loss is proved, let alone a calculation of it. It is more in the nature of an appeal to the court to give a judgment on the basis of some kind of discretion as to what ought to "feel fair".

2611. In my judgment, this is not a case in which such an approach is even possible in principle, let alone a legitimate exercise of this court's powers. Of course, the law and the court will "do the best it can", and if the court is confident that a party has suffered some loss as a result of unlawful conduct by another, it will generally not allow any difficulties of quantification to defeat the claim. Using the best logic it can, it will arrive at a quantification of the greatest sum which it can feel sufficiently confident is the minimum loss which the plaintiff has suffered. By definition, though, this will be the quantum of loss which the plaintiff has actually proved. However, that is in a case where the difficulties of estimation go only to quantum and not to the prior issue whether it is sufficiently proved that any loss has really been suffered at all. If the court cannot be sufficiently satisfied that the relevant unlawful conduct did, on balance of probability, cause some loss, the plaintiff simply fails to prove a necessary element of its case. I find that the Plaintiffs simply do not surmount this initial evidential hurdle.

2612. Even a cursory view of the way CCC's business operated shows that financial conditions in the market were variable, even day by day. One can see that in the records of margin calls. Any presumed results based on Dr Carron's theoretical modelling are not only sensitive to input assumptions but that sensitivity itself cannot be predicted, or extrapolated, or averaged, or removed by any sufficiently reliable process of reasoning which has been presented to me. This is the essential criticism made by the Defendants of Dr Carron's approach to providing a supposed quantification of damages – it is an exercise arrived at by taking it as read that some loss must have been suffered and then proceeding to suggest how it might be mathematically estimated. This process, or model, I find, makes too many generalisations or assumptions, about matters which could, and probably would, have a significant effect on outcomes, and which cannot be isolated. They cannot, therefore, be either ignored or reasoned about. This is the essence of the criticisms of Dr Carron's evidence, which is illustrated by Mr Bezant's evidence.

2613. Mr Bezant's short original report raised two key questions about Dr Carron's model, and whether its results were a sufficiently accurate replication of the real world to be a reliable basis on which to predicate outcomes and thence find the fact, let alone the calculation, of loss.

2614. As I understand it without the benefit of further explanation from Mr Bezant, the first key question was as to Dr Carron's assumption that CCC's RMBS could be sold, on the basis postulated in his model, at prices commensurate with trade data for smaller volume sale transactions made at the time without any discount for the volume of the postulated sales, either at all or as regards later instalments of such sales, and without the further knock-on effect of causing re-pricings of CCC's assets. The second point was that Dr Carron's model - which did not replicate the daily sequence of valuations and margin adjustments which operated on CCC's business in real life - did not and could not take into account the potential effects of margin calls on CCC's wider position, in particular the effects on its liquidity cushion arising from such sales, and the fact that, if the cushion ever became totally depleted, this would cause an event of default by CCC, which would then potentially trigger an

immediate liquidation of CCC's RMBS assets at liquidation (fire sale) prices – as in fact occurred in March 2008.

2615. Although, therefore, Mr Bezant had not himself made any hypothetical damages calculation, he had produced his own "balance sheet model" designed to model CCC's position on a daily basis, as in real life. This was in order to illustrate the effects of these points and to demonstrate (a) the sensitivity of Dr Carron's model to input assumptions, of which there were many, and (b) that (to paraphrase) Dr Carron's model was simply too broad brush to be a reliable basis for demonstrating or calculating whether losses would even have been avoided. Indeed, Mr Bezant's own model (he said) demonstrated that if different RMBS price assumptions were used and the potential repricing effect was taken into account, then CCC's capacity to meet margin calls - which was simply assumed by Dr Carron, in his model, not to affect the position at all - would lead to very different outcomes as to whether or when CCC might default. The consequences for CCC's ultimate supposed residual equity or net deficiency could therefore vary very widely. The examination suggested that, in certain circumstances, attempts by CCC to sell RMBS as suggested by Dr Carron would actually have been likely to have resulted in just as bad an ultimate net deficiency as the actual results of March 2008, and sometimes even worse.

2616. In cross-examination, Dr Carron was taken through the basis of Mr Bezant's model, and the examples which he had given, and he agreed, at least "broadly" (by which I understand him to mean that he had no significant reservations) with both the basis of Mr Bezant's model and the accuracy of his calculations. As already mentioned, Mr Bezant was then not called for cross-examination. Instead, the Plaintiffs produced a written annexure to their closing submissions seeking to dismiss or sideline Mr Bezant's evidence.

2617. They first claim that Mr Bezant confirmed Dr Carron's calculations of loss and damage. This he did, as matter of mathematics. What he did not confirm, and indeed denied, was that Dr Carron's calculations were a fair and reliable method for determining loss or damage.

2618. They then point out that Mr Bezant offers no substantive opinion evidence. This depends on what you mean by substantive opinion evidence. It is correct that Mr Bezant offers no opinion on the calculation of damages, but this is because Mr Bezant's opinion is actually that damages cannot be calculated because the assumptions that would require to be made in the counterfactual world in order to do so are so speculative as to be unreliable, even as founding an assumption that loss (or, I should say, less loss) was probable.

2619. The Plaintiffs thirdly argue that Mr Bezant's model is driven by assumptions he was instructed to make. Experts usually have to be instructed to make some assumptions in order to provide building blocks upon which they can express their opinions, and as regards the usefulness or reliability of their evidence, the question is then whether the assumptions which they have been instructed to make are tendentious or not. Having considered the points which the Plaintiffs make, I cannot see that the assumptions which Mr Bezant used were anything other than material for illustrating and explaining his misgivings and criticisms about depending on Dr Carron's model for the purpose of drawing any sufficiently reliable conclusions as to loss.

2620. Fourth and lastly, they criticise the output of Mr Bezant's model for allegedly showing only negative results and generating "counterintuitive" results.

2621. I have some misgivings about whether the Plaintiffs are entitled to advance even the critical arguments contained in their third section above, having taken the deliberate decision not to call Mr Bezant for cross-examination so as to test his evidence against these criticisms. Most definitely, in my judgment, they are not entitled to ask me to rely on the propositions contained in their fourth section without having done so. There are numerous instances in this case where expert evidence produces results which appear counterintuitive, but this is generally precisely because the interlocutor is not an expert, and requires education in order to appreciate the process or the reasoning which produces the apparently curious result. If counter-intuitiveness is to be relied on as a criticism, then I take the view that it is neither proper, nor actually effective, to do so without having put the criticisms to the author of the criticised conclusions, and given him the opportunity to explain, justify, or otherwise deal with them if he can.

2622. The allegedly "patently absurd" particular result which the Plaintiffs rely on as showing that Mr Bezant's modelling and his logic should be rejected, is that selling a mere $178Mn of RMBS on 1st October 2007 at a discount of 37 bps from IDP prices could have precipitated an immediate liquidation for CCC which thus, and on a not unlikely price assumption, would have produced a larger net asset deficiency than that actually sustained in March 2008. In fact, this was a result which I found perfectly comprehensible, and even plausible. To my mind, it rather went to underline the perilous uncertainty which might reasonably have been feared by those with knowledge and experience of the actions of participants in the bond and repo markets at the time.

2623. In all the circumstances I am satisfied that the criticisms made by Mr Bezant of the shortcomings of Dr Carron's modelling of "likely" avoidable losses to CCC, had it taken the stated "required action" of selling RMBS as the Plaintiffs ultimately contend for, are well founded. There is no other evidence in support of the Plaintiffs' case that CCC suffered identifiable loss thereby.

2624. Dr Niculescu's opinion was that the maximum sales of RMBS which CCC could have effected in small quantities from about September 2007 onwards without moving the market was $1Bn. Even if I were to take this as evidence against the Defendants that this is what they could and should have achieved - and this is not in fact the Plaintiffs' pleaded case, although I suppose it might arguably be comprehended within it – it is entirely speculation, I am satisfied, whether this would have made any difference at all to CCC's ultimate losses. The consequences of such a series of sales would be fact-sensitive, and depend on such chance matters as, for example, whether the consequent reduction in required repo capacity is assumed to have been taken in reduction of repo utilisation from a lender who subsequently priced its security aggressively so as to generate large margin calls, or from one who did not. But perhaps an even more telling point is that any increase in liquidity generated by such a set of sales, only about $25Mn, would not have produced liquid assets for CCC which would have saved the day, but would in practical terms only have gone to reduce the amount of CCC's borrowing from Carlyle. If I consider, therefore, whether a reduction of less than 5% (as this would have been) in the size of CCC's portfolio would have altered the dynamics of CCC's ultimate collapse in March 2008 so as to make any noticeable improvement in the position, I am just not satisfied that it would. The features which precipitated CCC's collapse were the ultra-aggressive demands for margin from its repo lenders and the concurrent withdrawal and general unavailability of repo funding on affordable terms from players in the repo markets.

These factors would have occurred anyway, and the result would have been the collapse of CCC with much the same (and certainly not discernibly less) losses as actually occurred

2625. The unreliability of Dr Carron's model means, therefore, that the Plaintiffs fail to satisfy me that any such avoidable loss as he proposes was suffered by CCC on balance of probability. Any such finding would be pure speculation on my part, and would not merely be as to how much such avoidable loss was suffered, but as to whether in fact any was suffered at all.

2626. The Defendants submit that, on a common sense view, CCC's disastrous collapse was caused by the unpredictable and unpredicted second market liquidity crisis of late February/early March 2008 and not by the Defendants' adoption and progression of the Capital Preservation Strategy. The Plaintiffs submit that this would be an incorrect finding of fact, and the correct finding is that it was caused by the adoption of the capital preservation strategy rather than deleveraging by sales of RMBS. They say this for two reasons. First the possibility of a further financial crisis such as that which actually occurred in February and March 2008 was a perfectly foreseeable event which the Defendants were under a duty to protect CCC from by devising and operating a business model which did so, and this required deleveraging. Second the events of March 2008 were not a new "cause" but a continuation of the previous and continuing "cause" of adverse financial circumstances which had been in effect since August 2007.

2627. I prefer the Defendants' arguments on this point as well. At the time of the liquidity crisis of March 2008, CCC was not on a course of spiralling down towards disaster owing to the continued effects of adverse market conditions since August 2007. I accept and find that its overall financial trajectory over the previous six or seven months had been one of very gradual improvement in health, and if there had been no major liquidity "event" at the beginning of March 2008, the likelihood is that this would have continued. Continuation in this way might not have suited investors, anxious for a dividend, but that is an entirely different point. I therefore find that it was the second crisis of March 2008 which is correctly seen as the effective cause of CCC's collapse and of the losses which it actually suffered. Therefore, even assuming the adoption of the capital preservation strategy had been a breach of duty, I would be inclined to classify that breach as a mere circumstance, and not a cause, of CCC's ultimate losses.

2628. By the same token, had I come to the conclusion that the Defendants ought to have known that CCC stood no reasonable prospect of avoiding insolvent liquidation, I would have concluded that the evidence did not prove that CCC's continuing in business until the time of its collapse had actually resulted in any worse financial outcome than if it had been wound up earlier. Ironically, even Dr Carron's figures tend to show that CCC's financial position was actually improving over the period during which the Plaintiffs assert their claims for breaches of duty and wrongful trading; the measure of their damages claims actually tends to get lower the nearer one approaches the ultimate collapse.

2629. I should mention that, as the Defendants observe, the Plaintiffs have not sought to put their case on the basis of "loss of a chance", and in my judgment they were right not to do so. This is not a case of loss of a defined gain where the uncertainty is whether, because of the breach of duty, the gain would have been obtained or not, which is the classic case for evaluating loss of a chance. Since there has been no attempt to advance such an argument, though, I do not need to analyse its unsuitability in any more detail.

2630. The Plaintiffs therefore fail to demonstrate that CCC suffered any loss as a result of the alleged breaches of duty in this matter. This is therefore a further and ultimate reason why this claim fails.

2631. Since I have concluded that there is no evidence sufficient to demonstrate that any loss could be attributed to the alleged breach(es) of duty, I do not go on to consider the further hypothetical question what measure of damage I would have assessed and awarded if I had concluded that some loss was demonstrated. The number of hypothetical counterfactual assumptions then required would make that meaningless.

17. The alternative claim

2632. I have not so far mentioned the alternative claim made against the Entity Defendants in the Cause for unjust enrichment. This is formulated as a claim that those Defendants have

> *"received fees, interest payments, expenses and share-based compensation exceeding $75Mn"*

and have thereby been unjustly enriched at the expense of CCC such that they should be required to disgorge those sums "*in equity and good conscience*".

2633. This claim has not figured prominently in the trial itself, and the juridical basis for it has not really been satisfactorily explained. It is notable that the items mentioned are varied in nature and were in fact paid variously to CIM and (probably) TCG rather than Holdings, but they are simply lumped together as an apparently composite claim against all three Defendants.

2634. As the trial developed, it was said by Advocate Wessels that the claim was being put on the grounds that the claimed breaches of duty "rendered the services worthless". This appears to amount, therefore, to a claim to recovery on the grounds of total failure of consideration, or "failure of basis", which would apply most naturally to a claim for return of fees. As regards interest payments, this could relate only to interest on the Carlyle loan to CCC. Although the reasonableness of the interest rate of 10% charged was put in issue by the Plaintiffs, this appeared to be largely a matter of formality, because no evidence was adduced as to its being unreasonable, and no recognised legal basis for its recovery was actually pleaded or otherwise suggested. The expenses were never identified. The share based compensation apparently referred to the grant to CIM of restricted stock in CCC, once valued at $55Mn but plainly worthless since the liquidation of CCC and thus giving rise to no enrichment, unjust or otherwise.

2635. As the claim therefore appears to focus on fees, it would essentially be against CIM, to whom such fees were paid. They were management fees and originally the incentive fee under the IMA, insofar as the latter was earned and paid in respect of the period before the IPO; it was not earned in the third quarter of 2007 and was waived in respect of the fourth quarter and not earned thereafter. The total of such fees was $17,834,000.

2636. As a separate alternative claim for recovery based on total failure of consideration, (although this claim is more likely to be governed by Delaware law, I assume that the applicable principles would be the same as Guernsey law, this not being a point which was dealt with in the expert evidence), this claim must fail, for the simple reason that there was no such total failure. CIM rendered the services according to the terms of the IMA, and the fees were

properly due and owing and earned, in that respect. This applies to fees earned and paid after, as well as before, the IPO, but obviously even more clearly before it. Since I have held that there was no breach of contract on the part of CIM (except for the minor matter in November 2007 which was *de minimis)*, the possibility of awarding a return of fees as an alternative measure of damage for contractual damage which is proved but not capable of satisfactory quantification does not arise.

2637. For the above reasons, this alternative claim against the Entity Defendants is also dismissed.

18. Summary of conclusions

2638. As I said towards the outset, many paragraphs ago, despite the length of this judgment I have not referred to or made findings on every single allegation made by the Plaintiffs and contained in the Cause, for reasons which I have rehearsed throughout. Harking back to the guidance of *Smith v Molyneaux* [2016] UKPC 35, I trust that I have, though, given at least one adequate reason for each of my material conclusions. Insofar as any unmentioned allegations are material to my decisions on the effectual breaches of duty and suchlike alleged, the findings which I would make about them can be inferred. However, for the avoidance of doubt, in considering this judgment I have gone through the helpfully focused analysis of the individual allegations of breach actually pleaded in the Cause which was made by the First to Fourth Defendants and is contained in Paragraphs 1626 to 1675 of their closing written submissions, and which gives the location of those Defendants' response, and any required explanations. I have found myself in almost universal agreement with the Defendants' submissions in those paragraphs.

2639. I can therefore summarise my conclusions in the case as follows:

As regards the First to Seventh Defendants:

(1) With regard to the claims for breach of duty made against the First to Seventh Defendants the action fails, first, because those decisions and actions of the First to Seventh Defendants which the Plaintiffs plead to have been both breaches of those Defendants' respective fiduciary duties and/or duties of skill and care towards CCC, and to have caused damage to CCC, were all decisions or actions within the range of decisions or actions which a duly diligent, skilful, conscientious and loyal director of CCC (having, in any individual case, any enhanced level of skill actually possessed by such individual Defendant) might reasonably have made in all the material circumstances at the time. The above conclusion is sufficient to dispose of these claims.

(2) However for the avoidance of doubt, I am also satisfied that the individual Defendants did each apply proper and appropriate care and skill in taking the material decisions and actions. Moreover, even if any individual Defendant arguably failed to do so in any particular instance, a sufficient majority of the Defendants to carry such decision into effect did so in the full exercise of due skill and care, so that any such failure had no causative effect.

(3) I also find that the material decisions and actions were taken and made by each individual Defendant in the bona fide belief that they were in the best interests of CCC, including, insofar as appropriate at any particular time, the material interests of CCC's creditors. For the avoidance of doubt in this regard, I am satisfied that insofar as any Defendant

failed actively to distinguish between the interests of CCC and the Carlyle Group in any particular respect at any time, this either was not in respect of a decision material to the claims in the action, or alternatively was in respect of a matter as to which the interests of CCC and the Carlyle Group were in fact aligned such that there was no resulting detriment to CCC. I am further satisfied that, insofar as any individual Defendant may have had personal interests which could conceivably have conflicted with the material interests of CCC, no such individual Defendant did in fact allow such personal interest to affect his decisions adversely to CCC's interests. In any event, as I have already said, I have found that the actual decisions and actions taken were objectively within the range of decisions and actions which a properly loyal director of CCC could reasonably have taken.

(4) For completeness, I also find that there was no material deficiency (if any) in the processes by which the material decisions were taken by these Defendants, having regard to all the circumstances of the case.

(5) The claim of wrongful trading against the First to Seventh Defendants fails because I am satisfied that at no time prior to an immaterial few days shortly before CCC was actually placed in insolvent liquidation did the Defendants conclude, nor ought they reasonably to have concluded, that there was no reasonable prospect that CCC would avoid going into insolvent liquidation.

As regards all Defendants

(6) The above conclusions go to liability, but even if I were wrong about that, the Plaintiffs have failed to satisfy me that CCC suffered any demonstrable damage or loss consequent upon the matters alleged as the material breaches of duty, above. In other words, the evidence fails to satisfy me that, if the Defendants had made the decisions and taken the actions which the Plaintiffs claim they ought to have done, CCC would thereby, on balance of probability, have avoided some (ie any) part of the losses which it in fact sustained upon its liquidation in March 2008. This conclusion is further, and independently, sufficient to dispose of these claims.

As regards CIM in contract or tort

(7) With regard to the contractual claim against CIM, this also fails. CIM performed its contractual duties to CCC through the Third (principally) and the Fourth Defendants and the team of staff to whom those Defendants gave instruction and authority. Treating the material decisions and actions considered above as including responsibility for the acts of such staff, and being measured against the standards of loyalty, skill and care to be expected contractually under Delaware Law from CIM as an investment manager, I am satisfied that CIM performed its contractual duties and functions with the due standards of skill, care and loyalty which were contractually required of it under Delaware Law (save in respect of one very minor failure in November 2007, which has not been proved to have caused any loss to CCC and therefore does not, in any event, give rise to any liability).

In any event, and in general, the Plaintiffs have similarly failed to satisfy me that CCC suffered any identifiable damage in consequence of the alleged breaches of contractual duty by CIM, even if these had been proved.

The same facts and matters were relied on in support of the alternative allegation of breach of a tortious duty of care. No different standards or considerations were argued to apply and it follows that that alternative basis of claim fails as well.

As regards the Entity Defendants

(8) With regard to the claims against CIM, TCG and Holdings as *de facto*, alternatively shadow directors of CCC, such claims would fail for the above reasons, but they also fail *in limine* because I hold that no such Defendant ever became a *de facto* or a shadow director of CCC.

(a) As to CIM, (i) any acts carried out by CIM on behalf of CCC, even if acts which might otherwise be required to be carried out by CCC's directors, were in fact referable to and carried out by CIM in its capacity as Investment Manager of CCC, and not as a director of CCC, and (ii) insofar as any of the actual directors of CCC, or a sufficient majority of them, were accustomed to act in accordance with proposals which could be considered to emanate from CIM, such actions were in the nature of voluntarily following professional advice and were not in the nature of acting in accordance with instructions or directions from CIM.

(b) As to TCG and Holdings, (i) there is no evidence that either TCG or Holdings carried out any act (let alone a material one) which could only be carried out by a director of CCC, so as to render TCG or Holdings a *de facto* director of CCC in that respect, and (ii) there is also no evidence that either TCG or Holdings ever issued or purported to issue instructions or directions to the actual directors of CCC, or any of them.

2640. In a nutshell, CCC's original business model was reasonable. The liquidity cushion built into that model had operated as intended and in fact helped CCC to survive an even worse financial crisis than the notorious LTCM crisis of 1998. CCC's directors then made judgements to enable CCC to try to regain health and strength which were reasonable at the time. CCC failed because the depth of the weaknesses in the financial markets was so great that those weaknesses came to threaten, not merely the profits of major investment and commercial banks, but their very viability, and hence to cause a systemic withdrawal of what had previously been a very normal, stable and reliable form of finance. CCC's directors did not appreciate the depth of this instability, but in this they were in wide and good company. To suggest that there was anything that they, or CIM, clearly ought to have done significantly differently from July 2007 until CCC's eventual collapse in March 2008 is, in my judgment, being entirely wise with hindsight.

General

2641. Viewing my conclusions in terms of the List of Issues which I originally formulated, I do not need to recite my answers to those individual issues because it will be readily appreciated that I have in effect found in favour of the Defendants on all of the substantive issues and also on the issue of no sufficient proof of loss. The remaining issues, such as the technical scope of

statutory misfeasance, the scope of the exoneration clauses in the IMA and in CCC's Articles of Association or the granting of statutory relief from liability do not arise.

2642. For the above reasons, therefore, this action, with regard to the claims other than the directors' disqualification claims which are presently stayed, is dismissed.

2643. It remains only for me to repeat my thanks to the Advocates involved in the case for their hard work and skill, and their most able presentation of arguments, all of which has assisted me greatly, and also for their courtesy and unfailing good humour throughout this very long trial.

Appendices (Not reproduced)

(i) Agreed chart of CCC's Repo Funding as at Repo Roll Dates (Dr Carron)

(ii) Agreed chart of CCC's daily and monthly net asset value (Mr Shaw)

(iii) Agreed chart of the average final price of CCC's RMBS assets, (Mr Shaw)

(iv) Agreed charts of CCC's average and "effective" repo haircut levels, (Mr Shaw)

(v) Agreed chart of CCC's available soft repo capacity and capacity actually used, (Mr Shaw)

(vi) Agreed chart of CCC's liquidity cushion measured in both absolute $ terms and as a percentage of CCC's adjusted equity, (Mr Shaw)

(vii) Agreed chart of CCC's RMBS as a percentage of total asset allocation, (Mr Shaw)

(viii) Agreed chart of CCC's leverage ratio, (Mr Shaw)

(ix) Agreed chart of CCC's bi-weekly 20 Day 99% portfolio Value at Risk calculations, (Mr Shaw)

(x) Agreed chart of CCC's share price, (Mr Shaw)

(xi) Agreed chart of net interest income and principal repayments of CCC's RMBS, by month and cumulatively, together with levels of principal outstanding and repo lines used. (Mr Shaw)

(xii) Agreed chart of the number of CCC repo counterparties (Mr Shaw)

(xiii) Agreed Table of CCC's liquidity cushion details 19 January 2007 to 5 March 2008 (Dr Carron)

Her Honour Hazel Marshall QC,
Lieutenant Bailiff

4th September 2017