CITATION: Barclays Bank v. Metcalfe &Mansfield 2011 ONSC 5008
COURT FILE NO.: CV-09-0370103
DATE: 20110907

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:	)	
BARCLAYS BANK PLC Plaintiff	)	Peter F.C. Howard, Eliot N. Kolers, Samantha Hosseini and Lindsey Love-Forester, for the plaintiff,
- and -	)	
METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS VII CORP., *in its capacity as Trustee of* DEVONSHIRE TRUST, THE BANK OF NEW YORK, *as Custodian*, and CIBC MELLON TRUST COMPANY, *in its capacity as Indenture Trustee* Defendants	)	J. Thomas Curry, Monique J. Jilesen, Kate McGrann and Brendan Gray, for the defendant METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS VII CORP., *in its capacity as Trustee of* DEVONSHIRE TRUST, Jeffery S. Leon, for the defendant CIBC Mellon Trust
	)	**HEARD:** September 21, 27, October 1, 4, 6, 12, 13, 14, 15, 18, 19, 20, 21, 22, 25, 26, 27, 28, 29, November 2, 3, 4, 5, December 6, 7, 8, 9, 10, 13, 14, 15, 16, 17, 2010, April 18, 19, 20, 21, 26, 27, 28, 29, May 2, 3, 4, 9, 10, June 6, 7, 8, 9, 2011

Newbould J. **REASONS FOR JUDGMENT**

[1] This judgment is lengthy and an index at the outset will assist in making headway through what is by any account a complex matter.

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1. Prelude

[2] This action arises from the events in 2007 and 2008 surrounding the liquidity crisis in the asset backed commercial paper (ABCP) market in Canada that led to a portion of the ABCP market referred to as the third party or independently sponsored ABCP market being compromised and restructured under the CCAA in 2008-9. The Devonshire Trust was the only trust, or in the jargon of the market, the only "conduit" in the independently sponsored Canadian ABCP market that was not a party to the CCAA restructuring.

[3] The plaintiff Barclays Bank PLC was counterparty to Devonshire by virtue of it being the asset and liquidity provider to Devonshire, as will be explained. It was only through the Devonshire Trust that Barclays participated in the Canadian ABCP market.

[4] Barclays and Devonshire each claim that the other breached the relevant agreements. The rights of Barclays and Devonshire in this action depend in part on the interpretation of the legal documentation that governs their relationship. The deal between them took nine months to negotiate. Each side had businessmen who were legally trained and who were advised by teams of outside lawyers. The legal documentation is byzantine in its complexity and would make the work of the most Philadelphian of lawyers look like mere child's play. The financial product involved was relatively new and complex, with many acronyms being used by the players as short form descriptions.

[5] There is collateral of $600 million plus interest held in trust. There is a further amount of approximately $183 million plus interest held by Devonshire. Barclays claims to have suffered a loss of $1.2 billion and claims entitlement to all of the funds. Devonshire claims to be entitled to all of the funds in order to pay the outstanding noteholders of Devonshire.

2. Asset Backed Commercial Paper market

[6] Commercial paper is a term used to refer to promissory notes, or bonds, issued in the commercial world. Asset backed commercial paper (ABCP) is a term used that refers to

commercial paper secured, or backed, by some asset. A secured note is a shorter description of ABCP.

[7] In the market involved in this case, securitization is a method of raising financing. It involves the use of a special-purpose entity such as a trust that repackages the cash flow from income-producing financial assets into securities, or notes, that are purchased by investors in the debt capital markets. In a securitization transaction, financial assets are purchased by the trust from operating or finance companies that sell or “originate” those assets. Examples of so-called traditional assets that are securitized are mortgages, loans, leases, and credit card receivables. Other assets are called “structured financial assets”, including “synthetic” assets such as credit default swaps (CDS), which were used in the transactions between Barclays and Devonshire.

[8] In securitizations, the trust (or conduit) acquires assets and earns a return from the income produced by those assets. To pay for the assets, the conduit issues ABCP. The ABCP is sold and interest is paid by the trust to the investors holding the notes at a spread over the Canadian Dealer Offered Rate (“CDOR”). The trust earns revenue on the spread between its return on the underlying asset and the cost of interest it must pay its investors on its ABCP.

[9] The ABCP market in Canada at the relevant times was described by Purdy Crawford, Q.C., who was the chairman of an investor’s committee that spearheaded the restructuring of the independent conduits in the Canadian ABCP market. In his affidavit filed in CCAA proceedings, Mr. Crawford described the market and the problems that arose as follows:

> [7] Before the week of August 13, 2007, there was an operating market in ABCP. Various corporations (referred to below as "Sponsors") arranged for the Conduits to make ABCP available as an investment vehicle bearing interest at rates slightly higher than might be available on government or bank short-term paper.
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> [8] The ABCP represents debts owing by the trustees of the Conduits. Most of the ABCP is short-term commercial paper (usually 30 to 90 days). The balance of the ABCP is made up of commercial paper that is extendible for up to 364 days and longer-term floating rate notes. The money paid by investors to acquire ABCP was used to purchase a portfolio of financial assets to be held, directly or

through subsidiary trusts, by the trustees of the Conduits. Repayment of each series of ABCP is supported by the assets held for that series, which serves as collateral for the payment obligations. ABCP is therefore said to be "asset-backed."

[9] Some of these supporting assets were mid-term, but most were long-term, such as pools of residential mortgages, credit card receivables or credit default swaps (which are sophisticated derivative products). Because of the generally long-term nature of the assets backing the ABCP, the cash flow they generated did not match the cash flow required to repay maturing ABCP. Before mid-August 2007, this timing mismatch was not a problem because many investors did not require repayment of ABCP on maturity; instead they reinvested or "rolled" their existing ABCP at maturity. As well, new ABCP was continually being sold, generating funds to repay maturing ABCP where investors required payment. Many of the trustees of the Conduits also entered into back-up liquidity arrangements with third-party lenders ("Liquidity Providers") who agreed to provide funds to repay maturing ABCP in certain circumstances.

[10] In the week of August 13, 2007, the ABCP market froze. The crisis was largely triggered by market sentiment, as news spread of significant defaults on U.S. sub-prime mortgages. In large part, investors in Canadian ABCP lost confidence because they did not know what assets or mix of assets backed their ABCP. Because of this lack of transparency, existing holders and potential new investors feared that the assets backing the ABCP might include sub-prime mortgages or other overvalued assets. Investors stopped buying new ABCP, and holders stopped "rolling" their existing ABCP. As ABCP became due, Conduits were unable to fund repayments through new issuances or replacement notes. Trustees of some Conduits made requests for advances under the back-up arrangements that were intended to provide liquidity; however, most Liquidity Providers took the position that the conditions to funding had not been met. With no new investment, no reinvestment, and no liquidity funding available, and with long-term underlying assets whose cash flows did not match maturing short-term ABCP, payments due on the ABCP could not be made -- and no payments have been made since mid-August.

3. The Barclays and Devonshire swap transactions

[10] Quanto Financial Corporation, the sponsor and financial services agent of Devonshire, was formed in October, 2005 by Mr. Lafleur-Ayotte and Mr. Alain Pelchat, both of whom had

been with National Bank. Mr. Lafleur-Ayotte and Mr. Pelchat had started up the conduit business while at National Bank, setting up three conduits. They left National Bank to establish Quanto, at which time National Bank transferred the conduit business to Quanto. Each of Mr. Lafleur-Ayotte and Mr. Pelchat owned 20% of Quanto at the outset, the other shareholders being National Bank and Deutsche Bank, each as to 15% and the balance of 30% being owned by key employees.

[11] In the fall of 2005 Mr. Lafleur-Ayotte and Mr. Pelchat began discussions with Barclays regarding a conduit business. They knew Mr. Lovisolo of Barclays from earlier days when all three worked at Deutsche Bank and they knew Mr. Neville of Barclays whom they had met while working for National Bank. The transaction with Barclays was negotiated and eventually agreed in August, 2006 and amended in December, 2006.

[12] Devonshire and Barclays entered into an ISDA[1] Master Agreement dated as of July 6, 2006, an Amended and Restated Master Credit Derivatives Confirmation Agreement dated December 1, 2006, two Amended and Restated Transaction Supplements dated August 16, 2006 and August 25, 2006 and two Amended and Restated Seller Credit Support Annexes (CSAs) also dated August 16, 2006 and August 25, 2006, a Trust Indenture dated August 2, 2006 and a Series A Supplemental Indenture made as of August 2, 2006, which, along with detailed Schedules and Annexes to these agreements, governed the credit derivative transaction between the parties.

[13] Devonshire was established as the special purpose trust for the purpose of acquiring and holding income-producing assets financed through the issuance of ABCP. Under the terms of the agreements between the parties, Devonshire was only permitted to acquire assets from Barclays. The two transactions in dispute were intended to be only the first of several transactions between the parties, but they became the only transactions.

[14] Barclays was the "asset provider" to Devonshire. The assets acquired by Devonshire from Barclays were two credit default swap transactions, or contracts, between Barclays and Devonshire called "synthetic leveraged super senior credit default swaps". Synthetic leveraged

[1] ISDA stands for International Swap Dealers Association, now the International Swaps and Derivatives Association. The form of the agreement was the 1992 form of the ISDA Master Agreement.

super senior credit default swap transactions came into the market in Canada in the fall of 2004 and were made by the independent conduits. The bank sponsored conduits did not enter into leveraged super senior contracts.

[15] Under these transactions, Barclays was a "credit protection buyer" and Devonshire was a "credit protection seller". That is, Devonshire sold Barclays protection against the possibility of credit defaults in a portfolio of debt obligations not owned by Barclays. Barclays paid a monthly premium to Devonshire for this protection and Devonshire agreed that if the level of losses in the portfolio reached a certain point, Devonshire would pay an amount to Barclays.

[16] The term of the two swaps was to run until 2016. The monthly premium paid to Devonshire by Barclays for this protection was the source of the payments to the noteholders who purchased their ABCP from Devonshire.

[17] The portfolio of underlying debt obligations consisted of 130 corporate bonds issued by various corporations in the first swap and 100 in the second swap, as well as various asset backed and mortgaged backed securities. The contents of the portfolio were negotiated between Barclays and Devonshire. Thus the transactions were called "bespoke" transactions. Because Barclays did not have any ownership interest in the pool of assets for which it was buying credit protection, the swaps were called "synthetic".[2]

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[2] Why the word "synthetic" is used other than industry jargon is unclear. The concept is no different than one boy betting against another that the Toronto Maple Leafs will not end up worse than some agreed place in the standings, such as third from last, and no higher than some agreed place, such as fourth place, in the next NHL season. The reason why Barclays would have an interest in buying protections against a decline in value of assets it did not own was because Barclays was a "market maker", a swap dealer acting as an intermediary between sellers and buyers of credit protection and sought to profit by earning a spread between the cost of buying credit protection and selling credit protection. In this case, the evidence was that it was very difficult to find someone who would take the exact opposite view on a bespoke transaction with the exact portfolio of names and terms. A CDS is different from insurance in that the credit protection buyer is not required to own or have an economic interest in the underlying debt obligations against which it is buying protection.

[18] In order to secure the contingent obligation of Devonshire to Barclays if there were credit defaults in the underlying portfolio, Devonshire was required to, and did, pay $300 million to Barclays for each transaction, or $600 million in total, at the outset of the transactions. Under the relevant agreements, if there were no defaults in the underlying portfolio of obligations at the end of the agreements in 2016 that required Devonshire to pay Barclays, Barclays was obliged to repay Devonshire the $600 million. In order to secure this obligation to repay Devonshire, Barclays was required to, and did, post $600 million of its own assets or funds as collateral, and it is held by Bank of New York under a custodian agreement.

[19] The swaps were called "leveraged" because while the amount that Devonshire could be called upon to pay under each swap was $3 billion, Devonshire was required to post collateral for this obligation of only $300 million for each swap. Thus the swaps were initially leveraged on a 10 to 1 basis, which allowed Devonshire to be paid premiums on $6 billion worth of protection for initial collateral of one-tenth that amount. However, to protect Barclays in the event that the value of the swaps to Barclays increased beyond certain trigger points based on a mark to market[3] valuation of the underlying portfolio for which credit protection was being purchased, Devonshire agreed to post further collateral to Barclays on certain conditions. This was to protect Barclays against its "gap risk", being the risk that the collateral held by Barclays was less than the loss to Barclays in the event that there was early termination of the swaps.

[20] The credit risk of the bond portfolio was broken into "tranches" and Devonshire was responsible only for losses in the tranche referred to as the "super senior" tranche. If aggregate losses in the bond portfolio exceeded 15% in the case of one of the swaps and 16% for the other the ("attachment point") Devonshire became liable for a portion of those losses.[4] The super senior tranche went up to 62.5% ("detachment point") for one swap and 60% for the other. Because of the quality of the corporate bonds which made up the underlying portfolio on which Barclays bought credit protection,[5] it was thought by both Barclays and Devonshire that it would be highly unlikely that any losses would occur during the term of the swaps that would reach the

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[3] Mark to market means that the swaps were valued daily based on Barclays model for doing so.
[4] Although the underlying portfolio included asset and market backed securities, losses on them only became payable by Devonshire to Barclays if losses in the super senior tranche for the bond portfolio became payable.
[5] Triple A rated corporation such as Volvo , Alcoa and Potash Corporation

attachment point, and thus highly unlikely that Devonshire would ever be called upon to pay anything to Barclays for losses in the super senior tranche.

[21] There were three classes of notes of one series issued by Devonshire, being short term notes (Class A), extendible notes (Class E) and floating rate term notes (Class FRN). The Class A notes were short term notes that matured within 30 to 90 days and were either rolled over on maturity by the holders or cashed in with new notes being issued by Devonshire to other investors. In order to ensure that there would be funds available to Devonshire to buy up maturing Class A notes in the event notes could not roll over, Barclays agreed to be a “liquidity provider’ to Devonshire. This means that Barclays agreed to supply funds to repay Devonshire’s maturing Class A notes upon the occurrence of a “Market Disruption” event. Barclays’ maximum obligation as liquidity provider was to provide $205 million in liquidity payments for one year, later extended to two years. Devonshire paid a monthly fee to Barclays for this liquidity protection.

[22] Whether there was a “Market Disruption” in August 2007 became a hotly contested issue.

[23] There were other features of the transactions that have taken on an importance in this litigation. One was what was described by Barclays in internal trade approval documentation as a non-standard non-recourse feature that did not permit any claim against Devonshire if upon the “unwind” or termination of the transactions, the collateral posted by Devonshire was not sufficient to cover Barclays loss. What collateral is available to Barclays in the event of a default by Devonshire is contested.

[24] Another is what Devonshire describes as a stop-loss provision, under which Devonshire had the right upon being called to post more collateral during the life of the swaps to terminate the swaps rather than post more collateral. The effect of this provision plays a role in the debate in the case as to the losses claimed by Barclays to have been suffered upon the termination of the swaps.

4. The Montreal Accord

[25] It was on August 13, 2007 that the independent ABCP market froze in Canada. Because of the uncertainty in the marketplace and the increased lack of liquidity, the spreads on ABCP notes quickly widened, which raised the likelihood of collateral calls being made on the conduits by the asset providers to provide more collateral to secure the asset providers. Because noteholders were not rolling their notes, liquidity calls were being made by conduits for cash to pay out these noteholders on their ABCP that became due.

[26] A meeting of the major players in the independent ABCP market was held in Montreal on August 15 and into the early hours of August 16. It was organized in large part by the Caisse, a very large investor in ABCP, and by National Bank, a large dealer of ABCP. It was attended by ABCP noteholders, dealers, and asset and liquidity providers. Barclays attended the meeting. The conduits were not represented. The idea was to get the asset providers to agree on a moratorium against any collateral calls being made for more security and a moratorium on the conduits from making liquidity calls for funds to pay noteholders who were not rolling their notes. As Mr. Davis of National Bank testified, the purpose was to prevent a blow-up of the market and to have everyone put their weapons down and take a pause.

[27] On August 16, 2007, before the opening of the markets, an agreement known as the Montreal Accord was made. It contained an interim agreement for 60 days called the Standstill Period that precluded calls by the conduits for liquidity payments and calls by the asset providers for collateral to be posted by the conduits. The Montreal Accord also contained a proposal with a framework of principles to be used in restructuring each of the conduits. It was later extended to March 14, 2008.

[28] Barclays, the asset and liquidity provider to Devonshire, was a signatory to the Montreal Accord. Major note holders of Devonshire who signed the Montreal Accord were the Caisse, National Bank and Desjardins Group. There were 22 conduits in the independent ABCP market at the time of the Montreal Accord. They initially were not signatories to it. However on October 15, 2007 Devonshire and all other affected conduits signed it.

[29] Following the Montreal Accord, a "Pan-Canadian Third Party Asset-Backed Commercial Paper Investors Committee" was formed by investors of ABCP notes to negotiate for investors in the restructuring of the ABCP market. Purdy Crawford Q.C. was appointed its chairman. It was the Investors Committee and its advisors, including Goodmans and JPMorgan, who spearheaded the negotiations on behalf of the conduits, including Devonshire.

[30] On December 23, 2007 a "Framework Agreement" was made covering 20 of the trusts[6]. This was an agreement in principle as to how those conduits were to be restructured and it eventually led to a restructuring under the CCAA. Barclays was not a signatory to the Framework Agreement as it was not prepared to make the kind of concessions required by that agreement.

[31] From then on the attempts to restructure Devonshire were carried on outside the provisions of the Montreal Accord. The discussions for the most part did not involve Devonshire. They were carried on by the major note holders of Devonshire, together with the Investors Committee, directly with Barclays.

[32] A CCAA filing took place in March, 2008 covering the restructuring of the 20 conduits that were parties to the Framework Agreement of December 23, 2007. The CCAA plan was later approved by Campbell J. and then by the Court of Appeal in August, 2008. After that, because of dramatic market changes that took place in the fall of 2008 following large financial failures, including Lehman Brothers, the plan was twice renegotiated in December, 2008 at the insistence of the Investors Committee led by Purdy Crawford. This larger restructuring closed in January, 2009.[7]

5. Interim suspension of rights

[33] When the market froze on August 13, 2007, Devonshire, like other independent conduits, was unable to roll its Class A notes, meaning noteholders whose notes became due on those days were unwilling to roll them over for new notes and Devonshire was unable to sell other notes to

[6] One of the trusts had been restructured in July, 2007.

obtain funds to pay the noteholders whose notes had become due. Devonshire sent market disruption notices to Barclays on August 13, 14 and 15 requesting payments from Barclays under the liquidity facility it had with Barclays to be used to pay the noteholders whose notes had become due. Barclays took the position that no market disruption event as defined in the relevant agreement had occurred and refused to provide any liquidity payments to Devonshire. On August 14, 2007 Devonshire delivered a default notice to Barclays, the effect of which was to give Barclays three days to cure the default.

[34] Because of the Montreal Accord, and in order to allow negotiations to take place with a view to restructuring Devonshire, Devonshire delivered a Suspension Notice to Barclays on August 16, 2007 in which it suspended without prejudice the effect of the default notice it had sent to Barclays and agreed not to take any further steps to enforce its rights under that notice until the end of the Standstill Period. Barclays wanted Devonshire to simply rescind the default notice, but Devonshire refused unless further assurances were provided, which did not occur. This Suspension Notice was extended for fixed periods of time until February 22, 2008, then daily until March 14, 2008, then for a fixed period until April 16, 2008, and thereafter on a daily basis until January 12, 2009.

[35] The effect of the Suspension Notice is contested. Further, Devonshire claims that the daily extensions of January 8 and 9, 2009 contained misrepresentations of fact by Barclays entitling Devonshire to set aside those extensions.

6. Events of January 13, 2009 and litigation

[36] The last daily extension between Barclays and Devonshire was made on Friday, January 9, 2009 effective through the close of business on Monday. January 12, 2009.

[37] Shortly after 9 a.m. on January 13, 2009 Barclays delivered a notice to Devonshire purporting to terminate the ISDA Master Agreement based on an alleged insolvency of Devonshire. Just moments before that, Barclays had given notice that it would pay to Devonshire

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[7] This larger restructuring is referred to in these reasons as the large Crawford restructuring or the Montreal Accord restructuring.

under protest the past due liquidity amount under the market disruption notices given by Devonshire on August 13, 14 and 15, 2007, plus interest, and these funds, some $71,000, were sent by Barclays just before 9 a.m. and received in Devonshire's bank account around 11 a.m. that morning. Barclays also issued and served its statement of claim that morning commencing this action.

[38] Devonshire did not accept that Barclays had grounds to terminate the ISDA Master Agreement. On the same day, at 2:22 p.m., Devonshire delivered a notice to Barclays purporting to terminate the ISDA Master Agreement for failure of Barclays to pay the liquidity calls made by Devonshire on August 13, 14 and 15, 2007.

7. Bifurcation order

[39] Prior to this trial, a bifurcation order was made by Campbell J. on consent, in which it was agreed that a number of issues would be bifurcated. The bifurcated issues were (i) whether there was a market disruption event in August 2007, (ii) whether Devonshire's market disruption notices and notice of default were valid, (iii) whether Barclays was in default under the notices sent by Devonshire up to August 16, 2007, (iv) whether Devonshire was precluded from asserting the occurrence of a market disruption event. It was agreed that for the purposes of this "first trial", these issues would be determined in favour of Devonshire without prejudice to the position of Barclays that its payment on January 13, 2009 cured any default.

[40] On October 15, 2010 I made a ruling as to what evidence could be led in this first stage of the trial as a result of the bifurcation order. In particular, I ruled that the only evidence pertaining to the alleged default of Devonshire that could be led at this stage was evidence relating to the claim that Devonshire was insolvent at some time after August 16, 2009.

8. Credibility of witnesses

[41] This case is one of extreme complexity involving a market unknown to all but those who have practised in it. I was fortunate to have counsel who recognized the need to make things intelligible, no doubt born from their need to understand the market from the time they first

became involved many years ago. The witnesses all did their best to simply matters to the extent that they could be simplified, and to explain the myriad of concepts. As might be expected, the witnesses without exception were highly educated and intelligent.

[42] Much of what happened in this case took place by e-mail. There were a large number of telephone conversations amongst the various participants, most of which were recorded because they were made on traders' lines that are automatically recorded, and transcripts of these calls were made exhibits. This was not a case, however, which could be decided on the basis of only such evidence. Issues were raised which required consideration of the credibility and reliability of the evidence of some witnesses. In making credibility and reliability assessments, the statement of O'Halloran J.A. in *Faryna v. Chorny* [1952] 2 D.L.R. 354 (B.C.C.A.), is helpful:

> The credibility of interested witnesses…cannot be gauged solely by the test of whether the personal demeanour of the particular witness carried conviction of the truth. The test must reasonably subject his story to an examination of its consistency with the probabilities that surround the currently existing conditions. In short, the real test of the truth of the story of a witness in such a case must be its harmony with the preponderance of the probabilities which a practical and informed person would readily recognize as reasonable in that place and in those conditions. … Again a witness may testify what he sincerely believes to be true, but he may be quite honestly mistaken.

[43] While I found the evidence of the fact witnesses of Barclays extremely helpful, I must say that I found some of them too engaged in trying to sell their case regarding the state of negotiations between Barclays and the Caisse and the state of the market, and as will be discussed, I have not been able to accept all of their evidence as reliable or credible. Regarding the fact witnesses called by Devonshire, I did not have the same concerns. Some had better recollection than others, as is not unusual, but they all attempted to give their evidence according to their recollection of things. Regarding Mr. Lafleur-Ayotte, I found him to be loquacious, and one of those persons who, when asked a question, hears more in the question than asked and drifts off into areas not directly responsive to the question. I did not find him purposely doing so, however, and did not find him trying to argue the case any more than most witnesses are prone to do. I found his evidence generally to be credible and reliable.

[44] Regarding the expert witnesses and their valuation evidence, a trial judge is entitled to accept or reject the evidence of an expert witness in whole or in part. The fact that the evidence of a witness is accepted or rejected in any part does not mean that the whole of the evidence of that witness must be accepted or rejected. A trial judge need not accept the valuation of the experts, and is entitled to make his own calculations to arrive at a valuation. See *R. v. Towne Cinema*, [1985] 1 S.C.R. 494 and *Connor v The Queen*, [1979] C.T.C. 365, 79 D.T.C. 5256 (F.C.A.). In *Connor*, Urie, J., referred to the trial judge's reasons and stated:

> ... In this case he accepted some of the evidence but he rejected in all cases the methods, at least in part, whereby the experts arrived at their valuations. He was entitled to do so and unless it can be said that thereafter he proceeded on a wrong principle or that he made a palpable error in reaching his own conclusions as to value, we ought not to interfere with his findings. We have not been persuaded by the arguments of counsel that he proceeded on a wrong principle or made any such error. Certainly he appears to have adopted parts of the methods used by the witnesses in making their calculations but in using only parts and not the whole of their respective methods we do not believe that he erred in law.

See also generally the decision of Greenberg J. in re *Domglas Inc;Domglas Inc. v. Jarislovsky* et al (1981) 13 B.L.R. 135;aff'd (1982) 138 D.L.R. (3d) 521, as to the role of a judge in setting value. In that case, Greenberg J. fixed value guided by, but not slavish to, the values and factors chosen by the various experts. See also my comments in *Consulate Ventures Inc. v. Amico Contracting & Engineering (1992) Ltd.* (2010), 318 D.L.R. (4th) 513; aff'd [2011] O.J. No. 2476 (C.A.).

9. Which law governs the Montreal Accord, the Suspension Notice and Extension Agreements?

[45] Devonshire contends that the contractual relations between Devonshire and Barclays embodied in the Montreal Accord, the Suspension Notice and extension agreements are governed by Quebec law and subject to an obligation to act in good faith, among other things. None of these agreements state what law governs them.

[46] Where an agreement does not stipulate the governing law, a court will, if possible, infer the parties' choice of law from the circumstances of the case. If it is not possible to infer the parties' intention in this manner, then the proper law is determined by the application of the

"closest and most real (or substantial) connection" test. See J. Walker, *Castel & Walker Canadian Conflict of Laws*, loose-leaf, 6th ed. (Markham, Ontario: LexisNexis, 2005) at §31.2c and d.

[47] With respect to determining the proper law of the contract by considering the system of law that has the closest and most substantial connection with the transaction, Ritchie J. stated in *Imperial Life Assurance Co. of Canada v. Colmenares*, [1967] S.C.R. 443 at p 4:

> [T]he problem of determining the proper law of the contract is to be solved by considering the contract as a whole in light of all the circumstances which surround it and applying the law with which it appears to have the closest and most substantial connection.

[48] The Suspension Notice recited the ISDA Master Agreement, the market disruption notices delivered by Devonshire under the Special Provisions Annex of that agreement and the default notice delivered by Devonshire under the ISDA Master Agreement. The ISDA Master Agreement expressly provides that it is to be governed by and construed in accordance with the laws of Ontario and the laws of Canada applicable in Ontario.

[49] The Suspension Notice provides that in light of the Montreal Accord and at the request of the consortium that signed it, Devonshire "hereby suspends without prejudice the effect of the Default Notice and agrees not to take any further steps or proceedings to enforce its rights thereunder until the end of the Standstill Period…" Thus the central issue as to the meaning of the Suspension Notice involves the effect of suspending the default notice and agreeing not to take steps to enforce Devonshire's rights under it. That is, it involves the extent to which the suspension of the default notice affected or amended the rights of the parties under the ISDA Master Agreement. The inescapable inference, in my view, is that as the Suspension Notice did not expressly provide what law was to govern it, the law governing the ISDA Master Agreement and the default notice, i.e. Ontario law, would be the applicable law involved in interpreting its meaning.

[50] Devonshire contends that as the meeting which led to the Montreal Accord was held in Quebec, and called by the Caisse and National Bank personnel from Montreal, Quebec law

governs its interpretation. As the Suspension Notice was given at the request of the participants to the Montreal Accord and incorporated by reference the Standstill Period contained in the Montreal Accord, Devonshire contends that the Suspension Notice should also be governed by Quebec law.

[51] I cannot accept these contentions of Devonshire. The Montreal Accord did not have a governing law clause. That may be due to the fact that the participants chosen to attend purposely excluded legal counsel for the participants. It is highly likely that the participants never discussed of the issue of what law was to govern. However, the evidence of Brian Davis of National Bank who was instrumental in calling the meeting, was that the concerns that were dealt with involved liquidity calls that had been made by a number of trusts, including Devonshire, and collateral calls that asset providers had or could make. He testified that the purpose of the Montreal Accord at that time was to have the players in the market put their weapons down and take a pause in order to prevent the market from blowing up. Those weapons arose from the ISDA Master Agreements applicable to all of the trusts, which were governed by Ontario law.

[52] The Support Agreement made as of March 14, 2008 by the participants to the large Crawford restructuring, following on the Montreal Accord and the Framework Agreement, does provide that the agreement is governed by Ontario law and the laws of Canada applicable in Ontario. That is some indication that the parties to the Montreal Accord did not intend Quebec law to govern it.

[53] In the circumstances, I would not infer that the parties to the Montreal Accord intended Quebec law to govern it or the Suspension Notice of Devonshire that was made following the Montreal Accord. The same is applicable to the extensions that followed. They extended “the Montreal Accord standstills and the related suspension of default notices”.

[54] In the circumstances, I conclude that Ontario law applies to the interpretation of the Montreal Accord, the Suspension Notice and extension agreements and to a consideration of any rights flowing from these documents, including a consideration of any obligation to act in good faith.

(a) Principles of interpretation

[55] The ISDA Master Agreement and its annexes and the several other related agreements are commercial contracts. In interpreting a contract, the goal is to determine the intent of the parties by reference to the words that they chose. The plain meaning of the words is to be given effect, read harmoniously and in the context of other provisions of the contract, and in light of the factual matrix as a whole. Interpretations that give effect to all the terms of a contract should be preferred over interpretations that render one or more terms superfluous or ineffective. A commercial contract should be interpreted in a manner that accords with sound commercial principles, good business sense and that does not result in absurdities. While evidence of the factual matrix is generally admissible and relevant to the construction of a contract, extrinsic evidence as to the meaning of a contract is inadmissible unless there is an ambiguity. See generally *Toronto-Dominion Bank v. Leigh Instruments Ltd.* (1998), 40 B.L.R. (2d) 1, aff'd (1999) 45 O.R. (3d) 417 (C.A.) and *Ventas Inc. v. Sunrise Senior Living Real Estate Investment Trust*, (2007), 85 O.R. (3d) 254 (C.A.).

[56] With respect to what may be considered to be the factual matrix, Goudge J.A. in *Kentucky Fried Chicken v. Scott's Food Services Inc.*, (1998), 41 B.L.R. (2d) 42 stated:

> While the task of interpretation must begin with the words of the document and their ordinary meaning, the general context that gave birth to the document or its "factual matrix" will also provide the court with useful assistance. In his famous passage in *Reardon Smith Line v. Yngvar Hansen-Tangen*, [1976] 1 W.L.R. 989 at 995-996 (H.L.) Lord Wilberforce said this:
>
> > No contracts are made in a vacuum: there is always a setting in which they have to be placed. The nature of what is legitimate to have regard to is usually described as "the surrounding circumstances" but this phrase is imprecise: it can be illustrated but hardly defined. In a commercial contract it is certainly right that the court should know the commercial purpose of a contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.

[57] In *Consolidated Bathurst Export Ltd. v. Mutual Boiler and Machinery Insurance Co.*, [1980] 1 S.C.R. 888, Estey J. stated the following regarding avoidance of interpretations that produced commercially unfair and reasonable results:

> … the normal rules of construction lead a court to search for an interpretation which, from the whole of the contract, would appear to promote or advance the true intent of the parties at the time of entry into the contract. Consequently, literal meaning should not be applied where to do so would bring about an unrealistic result or a result which would not be contemplated in the commercial atmosphere in which the insurance was contracted Where words may bear two constructions, the more reasonable one, that which produces a fair result, must certainly be taken as the interpretation which would promote the intention of the parties. Similarly, an interpretation which defeats the intention of the parties and their objective in entering into the commercial transaction in the first place should be discarded in favour of an interpretation … which promotes a sensible commercial result.

10. Did Barclays waive its right to remedy its default?

[58] On January 13, 2009 Barclays took steps to make a payment to Devonshire purporting to pay the outstanding liquidity payments that had been demanded on August 13, 14 and 15, 2007 by wiring $71,196,072.58, the amount of the liquidity calls made plus interest. Barclays also sent to Devonshire a document headed Liquidity Demand Notice. That document included the following statement:

> It has been and remains the position of Barclays that the Liquidity Call Notices were not proper and the Barclays was not and is not under any contractual obligation to pay the Liquidity Call Notices. Equally, Barclays takes the position that the Event of Default notice was not proper or justified as a matter of contract (collectively, the Barclays' Position).
>
> Notwithstanding the Barclays' Position, Barclays has arranged for payment of the Liquidity Amount which is being made within the contractual period for payment, as extended from time to time. Such payment is being made without any admission or inference that it is due or that any demand therefore was valid, and, accordingly, Barclays reserves all of its rights and remedies under the Master Agreement, including the right to demand the return of all such funds, subject to resolution of dispute, together with interest thereon.

[59] Section 5(a)(i) of the ISDA Master Agreement provides that a failure to make any required payment is an Event of Default if not remedied within 3 days:

> 5. Events of Default and Termination Events
>
> (i) Failure to Pay or deliver. Failure by the party to make, when due, any payment under this Agreement or delivery under Section 2(a)(i) or 2(e) required to be made by it if such failure is not remedied on or before the third Local Business Day after notice of such failure is given to the party.

[60] Devonshire takes the position that Barclays unequivocally waived its right to remedy its default in failing to pay the liquidity demands when made.

[61] The evidence makes clear, in my view, that Barclays never had an intention to pay the liquidity demands made on August 13, 14 and 15, 2007. On each of those days Barclays decided not to pay the demands. Barclays' position was that there was no market disruption event because the notes of bank sponsored conduits were rolling on each of those days. It is clear from internal Barclays documents prior to the signing of the contractual documents with Devonshire in the first place that Barclays intended to take the position that there would never be a market disruption event within the meaning of the contractual documents if the notes of bank sponsored conduits were rolling on days on which the notes of independent sponsored conduits such as Devonshire were not rolling. Barclays determined on each of August 13, 14 and 15, 2007 that notes of bank sponsored conduits in Canada were rolling and never after those days made any investigation on the matter. Barclays' notice of January 13, 2009 to Devonshire reiterated its position that it had no obligation to pay the liquidity demands of Devonshire.

[62] There is also no question on the evidence that Barclays made clear to Devonshire that it did not intend to make payment on the liquidity calls that had been made because on its view there had been no market disruption event. The question is whether on the evidence it can be inferred that Barclays waived its right to remedy its default by later making liquidity payments.

[63] In *Saskatchewan River Bungalows Ltd. v. Maritime Life Assurance Co.*, [1994] 2 SCR 490 Major J. described the law of waiver as follows:

> 19. Waiver occurs where one party to a contract or to proceedings takes steps which amount to foregoing reliance on some known right or defect in the performance of the other party… The elements of waiver were described in *Federal Business Development Bank v. Steinbock Development Corp.* (1983), 42 A.R. 231 (C.A.), cited by both parties to the present appeal (Laycraft J.A. for the court, at p. 236):
>
>> The essentials of waiver are thus full knowledge of the deficiency which might be relied upon and the unequivocal intention to relinquish the right to rely on it. That intention may be expressed in a formal legal document, it may be expressed in some informal fashion or it may be inferred from conduct. In whatever fashion the intention to relinquish the right is communicated, however, the conscious intention to do so is what must be ascertained.
>
> 20. Waiver will be found only where the evidence demonstrates that the party waiving had (1) a full knowledge of rights; and (2) an unequivocal and conscious intention to abandon them. The creation of such a stringent test is justified since no consideration moves from the party in whose favour a waiver operates. An overly broad interpretation of waiver would undermine the requirement of contractual consideration.
>
> 24 … The nature of waiver is such that hard and fast rules for what can and cannot constitute waiver should not be proposed. The overriding consideration in each case is whether one party communicated a clear intention to waive a right to the other party.

[64] One difficulty in concluding that Barclays waived its right to cure is that Barclays had taken the position from August 13, 2007 onwards up to January 13, 2009 that it had no obligation to cure. Intentionally waving a right to cure presupposes knowledge of an obligation to cure. It can be taken, however, that Barclays knew that if its position regarding no obligation to cure was incorrect, it had an obligation to cure.

[65] I am not able to conclude on the evidence that Barclays communicated a clear intention to waive its right to cure in the event that it was incorrect in refusing to pay the liquidity demands made by Devonshire. Barclays certainly communicated to Devonshire its intention not to pay, but did not go further and communicate any intention to waive a right to later remedy its default.

[66] Had I found that there was a communication by Barclays of an intention to waive its right to cure, I do not think that sections 9(b) or (f) of the ISDA Master Agreement would preclude a finding of waiver. Section 9(f) provides that a failure or delay in exercising any right will not be presumed to operate as a waiver. This section does not state that such a failure or delay could be deemed to be a waiver, but merely that a waiver will not be presumed. Section 9(b) provides that no waiver will be effective unless in writing and executed by each of the parties. However, there is authority that variation of a contract is effective even if the contract purports to exclude subsequent oral variations and also that oral statements may operate as a waiver of rights evidenced by an earlier written document or may set up an estoppel. See Waddams, *The Law of Contracts*, 6^{th} Edition at para. 329 and *Shelanu Inc. v. Print Three Franchising Corp* (2003), 64 O.R. (3d) 533 at para. 50.

11. Effect of the Suspension Notice

[67] Once Barclays had signed the Montreal Accord, it asked Devonshire to rescind the notice of default that Devonshire had sent on August 4, 2007. Devonshire did not want to do that for fear of liability to its noteholders in the event that a restructuring was not reached. It proposed a suspension rather than a rescission. Eventually that was settled on by Devonshire in the form of the Suspension Notice. Barclays was unhappy about it but was prepared to live with it and in its pleadings admitted that it accepted the terms.

[68] The Suspension Notice recited the ISDA Master Agreement, the market disruption notices and the default notice. It then provided:

> In light of the agreement reached on August 16, 2007 (the "Consortium Agreement") between the Bank and a number of investors and financial institutions (the "Consortium"), and at the request of the members of such Consortium.

[69] The Consortium Agreement referred to was the Montreal Accord. The operative part of the Suspension Notice provided:

> The Trust hereby suspends without prejudice the effect of the Default Notice and agrees not to take any further steps or proceedings to enforce its rights thereunder until the end of the Standstill Period (or any extension thereof consented to by the Trust), provided that the Bank complies with its obligations under the Agreement and as a Signatory under the Consortium Agreement.
>
> …
>
> The Trust otherwise reserves all of its rights under the Agreement and Default Notice.

[70] Devonshire contends that the language of the Suspension Notice "suspends without prejudice the effect of the Default Notice" suspended Devonshire's right to take steps to enforce its rights under the ISDA Master Agreement but did not suspend the obligation of Barclays to make the liquidity payments needed to remedy its default. It says this is made clear by the next part of the sentence “and agrees not to take any further steps or proceedings to enforce its rights thereunder" and by the last sentence which provides the Devonshire otherwise reserves all of its rights under the ISDA Master Agreement and default notice. Devonshire further says that the words "without prejudice" means that the Suspension Notice was without prejudice to Devonshire's rights under the agreements including its right to have the liquidity payments made during the three business days following the Default Notice.

[71] Barclays contends that one of the effects of the Default Notice was that it had three days to pay the liquidity payments, a failure of which would result in an event of default permitting Devonshire to terminate the swaps and that by suspending the effect of the Default Notice, Devonshire suspended the three day period which Barclays had to cure its failure to make the liquidity payments. Devonshire counters by contending that if Barclays were correct, the further provision that Devonshire agrees not to take any further steps to enforce its rights would not be needed and would be surplus.

[72] The Default Notice delivered by Devonshire to Barclays on the evening of August 14, 2007 notified Barclays of an Event of Default provided for under section 5(a)(i) of the ISDA Master Agreement, which provides as follows:

> **5. Events of Default and Termination Events**

> **(a) Events of Default.** The occurrence at any time with respect to a party or, if applicable, any Credit Support Provider of such party or any Specified Entity of such party of any of the following events constitutes an event of default (an "Event of Default") with respect to such party:—
>
> **(i) Failure to Pay or deliver.** Failure by the party to make, when due, any payment under this Agreement or delivery under Section 2(a)(i) or 2(e) required to be made by it if such failure is not remedied on or before the third Local Business Day after notice of such failure is given to the party.

[73] Absent the Suspension Notice, on the expiry of the three day period on August 17, 2007, Devonshire would have had the right to designate an Early Termination Date under paragraph 6(a) of the ISDA Master Agreement, which provides as follows:

> **6. Early Termination**
>
> **(a) Right to Terminate Following an Event of Default.** If any time an Event of Default with respect to a party (the "Defaulting Party") has occurred and is then continuing, the other party (the "Non-Defaulting Party") may, by not more than 20 days notice to the Defaulting Party specifying the relevant Event of Default, designate a day not earlier than the day such notice is effective as an Early Termination Date in respect of all outstanding Transactions.

[74] One of the effects, therefore, of the Default Notice was that if Barclays failed to make the liquidity payments within three business days after the Default Notice was given, an event of default would have occurred permitting Devonshire to terminate the swaps. By suspending the effect of the Default Notice, Devonshire in my view suspended whatever part of the three day cure period remained. Whatever the meaning of the words "without prejudice" in the Suspension Notice, they cannot make meaningless the suspension of the effect of the Default Notice.

[75] It is agreed that the Suspension Notice and its extensions constitute a contract. Part of the factual matrix surrounding the Suspension Notice is the Montreal Accord, which is recited in it. The Montreal Accord contained a framework for a long term restructuring. It also contained an interim agreement which provided, amongst other things,

> 3. Signatories who are counterparties of the Third Party ABCP conduits [Barclays was a signatory] will not pursue any existing margin calls or make any further margin calls during the Standstill Period.

> 4. The Third Party ABCP conduits [Devonshire was one] will agree not to pursue any existing liquidity calls during the Standstill Period or make any further liquidity calls for 150 days after the Standstill Period.

[76] The purpose in clause 3 of agreeing not to pursue any existing margin calls was to prevent the necessity of a conduit having to post collateral resulting from a margin call i.e. preventing the conduit from having to pay cash to meet a margin call. Likewise, the purpose of an ABCP conduit agreeing not to pursue any existing liquidity call was to prevent the counterparty on whom the liquidity call had been made from having to pay cash to the conduit required by the liquidity call.

[77] The operative paragraph in the Suspension Notice begins by providing that the suspension is given in light of the Montreal Accord and at the request of the members of the consortium who signed it. This is an indication that what was being sought in the Suspension Notice was an agreement by Devonshire consistent with clause 3 of the interim agreement contained in the Montreal Accord, i.e. an agreement "not to pursue" any existing liquidity calls, the meaning of which could only be not to require the payment by Barclays of the existing liquidity calls. Otherwise agreeing "not to pursue" the liquidity calls would be meaningless. The provision in the Suspension Notice that Devonshire agreed not to take any steps to enforce its rights until the end of the standstill period was consistent with that position.

[78] There was much argument as to the meaning of the words “without prejudice” in the Suspension Notice. The words are puzzling and there was no evidence of any discussion between the parties regarding them at the time the Suspension Notice was prepared and signed. Devonshire contends that the words mean that the granting of the Suspension Notice could not be detrimental or prejudicial to Devonshire, in the sense that it could not be harmful to Devonshire, and thus the obligation on Barclays to make the payment within three business days was not suspended. In answer to a question as to whether the words meant “apart from what we are doing here it is without prejudice to our other rights”, the response was that it had to mean more as the last sentence in the Suspension Notice already provided that Devonshire otherwise reserved all of its rights under the ISDA Master Agreement and Default Notice.

[79] I confess to being unsure what was intended by the words "without prejudice". The best I can make of them is that Devonshire was saying that the effect of the Default Notice was suspended without prejudice to the rights of Devonshire under that Default Notice at the end of the standstill period.

[80] Barclays contended that in the event of any ambiguity in the meaning of the Suspension Notice, regard could be had to discussions between Mr. Lafleur-Ayotte and representatives of Barclays prior to Barclays agreeing to operate under the terms of the Suspension Notice. It is not necessary in my view to consider that evidence. However, if I were to do so, I would not put much if any weight on it. Two things from the evidence appear clear. One is that people at Barclays had little regard for Mr. Lafleur-Ayotte and I doubt very much if they paid any attention to his views. It is also clear from the conversation in question that they wanted to look at the document before considering their position.

[81] In my view by construing the language of the Suspension Notice and considering its factual matrix, the time during which Barclays had to pay the existing liquidity calls in order to remedy its failure was suspended during the period of the Suspension Notice as extended from time to time.

[82] The default notice was given at 8:07 p.m. on Tuesday, August 14, 2007, after the close of business that day, and so is taken to have been given on August 15, 2007. The Suspension Notice was given at 7:44 p.m. on August 16, 2007, after the close of business that day, and so is taken to be effective on August 17, 2007. Therefore one of the three days to remedy Barclays' failure to pay the liquidity calls expired before the Suspension Notice.

12. Misrepresentation claim

(a) Nature of claim

[83] Devonshire claims that in extending the Standstill Period on January 8 and 9, 2009, Barclays misrepresented the state of negotiations that were going on between Barclays and the Caisse. This was just days prior to the purported termination of the ISDA Master Agreement by Barclays on January 13, 2009. The parties agree that the daily extensions of the Standstill Period

were each separate contracts. Devonshire claims that the extensions that took place on January 8 and 9, 2009 should be rescinded because of the misrepresentations. Devonshire claims that even if the three day cure period for Barclays to cure the default did stop running on August 16, 2007 during the Standstill Period, it started running again at the latest on January 9, 2009 and expired before January 13, 2009.

(b) Relevant facts

[84] Following the Montreal Accord and the suspension by Devonshire of its notice of default, the Standstill Period between Barclays and Devonshire was extended by various agreements to April 18, 2008. Following the expiry of the extension agreement on April 18, 2008, the Standstill Period and the Suspension Notice served by Devonshire were extended by daily e-mails sent on each business day from Barclays to Mr. Lafleur-Ayotte of Quanto. These e-mails contained the same language each day as follows:

> "There are still a number of issues being worked out regarding the proposed restructuring of Devonshire Trust. Accordingly, for the sake of good order we are confirming that, as between Barclays and Devonshire, the Montreal Accord standstills and the related suspension of default notices have and will continue through [the next business day] to allow for these negotiations to continue. If anyone takes a different position, please let us know ASAP." (underlining added)

[85] The second last e-mail was sent on January 8, 2009 and the last was sent on January 9, 2009. The last one extended the standstill and suspension of Devonshire's default notice to January 12, 2009, which was the next business day, a Monday. Devonshire takes the position that the underlined words misrepresented the situation in that the restructuring negotiations being held by Barclays had reached an impasse and that Barclays did not at that stage expect the negotiations to be successful and planned instead to terminate the Devonshire swaps. In order to understand the issue, it is necessary to review what the discussions were by this time.

[86] Following the Montreal Accord, discussions were held amongst all of the major parties in the ABCP market with a view to restructuring the entire market. These included discussions by Barclays with the major Devonshire noteholders with a view to a restructuring of Devonshire.

No one on behalf of Devonshire or Quanto participated in these negotiations. Legal and financial representatives of the Investors Committee participated from time to time.

[87] As early as August, 2007 Barclays was of the view that Devonshire was a good trust to be restructured individually with the noteholders, and it proposed to the Caisse as well as other large noteholders the idea of taking some or all of the leveraged super senior trades out of Devonshire and creating a super senior swap directly between Barclays and the Caisse and other note holders. The effect of such a transaction would be to remove from Devonshire that portion of the swap between Barclays and Devonshire represented by the notes held by each note holder and transferring that swap to a new swap between Barclays and each particular note holder who agreed to do it. If the new swap were on economically identical terms as the swap between Barclays and Devonshire, Barclays would effectively be made whole for that portion of the swap transferred to the note holder. The first of such proposals was sent to the Caisse, National Bank and Desjardins on August 31, 2007. Later iterations of the proposal were sent to them and to Citibank as well.

[88] Although Barclays wanted to achieve a restructuring by the end of 2007, that was not possible, and discussions continued. Barclays was concerned with delays and in early April, 2008 was considering terminating the Devonshire swaps if the latest term sheet sent by Barclays was not signed by the Caisse, National Bank and Desjardins within a week.

[89] On April 8, 2008 a meeting took place in New York amongst representatives of Barclays, the Caisse, National Bank and the Investors Committee. Attending the meeting for Barclays were a number of executives, the most senior of whom was Mr. Jerry del Missier, the co-CEO of Barclays Capital. There were a number of representatives from the Caisse, the most senior of whom was Mr. Henri-Paul Rousseau, the CEO of the Caisse. National Bank was represented by Mr. Ricardo Pascoe.

[90] A power point presentation was made by the Caisse in which a number of concerns of the Caisse with the Barclays term sheet were set out. The concerns had to do with accounting issues that the Caisse said would be very unfavourable to it. At the end of the power point presentation there was a counter-proposal by the Caisse and National Bank which contained terms, including

terms regarding how to deal with the small noteholders who held $75 million of Devonshire notes. During the presentation, the Caisse stated that neither Citibank nor Desjardins wanted to participate in a swap proposal.

[91] Gregory Neville of Barclays attended the meeting. He testified that after the power point presentation, the Barclays representatives went into a side meeting to discuss the proposal of the Caisse and concluded that while they were concerned about Desjardins and Citibank, they could work with the Caisse’s proposal and agreed to go back into the meeting and accept the proposal and then later work on Desjardins and Citibank. Mr. Neville testified that they went back into the meeting and told the Caisse that they accepted the proposal of the Caisse and would work toward a revised term sheet to reflect the terms. He said that Mr. del Missier spoke on behalf of Barclays and Mr. Rousseau spoke on behalf of the Caisse. He said that the meeting ended with a handshake deal.

[92] Mr. Bergeron of the Caisse and Mr. Pascoe of National Bank both testified that no agreement was reached on all necessary terms for a restructuring and that further work was required.

[93] On April 9, 2008, the day following the meeting in New York, Mr. Neville sent a revised term sheet to the Caisse, National Bank, Desjardins and Citibank. Desjardins and Citibank did not want to participate and that month Barclays acquired the notes held by Desjardins and Citibank at only a fraction of their face value.

[94] From mid-April to mid-September, 2008, there were ongoing discussion amongst lawyers for Barclays, the Caisse and National Bank regarding the term sheet. Matters proceeded slowly.

[95] On October 10, 2008 Barclays and National Bank signed a framework agreement under which Barclays acquired the National Bank notes with a face value of $59.2 million for one dollar. National Bank agreed to assist Barclays in obtaining MAV II notes that would become available upon the successful larger restructuring of the ABCP market. These MAV II notes

would then be offered by Barclays to the small noteholders[8] holding notes with a total face value of $75 million. While the offer to be made to the small noteholders pursuant to this framework agreement was not conditional upon a successful agreement between Barclays and the Caisse, Barclays did not proceed with the offer after it failed to reach an agreement with the Caisse.

[96] After the agreement was made between Barclays and National Bank, the only remaining Devonshire note holder with whom there was no agreement, apart from the small noteholders holding about $75 million of notes, was the Caisse which held Devonshire notes with a face value of $385 million. Once Barclays had made its deal with National Bank, Barclays pushed to settle terms with the Caisse. By this time, the senior officers of the Caisse at the time of the meeting in New York in April, 2008, including Mr. Rousseau and Mr. Guay, were no longer at the Caisse and Barclays had to deal with other personnel, and in particular Mr. Claude Bergeron, a vice-president of the Caisse.

[97] Another thing that had changed was the market for ABCP. From September to December 2008 there were large financial failures, including Fannie Mae and Freddie Mac being put into conservatorship, the bankruptcy of Lehman Brothers and the failures of Washington Mutual and three Icelandic banks. World markets reacted and became extremely illiquid. Appetite for risk dried up. Continued deterioration of the credit market caused credit spreads to widen to unprecedented levels and investment grade debt was trading at junk debt spreads. The mark to market values of swaps moved severely against the position of investors in the ABCP market. Although a framework agreement in principle had been reached by the Investors Committee led by Purdy Crawford on December 23, 2007 with the asset and liquidity providers for the large restructuring involving 20 conduits, new rounds of negotiations twice led to modifications in December 2008 to give investors more protection required by them as a result of the market changes.

[98] For Devonshire, the spreads increased from August, 2007 to January 2009 by an unprecedented 228%. In early November, 2008 the Caisse began asking for revised terms to

[8] These were not all small investors and included large institutions such as University of Alberta. They were referred to by all participants in the discussions as the “small noteholders”.

reflect the market changes, and made clear during the remainder of 2008 that it was looking for changes of the kind agreed to in the larger Crawford restructuring. While Barclays was not happy with the requested changes, it began to negotiate with the Caisse on the Caisse's requests and during those negotiations made a number of concessions.

[99] On November 4, 2008 Mr. Bergeron told Barclays that a mark to market valuation was no longer a good indication of value and he suggested some cap on the collateral requirements that the Caisse might be called on to deposit with Barclays. Barclays interpreted this as the Caisse wanting to change the trigger for collateral calls from a mark to market valuation of the swaps to a spread and loss trigger, which Barclays did not want. As Mr. Neville explained, Barclays lived in a mark to market world and if the trade with the Caisse was to have triggers on a different spread/loss basis, it could create a very significant gap risk for Barclays, which is a notional risk from Barclays's point of view if the mark to market value of the swaps is less than the value of the assets in Devonshire which is the collateral available to Barclays if the swaps are terminated early.

[100] On November 18, 2008, in anticipation of a meeting with the Caisse the following day, Barclays proposed as a compromise a partial spread/loss trigger mechanism once the mark to market reached 50%, with concessions on other points being made by the Caisse. At a meeting in New York the next day, Mr. Bergeron said they would discuss the Barclays proposal with his board the next week but said that they had problems with a spread trigger and preferred a loss-only trigger.

[101] On November 20, 2008, in anticipation of the Caisse board meeting to be held on Monday, November 24, 2008, Barclays sent a power point presentation that explained their proposal that had been made at the meeting in New York and term sheet that contained the proposal. The board did not deal with it then and on December 2, 2008 Mr. Neville again asked Mr. Bergeron to put the proposal to the Caisse's board. Mr. Neville testified that he did not think that was done. In exchanges of e-mails between Barclays' representatives and Mr. Bergeron in early December, Barclays took the position that it had a binding agreement that had been reached earlier in the year in April, 2008. The Caisse denied the existence of any binding agreement.

[102] One of the changes negotiated by the participants in the large Crawford restructuring due to the same changes in the market that were effecting Devonshire was a one year moratorium on collateral calls that could be made by asset providers. The Caisse followed suit and asked for the same thing from Barclays. On December 16, 2008 Mr. Neville made a proposal that Barclays would agree to such a moratorium on condition that the Caisse agree to a number of other changes, including increasing the initial recourse commitment of the Caisse to $1.5 billion for the term of the moratorium and thereafter unless certain conditions were met.

[103] On December 18, 2008 Mr. Charles Quintal, who was assisting Mr. Bergeron with Devonshire, e-mailed Barclays with a proposal that changed the Barclays proposal in a number of respects. The changes, which Mr. Neville described as huge, included lengthening the moratorium to 14 months, limiting the recourse obligation of the Caisse to $900,000 with no further collateral calls available to Barclays and amending to the benefit of the Caisse the spread/loss triggers. The e-mail ended by Mr. Quintal stating that he appreciated that Barclays might not find the terms acceptable. Later the same day Barclays responded to Mr. Quintal and said they would agree to the 14 month moratorium on collateral calls by Barclays, but with a $1.2 billion recourse obligation on the Caisse, and would agree to widen the spread/loss triggers as proposed by the Caisse. Barclays said it was still reviewing the request to change the trigger that Barclays would have to end the moratorium.

[104] On December 23, 2008 Mr. Neville and Mr. Quintal had a lengthy telephone discussion, in which Mr. Quintal re-iterated that the Caisse wanted a deal similar to the deal that was being negotiated by the Investors Committee for the remaining ABCP market and that was not going well for Barclays. Mr. Quintal threw out a number of $600,000 to $700,000 as the limit of the Caisse’s liability for a collateral call, which was less than their earlier position of $900,000, and increased the request for a moratorium for collateral calls to 18 months, longer than their earlier request for 14 months, with no ability to Barclays to terminate the moratorium at all regardless of the market losses of the underlying synthetic bond portfolios. On that day, the Investors Committee had announced that the moratorium in the larger Crawford restructuring had been increased from 14 to 18 months, and the Caisse sought the same from Barclays. Mr. Neville told Mr. Quintal that he would take the proposal back to the Barclays traders, on whose

book the Devonshire trade was accounted for within Barclays, but that he was not optimistic that they were even close.

[105] Christmas and New Years intervened with no further communications between Barclays and the Caisse.

[106] On January 8, 2009, at 12:46 p.m., Mr. Lovisolo of Barclays sent an e-mail to Messrs. Bergeron and Quintal of the Caisse enclosing a term sheet that reflected what Mr. Lovisolo said was agreed between the parties in April, 2008. It did not reflect the later terms that had been discussed between them since November, 2008. The e-mail requested that Messrs. Bergeron and Quintal assemble a meeting of the board of directors of the Caisse to "ratify our previous agreement on the restructuring of the Caisse's holdings". The e-mail concluded by stating that Barclays looked forward to receiving a signed copy of the term sheet by no later than 5 p.m., Monday January 12th. On cross-examination, Mr. Neville reluctantly acknowledged that the deadline in the e-mail could fairly be called an ultimatum.

[107] Mr. Bergeron testified that upon receipt of the January 8, 2009 ultimatum requiring the Caisse to sign the April 9, 2008 term sheet, he felt insulted and had no intention of recommending it to the board of the Caisse.

[108] The daily extension of the arrangements between Barclays and the Caisse was sent by Mr. Neville on January 8, 2009 at 4:47 p.m. There had been no communication between Barclays and the Caisse since the ultimatum had been sent earlier that day.

[109] On January 9, 2009, Mr. Neville took steps to arrange for the liquidity payment that was later made to Devonshire on January 13, 2009 to be set up within Barclays, and the payment was booked internally on January 9, 2009 to be effective January 13, 2009.

[110] On January 9, 2009 at 2:33 p.m., Mr. Neville and Mr. Quintal spoke on the telephone. Mr. Quintal told Mr. Neville that Mr. Bergeron said they were supposed to respond to the e-mail that afternoon but he did not think they would be in a position to deal with it by January 12 due to all of the work involved in the large Crawford restructuring that was to close

the week of January 12. After Mr. Neville told Mr. Quintal that 5 p.m. on Monday, January 12 was a real deadline, Mr. Quintal said that Mr. Bergeron would address the e-mail that afternoon. Nothing further was heard from the Caisse before the extension to January 12, 2009 was e-mailed by Barclays at 4:58 p.m. on January 9, 2009.

(c) Analysis

[111] A misrepresentation is an incorrect statement of a present or past fact that is false. See John D. McCamus, *The Law of Contracts* (Toronto: Irwin Law Inc., 2005) at p. 326.

[112] Partial disclosure of facts may also be misleading. See *Spinks v. Canada* [1996] 2 F.C. 563 (C.A.) per Linden J.A. at para. 29. In S.M. Waddams, *The Law of Contract*, 6th ed. at para. 439, it is stated:

> An incomplete statement may be as misleading as a false one, and such half-truths have frequently been treated as legally significant misrepresentations. Almost always something is said to induce the transaction and it is open to the court to hold that the concealment of the material facts can, when taken with general statements, true in themselves but incomplete, turn those statements into misrepresentations….Silence may, in its contest, amount to an assertion that there is nothing of significance to reveal.

[113] See also *Xerex Exploration Ltd. v. Petro-Canada*, 6 B.L.R. 94th) 1 (Alta. C.A.), in which it was stated:

> We can see no reason to disturb the learned trial judge's finding that there was a misrepresentation by silence or incomplete disclosure. Ordinarily in contractual negotiations between sophisticated parties, operating at arm's length, there is no general duty of disclosure. When a representation is made during the course of negotiations, however, the party making it must ensure that it is accurate so that it does not amount to a misrepresentation. This gives rise to a further duty to speak when silence effectively renders a representation, already made, inaccurate. Having brought a particular subject up in negotiations, a party assumes a duty to ensure that the other party is aware of all the material facts relevant to that assertion.

[114] Can it be said that the statements in the January 8 and 9, 2009 extension e-mails that “that there are still a number of issues being worked out regarding the proposed restructuring of the Devonshire Trust” and that “for the sake of good order” the extensions of the standstill

agreement and suspension of the default notice should continue "to allow those negotiations to continue" were accurate? In my view, for a number of reasons, it cannot. The statements were misleading. These statements had been made daily for over eight months and the last two in question gave the impression that it was business as usual so far as negotiations were concerned. It was not.

[115] Messrs. del Missier, Lovisolo and Neville gave evidence to the effect that when these last extensions were sent out, negotiations were continuing with a view or hope that they would result in some acceptable restructuring with the Caisse. For the reasons that follow, I do not accept that evidence.

[116] By the time these extensions were sent to Devonshire, what had occurred, and I so find, is that the "deal team" at Barclays dealing with Devonshire, being the sales team, credit structuring team and trading team[9] involved in the negotiations had come to the view that the Caisse would never agree to any reasonable terms and the decision was taken to back away from the terms that had been discussed between Barclays and the Caisse in November and December, 2008. Instead, Barclays put an ultimatum to the Caisse on January 8, 2009 to sign by January 12, 2009 at 5 p.m. the term sheet that had been given to the Caisse on April 9, 2008. No one at Barclays thought the Caisse would sign that term sheet and the decision was all but formally made to terminate the Devonshire trades. That formality occurred on January 12, 2009 shortly after 5 p.m. when, after the Caisse had failed to sign the term sheet, Barclays took the decision to terminate the trades, and they took steps to do so on the following morning.

[117] The conclusion I draw is that in sending out the April 2008 term sheet in January 2009, Barclays was effectively ending negotiations. The credit meltdown in world markets in October and November, 2008 was dramatic. It led the parties in the larger Crawford restructuring to twice negotiate new terms in December, 2008 and to governments at both the provincial and federal levels agreeing to participate in massive funding obligations. The Caisse was a major player in that restructuring who benefited from those new terms. For Barclays to revert without

[9] Throughout this process internal and external legal advisors were heavily involved, and considered part of the deal team dealing with the issues. What legal advice was given is protected by privilege, and generally has not been waived.

notice to the April 2008 term sheet after it had made several concessions in negotiations with the Caisse in November and December 2008, could only serve to cause a negative reaction in the Caisse who quite clearly could not be expected to agree to it. It was not done with a view of eliciting some other offer from the Caisse. Barclays did not want any other offer from the Caisse.

[118] The e-mail of January 8, 2009 from Barclays with the April 2008 term sheet requested Mr. Bergeron to convene a meeting of the board of the Caisse to confirm an agreement said to have been reached and contained in the April 9, 2008 term sheet. Yet the April 9, 2008 term sheet drafted by Barclays contained terms not discussed in the meeting in New York the day before and never agreed to afterwards, such as recourse increases of 6.25 % and 11.25% and cross-default provisions. Barclays knew that Mr. Bergeron had in December 2008 denied that any agreement had been reached in April, 2008. Mr. Bergeron had attended the meeting in New York on April 8, 2008 on behalf of the Caisse, as had Mr. Pascoe of National Bank. Their evidence, which I accept, was that while there was an agreement in principle reached on some issues, mainly on how to deal with the small noteholders, there was no binding economic agreement reached on all terms as between the Caisse and Barclays. As Mr. Pascoe testified, he left the meeting thinking that they had a framework for an agreement but that everyone understood they had a lot of work to do before they had an agreement.

[119] Barclays knew that National Bank did not consider itself bound by any alleged agreement reached in New York in April, 2008. On September 23, 2008, Mr. Davis spoke to Barclays and proposed that Barclays take back the Devonshire notes held by National Bank for a nominal consideration. In an internal e-mail that day, Mr. Neville referred to the position of National Bank as being “slimy” after negotiating with Barclays for over a year and then walking away. If Barclays were right, it had an agreement with National Bank from the time of the New York meeting in April, 2008. No mention was made of any such agreement in the internal e-mail of Mr. Neville on September, 23, 2008.

[120] The inference I draw is that in its e-mail of January 8, 2009 to the Caisse, Barclays was positioning itself to exit the Devonshire trades and that it knew that litigation would take place. Indeed Barclays issued and served its statement of claim on January 13, 2009

just moments after terminating the trades. The reference to an agreement reached in April 2008 in the e-mail of January 8, 2009 was, I believe, posturing by Barclays for the litigation that it knew would follow shortly.

[121] Mr. James Lee, a director of trading for Barclays in New York and involved at the time in the economic analysis of the Devonshire trade and terms being discussed with the Caisse, was of the view by December 23, 2008 that because of the market changes, it made more economic sense for Barclays to terminate the Devonshire trades than to going through a restructuring on the terms being discussed. Mr. Alexandre Pointier, to whom Mr. Lee reported, recommended that day that Barclays should "take a step back" and only mention the earlier proposal made to the Caisse, meaning the April, 2008 term sheet.

[122] On January 7, 2009 Mr. Lee recommended that given that the market had clearly moved in favour of Barclays as against the Caisse, Barclays should move off its latest proposal of December 18, 2008. He testified that his view at the time was that the changes in the market over the holidays meant that the cost to Barclays of terminating the trades had come down and that terminating the trades made sense unless they could get a substantially better deal from the Caisse than had been proposed in December, 2008 by Barclays.

[123] Barclays acted on these views by sending its ultimatum on January 8, 2009 to the Caisse with the term sheet that had been earlier provided to the Caisse on April 9, 2008, which required a response by January 12 at 5 p.m.

[124] At the time the term sheet was sent on January 8, 2009, Barclays did not believe that the Caisse would sign it, which is hardly surprising given the negotiations that had taken place between the Caisse and Barclays in November and December, 2008 to change the April 9, 2008 term sheet as a result of the dramatic market changes that took place in the fall of 2008 following the collapse of Lehman Brothers. The investors in the larger Crawford restructuring had refused to close without changes being agreed in two rounds of changes in December, 2008. The Caisse was the largest investor in Canadian ABCP and a major player in the conduits involved in that restructuring and it would have been completely against the Caisse's economic interests at that stage to sign the April, 2008 term sheet.

[125] The term sheet of April 9, 2008 was materially worse to the Caisse than the proposal of Barclays made on December 18, 2008. It did not contain any moratorium on collateral calls and required an initial $1 billion in recourse to be committed to by the Caisse. The trigger for collateral calls was to be a mark to market trigger instead of spread/loss triggers which Barclays had said in December they would accept in part. Nor was there any cap on collateral calls. Mr. Lee testified that he believed that the mark to market would have gone up after January 12, 2009 and that if the Caisse had accepted the April 2008 term sheet, it would have then been required to commit to additional recourse of over $1 billion.

[126] Mr. Lee did not believe that the Caisse would accept the earlier proposal of Barclays made on December 18, 2009 and while reluctantly, agreed on cross-examination that it was probable that the Caisse would not sign the April 2008 term sheet sent on January 8, 2009.

[127] Mr. Neville, who from the outset was the person on Barclays' sales team responsible for dealing with the Caisse, testified that at the time the term sheet was sent on January 8, 2009 he thought it unlikely that the Caisse would sign it.

[128] On January 12, 2009 in the morning, Mr. Neville told Ms. Sandra Godard, Barclays' relationship manager for large financial institutions based in Toronto, that neither he nor "anyone here" thinks the Caisse would sign the term sheet. Ms. Goddard told him that she was hearing the same thing and that she had had a heads up from Mr. del Missier, who is said to have ultimately made the decision to terminate the trades.

[129] Mr. Neville, who sent out the extension e-mail of January 8, 2009 (the January 9 e-mail was sent by the Barclays New York legal team but copied to many, including Mr. Neville), testified in chief that over the week-end before January 12, 2009 his belief that the Caisse would sign the term sheet went down. He also testified that he hoped that the Caisse might come back with last minute negotiations. This evidence, I believe, was given in an effort to support his position that the e-mails were not misleading and to justify the timing of his comment to Ms. Goddard on January 12, 2009 that no one thought the Caisse would sign the term sheet. However, I cannot accept his evidence on this point.

[130] Mr. Neville's assertion is contradicted by his evidence in several respects. At the time the term sheet was sent out on January 8, 2008 he thought it unlikely that it would be signed by the Caisse, and at no time did he say otherwise. He learned from his conversation with Mr. Quintal of the Caisse on January 9, 2009 that it was unlikely that the Caisse people could get to the e-mail by January 12th because of a weeklong closing process in Toronto of the large Crawford restructuring and when Mr. Neville said that the deadline of January 12th was a real deadline, Mr. Quintal said that Mr. Bergeron would address the e-mail that afternoon, which did not happen. There was nothing in the call with Mr. Quintal to give Mr. Neville any hope that the ultimatum would be accepted and Mr. Neville agreed on cross-examination that he knew from this call with Mr. Quintal that the Caisse was unlikely to sign the April 9, 2008 term sheet. I do not accept that Mr. Neville went into the week-end with positive views regarding the Caisse agreeing to the term sheet. Moreover, nothing material occurred over the week-end to make Mr. Neville change his views.

[131] Mr. Lovisolo, to whom Mr. Neville reported, testified that he thought that the chances of the Caisse signing the term sheet were 30%. I question the reliability of Mr. Lovisolo's evidence and his purported recall of the percentages that he mentioned. Regardless, it is clear he did not think it likely the Caisse would sign the term sheet. In my view, in light of the drastically changed economic circumstances since April, 2008, the chances of the Caisse signing the April 2008 term sheet in January, 2009 were nil.

[132] Mr. del Missier is the co-CEO of Barclays Capital. He authorized the term sheet to be sent to the Caisse on January 8, 2009. He was not communicating at the time with the Caisse, although he had met with the Caisse earlier on April 8, 2008. His information in December, 2008 and January, 2009 about the prospects for the Caisse agreeing to the term sheet was information learned from others within Barclays. He acknowledged on cross-examination that when the term sheet was sent to the Caisse, he thought there was a low probability that the Caisse would sign it.

[133] I do not accept that although Barclays thought was that it was unlikely that the Caisse would sign the term sheet, they thought there was a prospect that the Caisse would

respond to the term sheet in a way that could lead to an agreement with Barclays such that it could be said there was negotiations still going on at the time of the extension e-mails in question.

[134] The sales team involved at Barclays thought that the Caisse would not accept any reasonable terms, which was an indication that not only would the Caisse not sign the term sheet, but that it would not come back with any proposal that would be acceptable to Barclays. On January 7, 2009 Mr. Pointier, a trader and part of the credit derivates team, reported by e-mail to his superior Mr. Azzollini that after discussion with “sales”, it was clear that the Caisse was not going to accept any reasonable terms. Mr. Neville, who was part of the sales team, testified that the discussion was a group discussion, in which he was involved, and involved more than one discussion.

[135] Further, Mr. Neville told Mr. Davis of National Bank on January 13, 2009 that Barclays had given the Caisse a deadline of 5 pm on January 12, 2009 “to stop negotiating” and sign the term sheet. On the afternoon of January 13, 2009 Mr. Neville told Mr. Silgardo that it was the unanimous view of Barclays that they were never going to get anywhere with the Caisse who kept making increasing demands and so Barclays gave the Caisse an opportunity to change their position and come back to fall in line with Barclays. These statements, which were made on the telephone and recorded, were quite inconsistent with any belief of Mr. Neville at the time the extension e-mails of January 8 and 9, 2009 were sent that further negotiations with the Caisse might be successful.

[136] Mr. Lovisolo testified that he thought that there was a 30% chance that the Caisse would respond to the ultimatum by making an alternative proposal, the implication of this evidence being that there was some prospect of further negotiations with the Caisse at the time the extension e-mails were sent on January 8 and 9, 2009. Again, I have doubts of the reliability of Mr. Lovisolo’s evidence. In any event, I do not accept this implication.

[137] Mr. Lovisolo did not think it likely that the Caisse would accept the ultimatum to sign the April 8, 2008 term sheet. Nor was he prepared to accept anything less, as is evident from a call he made on January 8, 2009 to Mr. Truell, whom Mr. Lovisolo said ran corporate

communications for Barclays. He told Mr. Truell that they were giving the Caisse one final chance to sign the term sheet and if the Caisse did not sign it, they were going to “blow up the box”, meaning terminate the Devonshire trades. There was no discussion regarding any other possibility such that negotiations with the Caisse might continue if the Caisse did not sign the term sheet. The reason why there was no such discussion, and the reason for the termination, is to be found in Mr. Lovisolo’s call to Mr. Truell in which he said that the market had changed since December and that it was now economic for Barclays to blow up the trade. He also told Mr. Truell that Barclays did not want to be out after the group was done, which meant that Barclays did not want to be exposed to the Caisse after the large Crawford restructuring had been completed because it was concerned that the Caisse would then have less incentive to deal with Barclays and more incentive to walk away from the trade.

[138] Mr. Lovisolo’s real feelings towards the Caisse were contained in an e-mail of December 16, 2008 that he sent to Mr. del Missier and others in which he said that the strategy of the Caisse was to have Barclays negotiate against itself and to walk away if it could not get a deal it could live with and that he did not expect the Caisse to come back with a real counter proposal to what Barclays was then proposing. There was nothing that the Caisse did after that that could have given Mr. Lovisolo any comfort that the Caisse would continue negotiations that could realistically result in a deal with Barclays. He acknowledged on cross-examination his view that if the Caisse did not sign the term sheet, Barclays should and would likely terminate the Devonshire trade.

[139] Mr. del Missier testified in his evidence in chief that when the term sheet was sent to the Caisse on January 8, 2009 he thought one response from the Caisse might be a counter-proposal and he was hopeful that they could re-engage with the Caisse to get a restructuring. He said that Barclays was not ending negotiations but fully expecting and hoping to continue. On cross-examination he testified that the parties were in negotiations and he thought that they might end up with a restructuring close to the terms agreed in April, 2008. While Mr. del Missier apparently ultimately gave approval to the recommendation to terminate the trades, I do not believe that what he testified to was the thinking of the deal team and I have some difficulty accepting his evidence as reliable.

[140] While it was from others that Mr. del Missier was getting his information at the time, he was not able to say in the witness box that he was aware of what the deal team knew. On December 23, 2008 Mr. Quintal of the Caisse told Mr. Neville that what the Caisse wanted for a deal would "not be pretty" from Barclays point of view, a view that Mr. Neville held. Mr. del Missier testified that he was not aware of what was going back and forth and he could not recall if he was told of the position of the Caisse as expressed on December 23, 2008. Further he testified he did not recall if he was told of the view of the sales team by January 7, 2009 that the Caisse would never agree to any reasonable terms. If Mr. del Missier held the rosy view that he testified to, of which I have considerable doubt, it appears that it would have been a misinformed view.

[141] What is more indicative of Mr. del Missier's view at the time was contained in an e-mail he sent to Mr. Silgardo on January 8, 2009, a few minutes before the e-mail was sent by Mr. Lovisolo to the Caisse with the April 9, 2008 term sheet. Mr. Silgardo was the CEO of Barclays Global Investors in Canada which managed money on behalf of large financial institutions. In his e-mail Mr. del Missier said that over the next 48 hours Barclays was going to try to put pressure on the Caisse to sign the agreement he said had been reached, and "if they don't sign we will likely terminate and things will get legal (and public) very quickly". He asked Mr. Silgardo to keep the information confidential. Mr. del Missier did not expect the Caisse to sign and said nothing about expecting the Caisse to come back with some proposal that he thought would lead to some other restructuring. On the same day he sent the same e-mail to Sandra Godard, Barclays' relationship manager for large financial institutions based in Toronto.

[142] What Mr. del Missier told Mr. Silgardo was consistent with what Mr. Dunsche told Mr. Brandon Ashcroft, a Barclays' communications person, on the same day, January 8, 2009, to arrange for a media statement to be released by Barclays in the event that the Devonshire trades were terminated. He told Mr. Ashcroft that in the first few weeks of January, 2009 the market had turned around and that the options that had been presented to the Caisse as concessions by Barclays were now a lot more expensive than terminating the trades. He also told Mr. Ashcroft that as a result, Barclays had taken all these other proposals off the table and given the Caisse an ultimatum to sign the earlier term sheet of April, 2008. Mr. Dunsche went so far as

to say that while Barclays did not expressly say so, the strong hint made to the Caisse was that if term sheet was not signed, Barclays' only recourse would be to terminate the trades.

[143] I also have difficulty with Mr. del Missier's statement that he thought that they might end up with a restructuring close to the terms agreed in April, 2008. The dramatic market changes in the fall of 2008 as a result of the large financial failures meant that holders of ABCP notes could not agree to close any restructuring based on terms discussed or worked out before those changes occurred. Mr. del Missier either knew that or was too far from the market to have an informed view.

[144] The framework agreement made in the larger Crawford restructuring in December, 2007 had to be extensively changed in December, 2008 in order to achieve a restructuring. The Caisse was the largest investor in the trusts that were restructured in that restructuring, and the economic forces in play in the larger restructuring would obviously have to come into play in the Devonshire restructuring. That is why Barclays had made so many concessions in negotiations with the Caisse in November and December, 2008 and no informed person could expect the Caisse to agree to terms close to those discussed in April, 2008.

[145] There is an e-mail from Mr. del Missier sent shortly after midnight on January 12, 2009 that is peculiar. It suggests to me that Mr. del Missier was not much involved in the decision taken earlier in the day to terminate the Devonshire trade. I am of the view that his evidence as to what happened that day is unreliable.

[146] On January 12 at 5:09 Mr. Lovisolo sent an e-mail to a number of people at Barclays, including Mr. del Missier, which stated that at 4:52 p.m. that afternoon Barclays had received an e-mail from the Caisse. Mr. Lovisolo did not say what the e-mail from the Caisse disclosed. After mid-night, at 12.49 a.m. on January 13, 2009, Mr. del Missier forwarded that e-mail to the Barclays Capital executive committee with the note "Still a chance of last minute settlement as our threat to terminate has appeared to have woken them up". While it is asserted that this e-mail is supportive of the position of Barclays that they still hoped for a negotiated settlement with the Caisse, I do not accept that.

[147] There is no evidence that the e-mail from the Caisse at 4:52 p.m. was forwarded to Mr. del Missier and his evidence in chief was that he did not recall if he received it. On cross-examination he gave inconsistent statements regarding it, stating at one point he could not recall if he read it, or if "we" met as a group to discuss it, or if there was any discussion about it, and at another point stating that he read the e-mail from the Caisse at least in part before making the decision to terminate the Devonshire trade. He testified in chief that he was aware of the basic message in the response of the Caisse and that he was very disappointed with it and accepted the recommendation to terminate the Devonshire trades. Yet he testified that his statement to the executive committee that there was still a chance of a last minute settlement as the Caisse had appeared to have woken up was based on the e-mail, which he had said was very disappointing to him.

[148] When Mr. del Missier made the ultimate decision is unclear. He did not testify as to when that happened. Nor did anyone else. Mr. Lovisolo testified that shortly after the e-mail came in from the Caisse, the deal team met and decided to terminate the Devonshire trade. He said the persons present were himself, Mr. Neville, Mr. Dunsche, Mr. Wysocki, Mr. Warren and their counsel. He testified that they would not have terminated the trade without Mr. del Missier's approval and that it was fair to say that the decision to terminate was made subject to his approval. Mr. Lovisolo could not recall who telephoned Mr. del Missier for his approval. Mr. Neville's evidence was that the decision was a group discussion but that ultimately Mr. del Missier and Mr. Bommensath made the decision.

[149] I gained the clear impression that Mr. del Missier does not remember much of that day. This is hardly surprising given his position and responsibilities at Barclays. It appears likely that Mr. del Missier was not aware at the time he sent his e-mail to the executive committee what the response of the Caisse was and it may well be that it was sometime after that e-mail was sent that he accepted the recommendation to terminate. What is more likely is that he and the deal team at Barclays had made the decision in their minds by the time the term sheet was sent to the Caisse on January 8, 2009 that when the Caisse did not sign the term sheet, which they expected to be the case, they would terminate.

[150] Sometimes actions speak louder than words. On January 8, 2009, Mr. Kane of the London derivatives department of Barclays who is a trader who manages risk sent an internal e-mail to James Lee, Alex Pointier and others that he executed a hedge at the end of the day on January 8, 2009 "partly thinking about potential Devonshire impact next week." On January 12, 2009 at 1:41 p.m. London time (8:41 a.m. New York time) Mr. Kane sent another e-mail to the same people that stated that Barclays traders had managed to do a few trades "mainly in anticipation of Devonshire unwind". The timing of these trades, of course, was after the ultimatum of January 8, 2009 and prior to the deadline given to the Caisse to agree to the term sheet by 5 p.m. on January 12 and was contrary to any notion of any continuing negotiations if the Caisse did not agree to the ultimatum put to it. These e-mails reflected a belief that the Caisse was not going to agree and that the result would be a termination of the Devonshire trades.

[151] While Mr. Kane was a junior trader, he was helping to trade the credit risk in the Barclays book. Mr. Pointier was the Barclays global head of correlation and exotic trading to whom he reported. There was no response from Mr. Pointier criticizing what Mr. Kane had done. Mr. Lee was not able to say whether Mr. Kane had been instructed to do the hedges, but no one was called to say that Mr. Kane was acting on his own. While Mr. Lee may not have been asked to do any hedging regarding the termination prior to the evening of January 12, 2009, that does not mean others such as Mr. Kane acting under the authority of Mr. Pointier were not doing hedging in anticipation of a Devonshire termination. I can only assume that the evidence of Mr. Pointer would not have been helpful to Barclays, but whether that is the case, the inference I draw from the evidence is that Mr. Kane was not acting on his own without some instructions.

[152] Also, on January 8, 2009, in the morning prior to the delivery of the ultimatum to the Caisse, Mr. Pointier asked Ms. Franke to reserve the profit and loss statement for the day until there was more clarity on Devonshire. Ms. Franke was a director in the produce control group at Barclays covering the global correlation desk, including the Devonshire trade, and had responsibility for the oversight of the daily profit and loss calculation. Ms. Franke had "heard that rumour" that there "should [be] a real resolution by Monday." Ms. Franke had begun work by 10:00 a.m. on January 8, 2009 to gather the relevant trade information so "that when we terminate we knew the relevant trades."

[153] Barclays relies upon an earlier ultimatum to Devonshire noteholders that had resulted in positive results so far as negotiations had concerned to support its contention that it thought the ultimatum to the Caisse on January 8, 2009 would result in some response from the Caisse that could lead to an agreement. I do not find that at all persuasive. On April 4, 2008 Barclays sent to these noteholders and the Investors Committee a draft term sheet with a deadline of 4 days. That resulted in the meeting in New York on April 8, 2008 at which the terms as to how the small noteholders were to be dealt with were apparently agreed in principle. However, the Barclays e-mail attaching the term sheet sent out on April 4, 2008 stated that the term sheet included "all of the essential terms that we have been discussing", not terms that had been discussed eight months previously in markedly different market conditions that had since been substantially altered by the parties, including Barclays.

[154] Given that Barclays had sent out a term sheet to the Caisse on January 8, 2009 as an ultimatum, which the Barclays people involved in the transaction did not think the Caisse would accept, and given that Barclays intended to terminate the trades once the Caisse did not accept the ultimatum, all of this before the extensions that of January 8 and 9, 2008 were sent, the extensions were misleading, both in the language used and in what was not said. It was misleading to say that there were issues being worked out. The negotiations were over from Barclays' point of view. Moreover, having made the statements that it did, it was misleading for Barclays not to disclose the ultimatum that it had made and its intention to terminate the trades if the ultimatum, which it did not think would be accepted, was declined. Thus the daily extensions of January 8 and 9, 2009 contained misrepresentations of facts.

(d) Result of misrepresentation

[155] The parties agree that each daily extension formed a new contract. At issue is whether the extensions of January 8 and 9, 2009 should be rescinded because of the misrepresentations in them that I have found to exist.

[156] A material misrepresentation, whether innocent or fraudulent, may be grounds to set aside a contract entered into by one party in reliance on the representation. A fraudulent misrepresentation is a statement known to be false or made not caring whether it is true or false.

For innocent misrepresentation the misrepresentation might be entirely honest and careful, there is no need for promissory intention, the negligence of the party seeking relief is no defence, and there is a presumption that a material representation did in fact cause the misrepresentee to enter into the transaction. The presumption can be rebutted by proof of no reliance on the misrepresentation. See S.M. Waddams, *The Law of Contracts*, 6^{th} ed. at para. 419-421.

[157] The requirement that the misstatement of fact be material means that the misrepresentation must relate to a matter that would be considered by a reasonable person to be relevant to the decision to enter the agreement in question. See J. D. McCamus, *The Law of Contracts* (Toronto: Irwin Law, 2005) at p. 300. McCamus further states at p. 301:

> In addition to being shown to be material, the misrepresentation must have constituted an inducement to enter the agreement upon which the misrepresentee relied. Thus, a representee who undertakes his or her own separate investigation of the facts would not be held to have relied on the misrepresentation. On the other hand, is clearly established that the representee has no obligation to engage in "due diligence" and make such an independent investigation, even where the means of doing so are made available by the misrepresentor. Further, it is clearly established that the misrepresentation need not be the exclusive or even a predominant inducement for entering the agreement. It must be established, simply, that it was an inducement. Moreover, once it is established that a misrepresentation is of such a nature that it is liable to induce the misrepresentee to enter the contract, it would be presumed against the misrepresentor that such inducement did occur.

[158] As stated by McCamus, *supra*, it is not necessary for a plaintiff to establish that the misrepresentation was the sole inducement for acting and it matters not if the misrepresentation was only one of several factors contributing to the plaintiff’s decision. See *Sidhu Estate v. Bains* (1996), 25 B.C.L.R. (3d) 41 at paras 35-36; *Kripps v. Touche Ross & Co*. (1997), 89 B.C.A.C. 288 (C.A.) at paras. 102-103; *NBD Bank, Canada v. Dofasco Inc*. (1999), 46 O.R. (3d) 514 (C.A.) at para 81.

[159] The issue of reliance is a question of fact to be inferred from all the circumstances of the case and evidence at the trial. See G.H.L. Fridman, *The Law of Contracts*, 5th ed. (Scarborough: Thomson Carswell, 2006) at p. 293.

[160] Courts of equity in the past held that there could be no rescission after the contract induced by the misrepresentation had been executed except in the case of fraud, "error in *substantialibus*" or complete failure of consideration. See Waddams, *supra*, at para. 422 for a discussion of this history. Professor Waddams states that recent cases suggest that courts will be willing to find an "error in *substantialibus*" whenever justice seems to require rescission and he argues for a flexible test. He stated:

> It is submitted that execution should be recognized as a relevant, but not decisive, factor in determining whether, in all the circumstances, rescission should be denied because it might affect third parties or because of the plaintiff's undue delay in seeking his remedy.

[161] It is not argued that the statements which I have found to be misrepresentations were not material, nor could it be. They were relevant to the decision by Devonshire to accept the extensions in question. What is contended by Barclays is that there was no detrimental reliance on them by Devonshire.

[162] Mr. Lafleur-Ayotte testified that in the fall of 2008 Quanto had been informed that the negotiations between Barclays and the Caisse were going well and that the parties were close to reaching an agreement with Barclays. Quanto was also informed that National Bank had sold all of its Devonshire notes to Barclays and that an offer would be made to all of the small holders of Devonshire notes to exchange their notes for MAV II notes being issued in the large Crawford restructuring that was to close in early January, 2009. He testified that the only other information that he had about the Barclays negotiations was the information in the daily standstill e-mails that the negotiations were ongoing, which he said was consistent with his understanding of the situation. He was not aware of the ultimatum made by Barclays to the Caisse on January 8, 2009 to sign the April 2008 term sheet by the close of business on January 12, 2009.

[163] Mr. Lafleur-Ayotte testified in chief that if he had been told of the ultimatum made by Barclays and the deadline for a response, he would have verified the information with the Investors Committee. He testified that assuming he was told that the Caisse would not have accepted the Barclays ultimatum, Devonshire would have objected to the extensions on January

8 and 9, 2009 and its only option would have been to proceed with the termination of the swaps. He said that the only reason Devonshire did not terminate the swaps in August, 2007 was because of the Montreal Accord and Devonshire had committed to Barclays that it would not terminate the swaps if Barclays was negotiating in good faith with investors. If those negotiations had come to an end, there was no purpose in continuing with that arrangement and the only option would have been to protect the assets of Devonshire and take steps to terminate the swaps.

[164] Robert Girard is a partner at Fasken Martineau in Montreal. He was a director of M & M Alternative Investment VII Corp., the Issuer Trustee of Devonshire, and was the person who signed documents such as the default notice on behalf of the Issuer Trustee and who liaised between Quanto and the board of directors of the Issuer Trustee. Mr. Girard was not aware of the ultimatum of Barclays made to the Caisse on January 8, 2009. He testified that his understanding on that day and the following day as to the state of negotiations between Barclays and the Caisse was that the negotiations were ongoing and was based on the daily extension e-mails sent by Barclays on those two days. Nor was he aware of the response made by the Caisse to Barclays on January 12, 2009. He was surprised to learn of the termination of the swaps by Barclays on the morning of January 13, 2009.

[165] Mr. Girard testified that if had been told of the ultimatum of Barclays of January 8, 2009 with a hard deadline of January 12, 2009 at 5 p.m. and been told that the Caisse would not accept the term sheet offered he would have consulted with Quanto and then recommended to the board of the Issuer Trustee to immediately address the subject of the termination of the swaps.

[166] Counsel for Barclay's elicited on cross-examination evidence from Messrs. Lafleur-Ayotte and Girard that it relies on to counter the testimony of these witnesses given in chief. For reasons that follow, I do not think this evidence assists Barclays.

[167] On cross-examination, Mr. Lafleur-Ayotte said that on the assumption that he had been told by the Caisse that Barclays had put a deadline on the Caisse to respond to its term sheet by 5 p.m. on January 12, 2009 and that the Caisse intended to respond to Barclays within the

deadline, it would have been a difficult situation but he suspected that his advice would have been to not interfere with the daily standstills or object to them.

[168] On cross-examination, Mr. Girard said that had Devonshire been advised that in the past Barclays had set deadlines with the noteholders and those deadlines had led to progress in negotiation, that on January 8, 2009 Barclays had made a proposal to the Caisse and unilaterally proposed to the Caisse that Barclays would extend the standstill with Devonshire to January 12, 2009, and that on January 9, 2009 the Caisse had indicated to Barclays that it would make a response to the Barclays proposal by January 12, 2009, Devonshire would not have objected to the daily extensions on January 8 and 9 through to January 12, 2009.

[169] The issue is whether Devonshire reasonably relied on the statements made in the extension e-mails that I have found to be misrepresentations of fact. What Devonshire may have done had Mr. Lafleur-Ayotte or Mr. Girard been told things that they did not know is relevant in assessing their evidence, and in considering whether they reasonably relied on what they were told, but the underlying question is not what they may have done had they been told things that they were not.

[170] The questions put by counsel for Barclays on the cross-examinations of Messrs. Lafleur-Ayotte and Girard did not put the facts as I have found them. That is, they were not asked what Devonshire would have done had they been told (i) that Barclays had come to the view that the Caisse would never agree to any reasonable terms, (ii) that Barclays had put in its ultimatum to the Caisse a term sheet from April 2008 that did not reflect the market upheavals that occurred in the fall of 2008 or the revised terms that had been negotiated by the Investors Committee for the large Crawford restructuring and negotiated to some extent between Barclays and the Caisse, (iii) that no one at Barclays believed that the Caisse would accept the term sheet, (iv) and those involved at Barclays intended to terminate the swaps once the Caisse did not accept the ultimatum.

[171] In my view, and I so find, had Messrs. Lafleur-Ayotte and Girard been advised of these facts, they would have taken immediate steps necessary to terminate the swaps in order to

protect the assets of Devonshire, including not agreeing to the extensions of the standstill and the default notice suspension.

[172] Mr. Bergeron of the Caisse testified that if someone from Devonshire learned of the e-mail of January 8, 2009 from Mr. Lovisolo to the Caisse and asked him what the Caisse would do, he would have told Devonshire that the Caisse surely would not accept the ultimatum. I accept that evidence. His evidence on cross-examination, which I accept, was that he knew when he saw the e-mail from Mr. Lovisolo what his response would be. That response denied the existence of any prior agreement. Mr. Bergeron was insulted by the e-mail from Mr. Lovisolo and it would be more than unlikely that he would have given any different impression to Devonshire. Had Devonshire spoken to Mr. Bergeron before deciding what to do with the daily extensions of January 8 and 9, 2009, what Mr. Bergeron would have told them would have led Devonshire to immediately take steps to terminate the swaps.

[173] Barclays relies on an e-mail exchange by Mr. Martis with Mr. Neville as evidence that Devonshire were not influenced by the language of the daily extensions. I do not think the exchange assists Barclays. On Friday, March 14, 2008 a draft extension agreement was circulated by Barclays. Mr. Martis, a solicitor for Devonshire in Montreal, was away and could not open the draft on his blackberry. His partner working on the matter was also away. Mr. Martis was concerned that his silence might be taken to be consent to the draft. On Saturday, March 16, 2008 he sent an e-mail to Mr. Neville in which he referred to his inability to access the draft and concern that his silence be taken as consent. He said that the intention of Quanto and Devonshire was that until such time Barclays and the investors reached an agreement, or that Barclays or the Investors Committee determined that the negotiations had terminated unsuccessfully, the status quo established in August should be maintained on identical terms. He said Barclays would be hearing on Monday from his partner regarding the draft.

[174] I cannot accept that what Mr. Martis said in his e-mail in March, 2008 to tide things over until his partner could review draft documentation regarding an extension agreement would have continued to be the view of Quanto and Devonshire in January, 2009 had disclosure been made to them of the views and intentions of Barclays as I have found them to be. Barclays

had effectively decided to terminate any further discussions with its ultimatum which it knew would not be accepted by the Caisse.

[175] It is quite evident that Barclays did not want to disclose to Devonshire the true state of affairs and that Barclays had a concern that Devonshire might terminate the trades before Barclays if it had notice of the ultimatum.

[176] Mr. Martis of Faskens, solicitors for the indenture trustee of Devonshire, e-mailed Mr. Neville and Mr. Bergeron on December 30, 2008 and asked that as the Montreal Accord restructuring was now headed for a mid-January closing, would it now be appropriate to hear where Barclays stood with the Devonshire restructuring and when it might be expected to proceed to its consummation. Mr. Neville said he received the e-mail while he was skiing in Wyoming and did not respond to it. He said getting involved in Devonshire was not something he wanted to do and he did not think he had to respond. Mr. Dunsche on the same day e-mailed Mr. Neville and Mr. Lovisolo and said “Funny guy. Do we need to respond? Don’t think so.” Mr. Neville’s explanation on cross-examination that they had received humorous e-mails from Mr. Martis in the past rang hollow as an explanation for Mr. Dunsche’s comment to Mr. Neville.

[177] On January 6, 2009 Mr. Martis e-mailed Mr. Neville and asked “Gregg, any chance of a reply to my e-mail?” Mr. Neville did not respond, although he was back in his office after the holidays. He testified that he did not recall focusing on it at the time. This response is hard to credit. Devonshire was a big issue at the time for Barclays and Mr. Neville and there has to be an explanation why he did not respond to Mr. Martis.

[178] The inference I draw, in spite of Mr. Neville’s denial, is that Barclays did not want Devonshire to know the state of play or to answer a direct question from Mr. Martis regarding the expectations of a Devonshire restructuring. Mr. Neville acknowledged that Barclays did not want any advance notice to be given to Devonshire of the liquidity payment by Barclays and reluctantly admitted on cross-examination that it was possible that Barclays did not want to put Devonshire in a position where it could take steps to terminate before Barclays did. He also acknowledged that there was a risk that if Devonshire was given notice of the ultimatum put to the Caisse, Devonshire might take steps to terminate the trades, although he said he

thought that before doing so Devonshire would call the Caisse for permission. The failure to respond to Mr. Martis compounded the misleading nature of the extensions e-mails, which were also copied to Mr. Martis, in the face of these requests from Mr. Martis who clearly wanted to be advised of the situation.

[179] In my view, and I so find, the misrepresentations in the extension e-mails of January 8 and 9, 2009 influenced the decision of Devonshire to accept those extensions and were reasonably relied on by Devonshire to its detriment. Moreover, had the true situation be disclosed in the e-mails, Devonshire would have taken immediate steps towards terminating the Devonshire trades in order to protect the trust assets.

[180] Technically, it can perhaps be said that the two contracts entered into by the extensions of January 8 and 9, 2009 were executed, in that the standstill provisions continued. This, however, is not in my view any reason to refuse rescission based upon an innocent misrepresentation. No third-party rights will be disadvantageously affected by the rescission and the justice of the situation requires a rescission.

[181] While it is not strictly necessary for the purposes of the misrepresentation claim to determine whether the misrepresentations amounted to a fraudulent misrepresentation, in my view they did. Mr. Neville, who sent the extension e-mail of January 8, 2009, and the Barclays sales team knew that there were not a number of issues being worked out between Barclays and the Caisse and knew that the negotiations were at an end. They also knew of relevant facts such as the ultimatum put to the Caisse and the intention to terminate when the Caisse did not accept the ultimatum, which they expected would occur. The extension e-mail of January 9, 2009 was sent by Ms. Sheila Chapman, an in-house lawyer at Barclays in the New York. What she knew is not in evidence as it is a privileged matter. However, the e-mail was copied to Mr. Neville and others in the Barclays sales team who again knew of the misrepresentations. I view these e-mails as being part of the litigation strategy that shortly thereafter unfolded. Barclays did not want to disclose to Devonshire what was going on with the Caisse and did not want to run the risk that Devonshire might terminate the swaps before it did. The e-mails, to the knowledge of the Barclays sales team, were false.

[182] In the circumstances, Devonshire is entitled to rescission of the two extensions of January 8 and 9, 2009.

[183] One result of the rescissions is that the two remaining days during which Barclays had to remedy its default in paying the liquidity demands before an event of default occurred began to run on January 9, 2009.

13. Can Barclays rely on the insolvency of Devonshire to terminate the swaps?

[184] On January 13, 2009 Barclays delivered an early termination notice to Devonshire. The notice stated that an event of default had occurred with respect to Devonshire pursuant to section 5(a)(vii) of the ISDA Master Agreement and it designated January 13, 2009 as the early termination date. The notice did not state what the event of default was other than to refer to section 5(a)(vii) of the ISDA Master Agreement and did not state when the event of default had occurred.

[185] Section 6(a) of the ISDA Master Agreement provides that the non-defaulting party is to specify the relevant event of default. In its notice of early termination on January 13, 2009, Barclays did not do so. It merely stated that an event of default had occurred with respect to Devonshire pursuant to section 5(a)(vii) of the ISDA Master Agreement. It did not specify which subsection of (vii) it relied on and said nothing of the facts it relied on. It did not specify any date of an alleged event of default.

[186] Section 5(a)(vii) of the ISDA Master Agreement provides for 9 different classes of events as constituting an event of default, all of which involve financial distress of one kind or another. One of these, sub-clause 2, is now relied on by Barclays. It provides:

> (a) Events of Default. The occurrence at any time with respect to a party… of any of the following events constitutes an event of default (an “Event of Default”) with respect to such party:-
> …
> (vii) Bankruptcy. The party…

> (2) becomes insolvent or is unable to pay its debts or fails or admits in writing its inability generally to pay its debts as they become due;

[187] Strictly speaking, section 5(a)(vii)(2) contains four events of default: (i) a party becomes insolvent; (ii) a party is unable to pay its debts: (iii) a party fails to pay its debts generally as they become due: or (iv) a party admits in writing its inability generally to pay its debts as they become due. Each is distinct and not cumulative.

[188] With respect to the event of default that a party is unable to pay its debts, there is authority that evidence of a mere failure to pay the debt is not sufficient if there is evidence of a substantial reason for not paying. In *Re Taylor's Industrial Flooring Ltd*. [1990] BCC 44 (C.A.), referred to by Flaux J. in *Marine Trade S.A, supra,* Dillon L.J. stated:

> In my judgment, something more must be proved than simply that the company has not paid a debt. In some cases the circumstances surrounding the non-payment may justify the inference that the debtor is unable to pay its debts as they fall due. A series of dishonoured cheques might justify that inference. But in the present case a reason for non-payment has been put forward. The reason may not be a very good one, but unless it is not being put forward honestly, I do not see why an inference of inability to pay should be drawn from the fact of non-payment.

[189] Barclays does not rely on the first event of default contained in section 5(a)(vii)(2), i.e. a party becomes insolvent. The word "insolvent" is not defined in the ISDA Master Agreement. In Firth, *Derivatives Law and Practice*, (London: Thomson Reuters (Legal) Limited 2010), it is opined that the word may have to do with a balance sheet test of insolvency. This need not be considered as Barclays relies on the other three events of default referred to in section 5(a)(vii)(2).

[190] In its statement of claim, Barclays pleaded that from and after August 13, 2007 an event of default under section 5(a)(vii)(2) existed against Devonshire. In a ruling at the outset of the trial, I ruled that because of the scope of the bifurcation order, Barclays could not lead evidence at this stage on the issue of whether there was an insolvency of Devonshire prior to August 16, 2007, i.e. prior to the Suspension Notice. The word "insolvency" in the context of the

ruling was not intended to distinguish the different events of default contained in section 5(a)(vii)(2).

[191] Thus at this stage of the trial, Barclays contends that there was an event of default existing on January 13, 2009. Devonshire contends that for a number of reasons, Barclays cannot rely on the insolvency of Devonshire as a basis for terminating the swaps.

(a) Was Devonshire insolvent on January 13, 2009?

[192] More particularly, the issue is whether there was an event of default on the part of Devonshire on January 13, 2009 at the time Barclays delivered its notice of early termination.

[193] As at January 13, 2009, the Class A notes that matured on August 13 to 15, 2007 and thereafter up to November 7, 2007, totaling $209,716,441, had not been paid. Most of the Class FRN and Class E notes had long matured and were unpaid.

[194] From August 13, 2007 to January 13, 2009, no Devonshire noteholders made a demand on any class of Devonshire notes or presented a note for payment. Sometime after the Montreal Accord, the Devonshire noteholders signed an extraordinary standstill resolution pursuant to the Devonshire trust indenture directing the indenture trustee from delivering any notice of default to Devonshire, exercising any powers to declare money due and payable, taking any steps to realize on security, enforcing payment of money, exercising any remedies under the trust indenture or under any statute or at law or equity or taking other steps to enforce the trust indentures. The resolution stated that the noteholders wished the powers they held be used to effect a temporary standstill to facilitate the Montreal Accord beyond March 14, 2008. The term of the standstill was stated to run to April 14, 2008 or such later date as the Investor Committee might advise the indenture trustee. There is no evidence whether the Investor Committee did later advise of an extension, but in light of the Investor Committee's continuing efforts to restructure through to January, 2009 and the fact that the indenture trustee took no steps the entire time contrary to the instructions contained in the extraordinary resolution, it can safely be inferred that the instructions were explicitly or implicitly continued.

[195] Devonshire refers to authority that in considering whether a debtor has ceased to meet his liabilities as they become due (the BIA language for insolvency) a court should consider the attitude of creditors regarding payment. In *Re Tysak Ltd* (1981), 38 C.B.R. (N.S.) 142 Saunders J. stated:

> While the attitude of a creditor is not relevant to the issue of whether his account is overdue, the fact that a creditor is not pressing and is willing to tolerate delay in payment is, in my opinion, one circumstance that may be taken into account in determining whether a debtor has ceased to meet its liabilities.

See also *Re 345531 Ont. Ltd.*, (1980) 35 C.B.R. (N.S.) 18 per Saunders J.

[196] Barclays counters this by relying on a statement of Ground J. In *Re Brock R.V. Centre* (2007), 33 C.B.R. (5th) 219, Ground J. stated:

> The law is clear that the fact that Brock R.V. was not being pressed for payment of a particular debt does not make it any less a liability for purposes of the B.J.A. In *Re Cappe* [1993] O.J. No. 775, I stated at pg. 6:
>
>> In *Re Hayes* (1979), 34 C.B.R. (N.S.) 280 (B.C.S.C.), the debtors argued as a defence that given creditors other than the petitioning creditor were not pressing for payment, they had not failed to meet their liabilities generally as they became due. The Court was of the view that in order to refuse a petition, a debtor must satisfy the court affirmatively that they are able to pay their debts, not that the creditors are not pressing for payment.

[197] I have been referred to no case dealing with the language in the ISDA Master Agreement as to what is meant by the words "fails to pay its debts as they become due". I take the words of the BIA "ceases to meet his liabilities generally as they become due" to mean the same as the words "fails to pay its debts generally as they become due**"** in the ISDA Master Agreement.

[198] Regarding the test for a party being "unable" to pay its debts, Devonshire relies on a statement of Briggs J. in *Re Cheyne Finance plc* [2008} 2 All ER 987 dealing with the words "unable to pay its debts as they fall due" in the U.K. Insolvency Act relied on by Lord Neuberger MR in *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL Plc & Ors*, [2011] EWCA Civ 227 who stated:

> This is not dissimilar from the point made in relation to section 123(1)(e) by Briggs J in *Re Cheyne Finance plc* [2008] 2 All ER 987, para 51, when he contrasted "a momentary inability to pay … as a result of temporary liquidity soon to be remedied" with "an endemic shortage of working capital" which renders "a company … on any commercial view insolvent, even though it may be able to pay its debts for the next few days, weeks or months before an inevitable failure." … The point that I think Briggs J was making is that section 123(1)(e) does not require slavish adherence to the immediate present. It is unnecessary to decide whether that is correct, although it is only right to say that, as at present advised, I am inclined to think that it is. However, that does not call into question the conclusion that section 123(2) applies to a company whose assets and liabilities (including contingent and future liabilities) are such that it has reached the point of no return.

[199] Devonshire is a very unusual case. It is not about a debtor who was having financial difficulties unable to earn or raise enough cash to pay off its debts.

[200] Once the financial crises in August 2007 took hold, the negotiations to restructure the ABCP market, including the negotiations for Devonshire, were with the intent that the asset providers, including Barclays, would enter into direct swap contracts with the noteholders of the various conduits, including the Devonshire noteholders. It was never contemplated that the noteholders would look to Devonshire. The swaps would be taken out of Devonshire. It is not surprising that the noteholders who were negotiating with Barclays instructed the trustee not to take any steps to enforce the notes.

[201] The standstill arrangements between Barclays and Devonshire were consistent with this dynamic as Devonshire agreed during the standstill not to enforce its rights against Barclays under its default notice, i.e. not to attempt to obtain the liquidity payments which it would require in order to pay the Class A notes unpaid at the time of the standstill, so long as Barclays complied with its obligations as a signatory to the Montreal Accord. The Montreal Accord contained a long-term proposal under which all outstanding ABCP would be converted into term floating rate notes maturing no earlier than their scheduled termination dates and the signatories, including Barclays, agreed in principle to the long-term proposal and to work in good faith to bring about its timely implementation. By agreeing to this long term proposal, Barclays could hardly have expected Devonshire to take any steps to attempt to pay off its noteholders.

[202] Major note holders of Devonshire, including Desjardins and National Bank, sold their notes to Barclays. They did not attempt in any way to collect on their notes from Devonshire, nor did Barclays once it acquired these notes. Barclays had no intention during the standstill to attempt to collect on the Devonshire notes that it had acquired, and once it terminated the standstill its efforts were not to collect on the notes but rather to terminate the swap contracts and obtain the collateral held by Mellon Bank and arguably by Devonshire in order to compensate it for its loss as provided for in the ISDA Master Agreement.

[203] On October 20, 2008, without any input from either Devonshire or Barclays, DBRS withdrew its rating of Devonshire. The DBRS press release stated: "As efforts continue to restructure Devonshire, it is now no longer necessary for DBRS to continue its rating of Devonshire." Up to then, Devonshire throughout had a AAA rating from DBRS. Without a rating, it would be impossible for Devonshire to issue new notes. Neither Barclays nor Devonshire objected to this withdrawal of the rating, obviously because neither contemplated that Devonshire would try to raise new capital to pay off its noteholders.

[204] Barclays relies on a statement by Xeno Martis, a solicitor at Faskens acting for Devonshire, as constituting an admission in writing on the part of Devonshire of its inability generally to pay its debts as they become due. I would not accept this argument.

[205] In December, 2007 there was a proposal to amend the trust indentures for the trusts that Quanto was administering, including Devonshire, in order to solve a tax issue. During the standstill, the affected trusts were collecting revenues from swap counterparties without corresponding expenses, creating a potentially unrecoverable tax liability for the trusts. Faskens recommended a solution to the Investor Committee. The solution was based upon a market practice of debtors to pay a forbearance fee to creditors. The obligation to pay the forbearance fee would correspond approximately to the taxable income that accumulated in the trust. The obligation to pay the forbearance fee would be at the bottom of the waterfall of payments to be made to creditors, so that the forbearance fee would not be paid before noteholders themselves were paid in full.

[206] The note of Mr. Martis stated:

> …The compensation being offered is simply a fee articulated in the form an interest expense. The Trusts are insolvent and are compensating the creditors that have the power to accelerate their debts with a fee in consideration of a standstill intended to allow its creditors to restructure their debt. Those creditors that have that power are the holders of all of the Notes and not just the holders of the A Notes. That is all we were doing…

[207] Mr. Martis was making an argument to support the recommendation, in order to save a potential tax. In the end, what he proposed was not agreed to or carried into effect. He had no authority from Quanto or Devonshire to make an admission in writing of an event of default.

[208] The standstill terminated at the close of business on January 12, 2009. Had someone taken the position at the opening of business on January 13, 2009 that Devonshire had ceased to pay its liabilities generally as they became due and thus should be put into bankruptcy under the BIA, it is difficult to think that in these circumstances the petition would have been successful. This situation is more than creditors not pressing for payment, which in itself is a circumstance which Saunders J. would take into account. It is a situation in which Barclays had agreed to a long-term proposal to change the terms of the outstanding notes to make them long term and was negotiating with the Devonshire noteholders to that end.

[209] However, a bankruptcy order is a discretionary order. The fact that a bankruptcy order might not be made that day does not necessarily mean that Devonshire had not failed generally to pay its debts. While it may be a harsh conclusion, for the purposes of the ISDA Master Agreement I am of the view that on January 13, 2009 Devonshire had failed generally, and was unable, to pay its debts as they had become due.

(b) Did Barclays elect to abandon its right to rely on the insolvency of Devonshire?

[210] Devonshire contends that by its actions Barclays should be taken to have abandoned its ability to rely on the insolvency of Devonshire.

[211] The general conditions of the ISDA Master Agreement contain provisions regarding the requirement to pay money. They provide:

> 2. **Obligations**

(a) General Conditions.

> (i) Each party will make each payment or delivery specified in each Confirmation to be made by it…
>
> (iii) Each obligation of each party under section 2(a)(i) is subject to (1) the condition precedent that no Event of Default or Potential Event of Default with respect to the other party has occurred and is continuing…

[212] Therefore the obligation to make payments under the relevant agreements is subject to the condition precedent that there is no existing event of default. Thus, the obligation of Barclays to make payments to Devonshire for credit protection under the swap contracts was subject to the condition precedent that there was no insolvency event of default on the part of Devonshire.

[213] Barclays did not take the position following the Suspension Notice that an event of default had been committed by Devonshire under 5(a)(vii) of the ISDA Master Agreement, which I shall refer to as taking the position that Devonshire was insolvent, or take steps to terminate the swaps. It could have. Barclays as a credit protection buyer continued to pay monthly payments to Devonshire as the credit protection seller against the possibility of defaults in the underlying portfolio of debt obligations. This carried on right to the end until Barclays delivered its early termination notice on January 13, 2009. Likewise, Barclays continued to charge Devonshire for liquidity protection against a market disruption event under the liquidity line until that protection terminated by its terms in February, 2008 by deducting the liquidity premium payable by Devonshire from the protection premium payable to Devonshire.

[214] Devonshire contends that by making these protection payments and not taking steps to terminate under section 6(a) of the ISDA Master Agreement, Barclays elected to affirm the ISDA Master Agreement and abandoned its right to claim insolvency as an event of default.

[215] Devonshire relies on a passage in Firth, *Derivatives Law and Practice*, (London: Thomson Reuters (Legal) Limited 2010). The same text is relied on by Barclays for a different point. In chapter 11, dealing with the ISDA Master Agreement, it is stated on p. 11-59 that a right to terminate will be lost if the non-defaulting party affirms the agreement. It is also stated

that it is a question of fact whether this has occurred and that notwithstanding a non-waiver clause, for the non-defaulting party to continue to perform the agreement without protest for a significant period may be construed as an election by it to abandon its right to terminate. Two cases are cited for these propositions. Neither case deals with an ISDA Master Agreement.

[216] The first case is *Motor Oil Hellas (Corinth) Refineries SA v. Shipping Corp of India* [1990] 1 Lloyd's Rep. 391 (H.L.). In that case, a vessel was chartered to load oil at a safe port. The port nominated by the charterer was not safe, but by various actions the owner was taken to have acted on the nomination. It was held that by its actions, the owner of the vessel elected to accept the nomination and thereby waived or abandoned its right to reject the nomination. In the course of his judgment, Lord Goff made an extensive analysis of the doctrine of election and affirmation of a contract. He stated, amongst other things :

> It is a commonplace that the expression "waiver" is one which may, in law, bear different meanings. In particular, it may refer to a forbearance from exercising a right or to an abandonment of a right. Here we are concerned with waiver in the sense of abandonment of a right which arises by virtue of a party making an election. Election itself is a concept which may be relevant in more than one context. In the present case, we are concerned with an election which may arise in the context of a binding contract, when a state of affairs comes into existence in which one party becomes entitled, either under the terms of the contract or by the general law, to exercise a right, and he has to decide whether or not to do so. His decision, being a matter of choice for him, is called in law an election. Characteristically, this state of affairs arises where the other party has repudiated the contract or has otherwise committed a breach of the contract which entitles the innocent party to bring it to an end, or has made a tender of performance which does not conform to the terms of the contract.
>
> …
>
> In all cases, he has in the end to make his election, not as a matter of obligation, but in the sense that, if he does not do so, the time may come when the law takes the decision out of his hands, either by holding him to have elected not to exercise the right which has become available to him, or sometimes by holding him to have elected to exercise it. Instances of this phenomenon are to be found in s. 35 of the *Sale of Goods Act*, 1979. In particular, where with knowledge of the relevant facts a party has acted in a manner which is consistent only with his having chosen one of the two alternative and inconsistent courses of action then open to him - for example, to determine a contract or alternatively to affirm it – he is held to have made his election accordingly, just as a buyer may be deemed to

> have accepted uncontractual goods in the circumstances specified in s. 35 of the 1979 Act.

[217] The second case cited in Firth, *supra*, is *Tele2 International Card Co. SA v. Post Office Ltd* [2009] All E.R. (D.) 144. In that case Tele2 had failed to provide a guarantee of its parent company to the Post Office for obligations under a phone card supply contract, which failure gave the Post Office the right to terminate the contract. However, it was held that under the doctrine of affirmation of a contract by election, the Post Office had elected not to terminate the contract by continuing with the contract for a year after the breach.

[218] See also *Charter Building Company v. 1540957 Ontario Inc. (Mademoiselle Women's Fitness & Day Spa)*, 2011 ONCA 487 for a recent discussion by Epstein J.A. of the doctrine of election.

[219] Section 6(a) of the ISDA Master Agreement provides that if at any time an event of default has occurred and is then continuing, the non-defaulting party may deliver a notice of early termination and thereby terminate the contract. The word "may" indicates that the non-defaulting party need not do so, but may elect to keep the contract running. There is a body of case law that confirms that section 6(a) is a contractual right that may or may not be exercised. For example, in *Lomas et al. v. JFB Firth Rixson Inc. et al*., [2010] EWHC 3372 (Chancery), Briggs J. held that on the bankruptcy of Lehman Brothers, which was an event of default, the counterparty to Lehman Brothers on interest rate swaps made under an ISDA Master Agreement was entitled to not deliver an early termination notice and to rely on section 2(a)(iii) to withhold payment of interest payments otherwise payable to Lehman Brothers under the swaps. Briggs J. stated that section 6(a) was plainly to be exercised in such a way as the non-defaulting party considered best served its own interests "by way of a choice between alternative remedies" arising out of its counterparty's default. .

[220] The words "and is then continuing" in section 6(a) suggest that the non-defaulting party may not be required to immediately deliver its notice of early termination upon an event of default, if that is the course which it wants to follow. That does not necessarily mean, however, that a non-defaulting party cannot by later actions be taken to have affirmed the contract. Firth,

supra, says otherwise. No case was cited by Barclays in which a non-defaulting party under an ISDA Master Agreement continued to make payments to the defaulting party after an event of default and was held entitled at a later date to have the right to deliver an early termination notice.

[221] What happened in *Enron Australia Finance PTY Ltd. (In Liquidation) v. TXU Electricity Ltd.*, [2003] 48 A.C.S.R. 266 (N.S.W.S.C.); aff'd [2005] NSWCA 12 (C.A.) was the same as in *Lomas et al. v. JFB Firth Rixson Inc. et al*. On the insolvency of Enron, the counterparty to electricity swap contracts under an ISDA Master Agreement did not deliver an early termination notice and was held entitled to rely on section 2(a)(iii) to withhold payments otherwise payable to Enron. What is the critical difference in those cases is that unlike Barclays, the non-defaulting parties chose their remedy by stopping the payments that would have been required had there been no event of default.

[222] I agree with Devonshire that if, as is Barclays case, Devonshire became insolvent, Barclays elected to affirm the swap contracts by continuing to pay premiums to Devonshire for credit protection from losses in the underlying bond and ABCP portfolio and by continuing to charge and collect liquidity payments from Devonshire. It was open to Barclays not to enter into any standstill agreement, or elect at any time not to renew it, and to take the position that it was going to rely on section 2(a)(iii) and not make any further payments because of Devonshire's insolvency, but it did not do so. What its motivation was to keep making the payments is perhaps not relevant, but on my view of the evidence, the answer lies largely on the concern that Barclays had from the outset of the financial crises right through to January, 2009 of the effect on its "franchise", i.e. the effect on its reputation in the Canadian marketplace, if it were seen to be what it referred to as an "outlier" in terminating an ABCP program during reconstruction discussions. Barclays contends that it also did so on the strength of assurances from National Bank and the Caisse as to what it would do in a restructuring, but I think Barclays overstates considerably the assurances that it says it had from National Bank and the Caisse. It is clear that Barclays continued to make the premium payments with its eyes wide open.

[223] Barclays could have taken the position that Devonshire was insolvent and refuse by virtue of section 2(a)(iii) to make payments to Devonshire. It did not do so from August 16, 2007 onward. It elected not to exercise that right, which was effectively abandoning that right. Nor during that time did it elect to terminate the swap contracts. Even if Barclays was entitled under section 6(a) of the ISDA Master Agreement to sit on its hands after the insolvency of Devonshire until it was favourable to it to terminate the swap contracts, it would be quite inconsistent for it to elect to abandon its right to refuse payment to Devonshire due to Devonshire's insolvency, and to affirm the existence of the swap contracts, and now claim that it was entitled on January 13, 2009 to terminate the contracts on the basis of Devonshire's insolvency, which it pleads occurred from and after August 15, 2007.

[224] Just because Barclays case at the trial was that Devonshire was insolvent on January 13, 2009 does not protect Barclays. In its notice of early termination, Barclays did not specify any date of an alleged insolvency. In its statement of claim, Barclays pleaded that Devonshire was insolvent from August 15, 2007. On Barclays' case, if Devonshire was insolvent on January 13, 2009, Devonshire was also insolvent on August 15, 2007, prior to the date of the Suspension Notice, and on August 17, 2007 after the Suspension Notice, as the evidence indicates that from at least August 15, 2007 Devonshire it did not have funds to pay the Class A notes that were not rolling as a result Barclays refusing to acknowledge any liability under the liquidity facility. Indeed, Barclays argues that the liquidity backed notes, the Class A notes, were in default on their maturity, which means that Barclays argues that Devonshire was in default on these notes on which payment was due on each of at least August 14 and 15, 2007. As well, the Class FRN and Class E notes had long become due, after which Barclays continued to pay its price protection premiums to Devonshire. Interest on the FRN notes was not paid on August 16, 2007 and thereafter and on September 25, 2007 the Issuer Trustee informed the Indenture Trustee that default had occurred on the FRN notes.

[225] To permit Barclays to terminate on January 13, 2009 on the basis of the insolvency of Devonshire, an insolvency that Barclays says commenced in August, 2007, in the face of Barclays afterwards making payments to Devonshire in spite of section 2(a)(iii), would be to ignore Barclays electing not to rely on section 2(a)(iii) and keeping the swap contracts in

effect. In my view, in the circumstances, Barclays has to be taken to have elected not to terminate the swap contracts on the basis of the insolvency of Devonshire.

[226] I conclude that for these reasons Barclays did not have the right on January 13, 2009 to terminate the swap contracts on the basis of the event of Devonshire relied on by Barclays. On that basis, its notice of early termination was ineffective.

[227] Barclays takes the position that sections 9(b) or (f) of the ISDA Master Agreement preclude such a finding. I do not agree. These sections deal with waiver. What is at issue is an election exercised by Barclays to affirm the contract.

[228] Section 9(b) provides that no waiver will be effective unless in writing and executed by each of the parties.

[229] Section 9(f) provides that a failure or delay in exercising any right will not be presumed to operate as a waiver. This section does not state that such a failure or delay could be deemed to be a waiver, but merely that a waiver will not be presumed.

[230] In *Tele2 International Card Co. SA v. Post Office Ltd*, *supra*, it was held that a clause stronger than section 9(f) would not preclude a finding of abandonment by election. In that case the clause in question provided:

> Waiver
>
> In no event shall any delay, neglect or forbearance on the part of any party in enforcing (in whole or in part) any provision of this Agreement be or be deemed to be a waiver thereof or a waiver of any other provision or shall in any way prejudice any right of that party under this Agreement.

[231] Aikens L.J. held that such a provision did not deal with the issue of election of whether or not to exercise a contractual right.

[232] Even if what was at issue was simply a waiver, the case of *Fitkid (York) Inc. v. 1277633 Ontario Ltd*. [2002] O.J. No. 3959 indicates that a non-waiver clause is not necessarily the end of the matter. In that case, it was held by Swinton J. that a landlord who had the right to

terminate a lease for failure of the tenant to pay rent waived that right by later accepting some rent and doing other acts consistent with the lease being in force. It was argued that the following provision in the lease precluded such a finding:

> Landlord's failure to insist upon a strict performance of any covenant of this Lease or to exercise any option or right herein shall not be a waiver or relinquishment for the future of such covenant, right or option, but the same shall remain in full force and effect. Acceptance of rent, whether due before or after and [sic] event of default, whether with or without knowledge of such default, shall not operate as a waiver by the Landlord of any right, including its right of forfeiture.

[233] Swinton J. rejected that argument and stated:

> Even where there is a term in the lease governing waiver, the cases on waiver indicate that courts look at the conduct of the landlord to determine whether it has elected not to terminate the lease in the circumstances after the right of forfeiture arises. In my view, despite the wording of Paragraph 41 of the lease, the acceptance of rent accruing after the act which gave the landlord a right of forfeiture is a waiver in law, since that acceptance presupposes the continued existence of the landlord and tenant relationship.

[234] There is also authority that variation of a contract is effective even if the contract purports to exclude subsequent oral variations and also that oral statements may operate as a waiver of rights evidenced by an earlier written document or may set up an estoppel. See S.M Waddams, *The Law of Contracts*, *supra*, at para. 329 and *Shelanu Inc. v. Print Three Franchising Corp* (2003), 64 O.R. (3d) 533 at para. 50.

(c) Is Barclays prevented by its own wrongdoing from relying on Devonshire's insolvency?

[235] Barclays failed to make liquidity payments under the market disruption notices delivered by Devonshire on August 13, 14 and 15, 2007. For the purposes of this first portion of the trial, it is agreed that the notices were valid and that Barclays was in default in failing to make these payments, without prejudice to its position that it cured the defaults on January 13, 2009.

[236] Devonshire takes the position that the failure by Barclays to make the liquidity payments was the proximate cause of its insolvency and that Barclays should not be able to take advantage of its breach by relying on Devonshire’s insolvency.

[237] Devonshire relies on the principle that no one should be permitted to take advantage of a state of affairs which he himself produced. In *Southcott Estates Inc. v. Toronto Catholic School Board*, [2010] O.J. No 1772 (C.A.) Sharpe J.A. stated:

> It is a well-established principle of contract law that a party cannot use its own breach or default in satisfying a condition precedent as a basis for being relieved of its contractual obligations.

[238] This principle extends to preventing a party from taking a benefit under a contract as a result of his own breach. The law presumes that the parties do not intend to permit a party in breach from relying on its own wrong for the purposes of obtaining a benefit under a contract. In the absence of clear express language indicating that the parties in fact had that intention, this presumption will not be displaced. See *Alghussein Establishment v. Eton College*, [1991] 1 All ER 267 (H.L.). In that case, Lord Goff stated:

> Although the authorities to which I have already referred involve cases of avoidance, the clear theme running through them all was that no man can take advantage of his own wrong.… A party who seeks to obtain a benefit under a continuing contract on account of his breach is just as much taking advantage of his own wrong as is a party who relies on his breach to avoid a contract and thereby escape his obligations.

[239] See also *Commissioner of Agricultural Loans of Ontario v. Irwin*, [1940] O.R. 489 at para. 15, per McTague J.A.

[240] Barclays makes several points in response to Devonshire's position. It says that it subsequently made the liquidity payments and thereby remedied any alleged failure to pay. Thus there was no breach by Barclays that would prevent it from exercising rights under the ISDA Master Agreement. I cannot accept that. It is agreed for the purposes of this trial that Barclays breached its obligations under the liquidity line by failing to make payments to Devonshire on

August 13, 14 and 15, 2007. Even if Barclays remedied the breach on January 13, 2009, that did not mean that there was no breach back in August 2007.

[241] Barclays also contends that Devonshire seeks to reverse its own actions in entering into the Standstill Agreement and later the Montreal Accord in which the obligation of Barclays to make the liquidity payments was suspended. This ignores the fact, however, that it was the failure of Barclays to make the liquidity payments that initially caused Devonshire to take those measures to attempt to protect the interests of the Devonshire noteholders. Barclays had made clear to Devonshire that in its view there was no market disruption event and that it was not going to make the liquidity payments. It was not realistic, as suggested by Barclays in argument, for Devonshire to wait for three days to see if Barclays would make the liquidity payments. Not only had Barclays failed to make the liquidity payments, but it also on the evening of August 15, 2007 sent a mandatory collateral call on one of the two swaps which, because it is agreed for the purposes of this stage of the trial that there was a market disruption event at the time, could not have been validly made.

[242] It is probably the case that at the time, the liquidity crisis in the independently sponsored ABCP market in Canada, partly at least caused by the refusal of the liquidity providers such as Barclays to acknowledge that a market disruption event had occurred, led to the Montreal Accord and, with respect to Devonshire, led Devonshire to agree to the Suspension Notice on August 16, 2007 and later to sign the Montreal Accord. It is not reasonable, however, on Barclays’ case as pleaded, for Barclays to assert that it was not a cause of Devonshire's insolvency at that time. Barclays pleads that from and after August 13, 2007 an event of default under section 5(a)(vii)(2) existed against Devonshire as the Class A notes that did not roll on August 13, 14 and 15 were due and payable at maturity. That alone meant Devonshire was unable to pay its debts as they became due.

[243] The Class E (extendible) and Class FRN (floating rate) notes to the knowledge of Barclays ranked pari passu with the Class A notes. This ranking was reflected in the Series A Supplemental Trust Indenture which was the subject of negotiations with Barclays. Interest became payable on one group of FRN notes on August 16, 2007. Although Devonshire had the

funds to make the FRN interest payment on August 16th, this interest was not paid. The Issuer Trustee made the decision not to pay interest on the Class FRN notes because all of the notes were pari passu and the Trust did not want to treat one class of noteholders differently from the others. The Class E notes that came to maturity were extended and, once interest was payable on them, it was not paid for the same reason.

[244] It is also probably the case, as Barclays asserts, that Devonshire would have needed to be part of the Montreal Accord to deal with the Class E and Class FRN notes because they were part of the same series as the Class A notes. Whether this would have been necessary had Barclays made liquidity payments on the Class A notes is a matter of speculation, but it is not a matter of speculation that Barclays failure was a prime cause of Devonshire agreeing to the Suspension Notice and later becoming a signatory to the Montreal Accord.

[245] The event of default of Devonshire relied upon by Barclays, being Devonshire's inability to pay its debts as they became due, began when Barclays failed to make the liquidity payments on August 13, 14 and 15 2007. Because for the purpose of this stage of the trial it is agreed that Barclays was in default in failing to make those liquidity payments, the event of default of Devonshire relied upon by Barclays was first caused by Barclays. Insofar as the insolvency of Devonshire on January 13, 2009 related to the Class A notes, Barclays would impermissibly gain a benefit on account of its own breach or wrong.

[246] I would not come to the same conclusion, however, regarding the insolvency of Devonshire on January 13, 2009 insofar as that insolvency relates to the Class FRN and Class E notes. The liquidity obligation of Barclays did not apply to these notes. Also, it was a decision by Devonshire, not Barclays, which led to those notes initially not being paid because they ranked pari passu with the Class A notes. To that extent, Barclays was not relying on its own breach on January 13, 2009.

(d) Should a term be implied preventing Barclays from relying on the insolvency of Devonshire?

[247] Devonshire claims that a term should be implied in the ISDA Master Agreement that Barclays cannot rely on the insolvency of Devonshire caused by Barclays's failure to make the liquidity payment as a ground to terminate the swap contracts.

[248] The tests for implying a term in a contract are well settled. A term it may be implied in a contract based on the presumed intention of the parties where the implied term is be necessary "to give business efficacy to a contract or is otherwise to meet the officious bystander test as a term which the parties would say, if questioned, that they had obviously assumed". What is important is a focus on the intentions of the actual parties. A court, when dealing with terms implied in fact, must be careful not to slide into determining the intentions of reasonable parties. This is why the implication of the term must have a certain degree of obviousness to it and why, if there is evidence of a contrary intention on the part of either party, an implied term may not be found on this basis. As well, no term will be implied that is inconsistent with the terms of the contract. See *M.J.B. Enterprises Ltd. v. Defence Construction (1951)*, [1999] 1 SCR 619 at para 27, per Iacobucci J. and *G. Ford Homes Ltd. v. Draft Masonry (York) Co. Ltd.*, (1983), 43 O.R. (2d) 401 (C.A.) at para. 9, per Cory J.A.

[249] Terms have been implied in contracts to the end that a party may not take advantage of wrong doing. In *Gillespie v. Bulkley Valley Forest Industries Ltd*. (1973) 39 D.L.R. (3d) 586 (B.C.S.C.); aff'd 50 D.L.R. 316 (C.A.), cited in Waddams, *The Law of Contracts*, 6th ed, para. 499, a term was implied in a contract under which an employer agreed to repurchase a departing employees home if the employee had been employed for 12 months that the employer would not wrongfully terminate the employment.

[250] An entire agreements clause that does not expressly bar an implied term does not preclude the implication of a term into a contract. See *CivicLife.com Inc. v. Canada*, [2006] O.J. No 2474 at para 48 (C.A.) at para. 52.

[251] Devonshire asserts that that the implication of a term prohibiting Barclays from relying on its own failure to respond to a Market Disruption Notice is necessary to give business

efficacy to the contract. Devonshire says that as a special purpose vehicle selling ABCP, its ability to pay its debts as they became due depended on the existence of a functioning market, or on ready access to liquidity in the event of a market disruption and that this fact receives objective confirmation in the emphasis placed on liquidity covenants by DBRS. Liquidity support in the event of a market disruption event was necessary to ensure a rating from DBRS of R-1 (high) of the Class A notes, without such rating the notes would not be marketable. DBRS was very involved in the criteria to be used in ABCP programs in Canada and the liquidity agreement reached between Devonshire and Barclays contained the latest DBRS criteria for a market disruption event made in June, 2006.

[252] Devonshire contends that if, as Barclays suggests, it was possible for Barclays to refuse to perform its covenants and then capitalize on this refusal by terminating the swaps, the rationale behind the entire program would be undermined. Devonshire's arrangements could scarcely have been rated as they were if it were made plain to DBRS that Barclays could terminate the swaps in reliance on the consequences of its own failure to respond to a market disruption notice.

[253] I would imply a term as suggested by Devonshire. It would not, as suggested by Barclays, read out the provisions of sections 5(a)(i) or5(a)(vii)(2) or otherwise be inconsistent with the ISDA Master Agreement and related contracts. No one could seriously contend that a party in breach of an agreement would be able to rely on the results of that breach to exercise a contractual right of termination, absent a very clear provision in the contract authorizing that result.

[254] Such an implied term, however, does not assist Devonshire because of the Class FRN and Class E notes that remained unpaid on January 13, 2009. That was not caused by Barclays.

(e) Could Barclays cure its failure to make the liquidity payments?

[255] On January 13, 2009, just before 9 a.m., Barclays took steps to have wired to Devonshire's bank the liquidity payments demanded by Devonshire on August 13, 14 and 15, 2007. Shortly after that, Barclays delivered its notice of termination of the swap contracts.

[256] Devonshire contends that Barclays was unable to remedy its failure to make the liquidity payments if it did not do so within three business days as provided in section 5(1)(a) of the ISDA Master Agreement. Section 5(a)(i) makes it an event of default where:

> Failure by the party to make, when due, any payment under this Agreement or delivery under Section 2(a)(i) or 2(e) required to be made by it if such failure is not remedied on or before the third Local Business Day after notice of such failure is given to the party.

[257] Barclays contends that even if the time to remedy the failure had passed, it was entitled to terminate the swap contracts because under section 6(a) of the ISDA Master Agreement the event of default must "be continuing" at the time the notice of early termination is sent, which Barclays says is an indication in this case that it could remedy its failure. Section 6(a) provides:

> If any time an Event of Default with respect to a party (the "Defaulting Party") has occurred and is then continuing, the other party (the "Non-Defaulting Party") may, by not more than 20 days notice to the Defaulting Party specifying the relevant Event of Default, designate a day not earlier than the day such notice is effective as an Early Termination Date in respect of all outstanding Transactions.

[258] Devonshire contends that the use of the word "remedied" in section 5(a)(i) is highly significant. It says that the ISDA Master Agreement does not provide that an event of default occurs if the amount that was supposed to have been paid is not paid within three business days. Rather, it provides that an event of default occurs if the defaulting party does not remedy "such failure", which means not just the failure to pay the amount due, but rather the failure to pay the amount due when due. Devonshire says that Barclays has "no right" to remedy its default once that has occurred. It distinguishes the default from a credit support default referred to in section 5(a)(iii)(1) which makes it a default if a failure to perform is continuing

after any applicable grace period, suggesting in that case a failure could be remedied after the grace period.

[259] I have difficulty with Devonshire's argument. I read nothing into section 5(a)(i) that deals with either an ability or inability to remedy the event of default after it has occurred.

[260] Devonshire relies on two U.K. cases dealing with charterparty contracts that gave ship owners the right to terminate the charters "failing the punctual and regular payment" by the charterers. In *Mardorf Peach & Co. Ltd. v. Attica Sea Carriers Corporation of Liberia* (*The Laconia*), [1976] 2 W.L.R. 668 (C.A.); rev'd [1977] A.C. 850 (H.L.)., it was held in the House of Lords, overruling the Court of Appeal on the point, that once a punctual payment of any instalment had not been made, a right of withdrawal accrued to the owners and the charterers could not avoid the consequences by tendering an unpunctual payment. The other case, *The Brimnes v. Tenax Steamship Co.*, [1975] QB 929, contains a similar statement by Cairns L.J. in obiter.

[261] I do not think these cases assist Devonshire. Firstly, they depended heavily on the obligation in the charterparty to make payments "punctually". More importantly, the charterparty did not contain a provision such as section 6(a) which provides a right to terminate if an event of default has occurred "and is then continuing". Those words contemplate that an event of default, however it is caused, may cease to be continuing, i.e. some step may be taken to cause it to no longer be continuing. In the case of a failure to make a liquidity payment within three business days after a notice of default has been given, the step that would be required would be to make the payment. In this case, if the payment were made by Barclays after the three business days had elapsed, but before termination of the swap contracts by Devonshire, the event of default would not be continuing.

[262] Thus I conclude that Barclays could cure its failure to make the liquidity payments, either by making the payment within the three business day period or after that if the trades were not terminated by Devonshire.

(f) Did Barclays make the liquidity payments on time to enable it to terminate the swaps?

[263] On January 13, 2009, just before 9 a.m., Barclays took steps to have wired to Devonshire's bank the liquidity payments demanded by Devonshire on August 13, 14 and 15, 2007. Shortly after that, Barclays delivered its notice of termination of the swap contracts.

[264] Devonshire contends that even if Barclays was otherwise entitled to terminate the swaps on January 13, 2009, Barclays was in default when it purported to do so because it failed to make the liquidity payments to Devonshire that morning before the termination occurred. Thus, Devonshire contends, Barclays was not a non-defaulting party at the time it purported to terminate the swaps, and as it is only a non-defaulting party who may terminate under section 6(a) of the ISDA Master Agreement, Barclays had no right to terminate. This contention involves an issue of (i) the interpretation of the relevant provisions of the ISDA Master Agreement and (ii) a technical question as to when the payment on January 13, 209 was made and received by Devonshire.

[265] The obligation to make a liquidity payment is contained in Annex VI to the ISDA Master Agreement. The annex provides that if a market disruption notice has been delivered to Barclays by Devonshire, "[Barclays] shall pay to [Devonshire]" the amount specified in the notice.

[266] Payments under an ISDA Master Agreement are governed by the following section:

> 2. Obligations
>
> (a) General Conditions
>
> […]
>
> (ii) Payments under this Agreement will be made on the due date for value on that date in the place of the account specified in the relevant Confirmation or otherwise pursuant to this Agreement, in freely transferable funds and in the manner customary for payments in the required currency.

[267] Barclays sent its payment by wire transfer from its bank, CIBC, to Devonshire's bank, National Bank. The money was received in the National Bank general account at 9:00 a.m. on January 13, 2009. It was credited to Devonshire's account at 10:59 a.m. that day. Devonshire was not able to confirm that these funds were received until 11:12 a.m.

[268] On January 13, 2009 Barclays sent notice to Devonshire that it had made arrangements for the liquidity payment by e-mail at 9:04 a.m. and notice of its early termination notices by fax (at 9:08 a.m. and 9:11 a.m.), by email (9:14 a.m.) and by hand delivery at a time unknown. Thus, at the time of the purported termination, the liquidity payment had been received by Devonshire's bank for some 8 minutes (four minutes after Barclays gave notice to Devonshire) but not yet credited to Devonshire's account.

[269] This timing was well orchestrated. Barclays did not want any advance notice to be given to Devonshire of the liquidity payment, as expressed by Mr. Neville, who also reluctantly admitted on cross-examination that it was possible that Barclays did not want to put Devonshire in a position where it could take steps to terminate before Barclays did.

[270] The arguments on this payment point are elaborate. The issue reminds one of a game of chess and the risk that one wrong move can prove calamitous.

[271] Section 2(a)(ii) provides for payments to be made "in the place of the account specified in the relevant Confirmation or otherwise pursuant to this Agreement", "in freely transferable funds" and "in the manner customary for payments in the required currency". Devonshire contends that payment was not made to it until the funds were credited to it in its account and available to it for withdrawal. Barclays contends that was it important is when the payment was made, and that occurred when Devonshire's bank had the money. When it was deposited into Devonshire's account is irrelevant.

[272] Under section 2(a)(ii), the payments are to be made "in the place of the account specified in the relevant Confirmation or otherwise pursuant to this Agreement". The word "Confirmation" is not defined in the ISDA Master Agreement. There is, however, a confirmation agreement entitled Amended and Restated Master Credit Derivatives Confirmation Agreement.

There is no “place of account” specified in it or in the six annexes to it. Annex VI, dealing with the liquidity payment requirement, states only that Barclays shall pay to Devonshire the amount set out in the market disruption notice not later than 2:30 p.m. Thus, according to section 2(a)(ii) of the ISDA Master Agreement, payments are to be made “pursuant to this Agreement”, which means they are to be made “to Devonshire”.

[273] In this case, as is the case with all wire transfers of large amounts of money between Canadian banks, the payment was made through the Large Value Transfer System (LVTS). The LVTS handles large real-time wire transfers between participant institutions and is operated by the Canadian Payments Association (CPA). Only member institutions in the CPA have access to the LVTS system. The LVTS is the only method for an immediately final and irrevocable payment in Canadian dollars other than by delivery of bank notes and coins. See Bradley Crawford, *The Law of Banking and Payment in Canada* (Looseleaf) (Aurora, ON: Canada Law Book, 2008) at paras. 12:10.10.

[274] The CPA is a statutory body created under the *Canadian Payments Act* with the power to create by-Laws and rules governing LVTS payments. The LVTS by-laws are subordinate legislation pursuant to that *Act.*

[275] Barclays contends that the conditions of payment prescribed in section 2(a)(ii) required the parties to make payments using the LVTS system. This presumably would flow from the language that payments will be made “in the manner customary for payments in the required currency”.

[276] There is no credit risk associated with payments through the LTVS system. See Bradley Crawford, *supra*, at p. 16-5:

> In the [LVTS], the system is so designed and operated that when the customer receives notice of the incoming payment, the payment is already irrevocably collected in good funds and on deposit with its bank. Even at the level of the banks, when an LVTS message arrives, the receiving financial institution has nothing to do except post it to the proper account and give notice to the account owner.

[277] The LVTS by-laws provide that a payment will be available to a payee when its bank credits the funds to its account. They provide:

> FINALITY OF PAYMENT TO PAYEES
>
> Timing of Payments to Payees
>
> 43. (1) On actual receipt by a receiving participant [National Bank] of a payment message, the receiving participant shall make the amount of the payment message finally and irrevocably available to the payee [Devonshire] on the earlier of
>
> (a) the end of the LVTS cycle [5:30 p.m.], and
>
> (b) a reasonable request by the payee being made to the receiving participant for the amount of the payment message.
>
> …
>
> Finality of Payment
>
> 45. For the purposes of sections 43, 44 and 46 to 51, once a receiving participant [National Bank] has actually received a payment message, final and irrevocable availability of the amount of the payment message by a receiving participant to a payee [Devonshire] is deemed to occur on the earliest of
>
> (a) credit in the amount of the payment message, less any service charges (subject to any provisions that may be set out in the rules regarding the disclosure and the manner of processing of service charges), being made to the account of the payee,…

[278] As to these provisions, Bradley Crawford, *supra*, states:

> These provisions appear to owe something to the precedent of the UNCITRAL Model Law on International Credit Transfers and, as such conform to the international norm for signalling the completion of a credit transfer operation…

[279] Thus, so far as the LVTS system is concerned, the payment from Barclays to Devonshire became available to Devonshire in this case when it was credited to the account of Devonshire at 10:59 a.m.

[280] Devonshire contends that as under the LTVS system the payment became available to Devonshire when it was credited to its account, it cannot be said that Devonshire received or had the use of the funds until those funds were put into its account, which took place at 10:59 a.m., nearly two hours after Barclays purported to terminate the swaps. Thus,

Devonshire contends, Barclays was in default at the time of the purported termination and not able to terminate the trades. In this contention, I think Devonshire is correct.

[281] Each side made reference to authorities in the U.K. to bolster their arguments. None of these are of course binding, but in any event I do not find them to be conclusive. One thing that becomes clear, however, is that a matter of minutes can be crucial as to whether payment was made in a timely matter.

[282] Barclays relies on cases for the proposition that if there is no credit risk to the payment being received by the receiving bank the payee's right to payment arises when the bank receives the payment and it does not matter when the payee's account is credited with the funds. These cases involved charter parties where the owners attempted to revoke the contract due to alleged late payments.

[283] In Zim *Israel Navigation Co. Ltd. v. Effy Shipping Corporation (the "Effy")*, [1972] 1 Lloyd's L.R. 18 (QB), a payment was to be made to the owners account at a branch of WD bank. It was credited to WD bank's overseas branch account at Hanover bank, a correspondent bank, on October 5th. Notice of this was received by WD's overseas branch in London on October 6th and shortly thereafter credited to the owner's account at the WD branch. The owner, however, had terminated the charter on October 5th. It was held that the payment had not been made before the charter was terminated because the payment had not been credited to the named account and the owner could not have drawn on any account until October 6th. This case would appear to support Devonshire rather than Barclays. It stands for the proposition that payment is not effected until the payee is in a position to draw on its account for the amount of the funds transferred.

[284] In *Tenax Steamship Co. Ltd. v. Reinante Transoceanica Navegacion S.A. (The Brimnes)*, [1973] 1 W.L.R. 386 (QB), the charterparty provided that payment was to be made in cash to the owner's account at Morgan Guaranty Trust (MGT) in New York. The owner sent instructions on April 1, the date for payment, to its bank Hambros, which upon receipt on April 2 sent by telex to MGT at 10. a.m. an order to pay instructing MGT to debit its account at MGT and credit the owner's account. Because a telex instruction was not considered legal tender, the

time of payment was held to be the moment when MGT made the transfer from the Hambros account to the owner's account, which occurred at 6.07 p.m. However, approximately 15 minutes before this occurred, but long after the telex had been received by MGT, the owner terminated the charter. It was held that the payment was not made before the termination. This decision is irrelevant because it involved payment instructions by telex, not legal tender.

[285] Barclays relies, however, on obiter in *Brimnes*, in which Brandon J. said that when payments on other occasions had been made by banker's cheques, it was reasonably clear that payment was effected when the banker's cheque was received by MGT. The point did not arise for decision. In the Court of Appeal, Edmund-Davies L.J. said in obiter that there was no contest that when payment by banker's cheque was made, the payment was made when received by MGT.

[286] Both Barclays and Devonshire rely on the statement of Brandon J. that the words "payment in cash" in the charterparty did not mean only bills or other legal tender, but "any commercially recognized method of transferring funds the result of which is to give the transferee the unconditional right to the immediate use of the funds transferred". Barclays says the word "right to the funds" crystallized when National Bank received the funds. Devonshire says that under the LVTS that did not occur until the funds were put into its account. I think too much is being made of the words of Brandon J. He was intending to describe the quality of a payment, not when it might be available as between a transferee bank and its customer.

[287] I do not think the case of *A/S Awilco of Oslo v. Fulvia S.p.A. Di Navigazione of Cagliari (The Chikuma)*, [1981] 1 W.L.R. 314 (H.L.) relied on by Devonshire is of much assistance. In that case, it was held that as the payment made by the charterers through its Italian bank on the due date was held not to be a payment in cash because under Italian banking law and the terms under which the payment was made, interest was not payable on the money for four days, and so the payment was held to amount to an overdraft facility.

[288] Barclays relies on statements by Lord Denning M.R. and Lawton L.J. in *Mardorf Peach & Co. Ltd. v. Attica Sea Carriers Corporation of Liberia* (*The Laconia*), [1976] 2 W.L.R. 668 (C.A.); rev'd [1977] A.C. 850 (H.L.). In that case, payment by the charterers was due on

Sunday, April 12. It was conceded by the charterers that as the banks were closed on the week-end, payment should have been made by Friday, April 10. Arbitrators found that a punctual payment was to be made by 3 p.m. on Friday, April 10 at 3 p.m. and that a payment by bank order on April 13, 2009 was too late. On appeal, Donaldson J. upheld the award. His decision was reversed in the Court of Appeal, which held the payment could be made on Monday the 13th and that while the payment was not transferred by the owner's bank to the owner's account before the owner terminated the charterparty, it was sufficient that the payment had been received by the bank. The majority held that there had been waiver of the requirement that the payment was due on the Friday, April 10 by virtue of the owner's bank accepting the payment on April 13. Denning M.R. said that the bank was the agent of its customer. Lawton L.J. stated that once the payment was received by the bank, the customer could draw against the cash at once, and internal paper work did not affect that situation. In dissent, Bridge L.J. held that the owner had not waived the requirement that payment be made on April 10.

[289] The House of Lords reversed the Court of Appeal decision, holding that the owner's bank had no authority from the owners to waive when payment was due and as the payment was not made on April 10, the charterers had the right on April 13 to terminate the charter. The issue as to whether payment by a bank order to a bank was sufficient to constitute payment to its customer was moot. Lord Wilberforce, with whom Lord Simon concurred, said in obiter "As between banks, a payment order is the equivalent of cash, but a customer cannot draw upon it. The amount must first be credited to his account, but he can, of course, make special arrangements for earlier drawing." Lord Fraser said that the payment would not have been made until it was credited to the owner's bank account, even though the payment order was one on which the payee's bank could safely rely because it was irrevocable and was made by a bank they could trust. He also said that he thought that the charterers must pay in sufficient time to allow for the period of processing normally required for the method of payment they had chosen. Lord Salmon said that while he preferred to express no concluded view, he was inclined to think there was no difference between dollar bills and a payment by money order. Lord Russell referred to the issue of payment in cash, and said while it was unnecessary to decide, he would incline to the view that a payment order between banks was the equivalent of cash and that it

should suffice for payment to be tendered to the nominated bank to be credited to the named account.

[290] Thus, in *Mardorf Peach* the issue as to whether payment to a bank is sufficient to be payment to its customer was moot, and in any event the various judges were split on the issue.

[291] Whatever the common law on the point is in the United Kingdom, the LVTS by-laws govern this case. Under them, Devonshire did not have any unconditional right to the use of the funds once received by National Bank. It was only after the funds were transferred into Devonshire's account that it can be said that funds were made available to Devonshire. Barclays must be taken to have been aware of the LVTS by-laws and their effect.

[292] With respect to the U.K. common law, the statement of Lord Fraser in *Mardorf Peach* that the payment would not have been made until it was credited to the owner's bank account seems to me to make commercial sense, as until that happens, the payee as a practical matter would not be able to draw on it. His statement that the payors must pay in sufficient time to allow for the period of processing normally required for the method of payment they had chosen also makes commercial sense. In the case of a wire transfer of funds through the LVTS, what that processing time is is spelled out in the by-laws.

[293] Barclays were in a hurry to carry out their plan of attack on the morning of January 13, 2009. Barclays had to know that Devonshire would in all likelihood not know of the payment into its account before it took steps to terminate the swap contracts. Barclays knew that Quanto, and particularly Mr. Lafleur-Ayotte, was in Toronto to review and sign documents in connection with the large Crawford restructuring. Their "Liquidity Amount Notice" was e-mailed at 9:04 a.m. and said that "Barclays has arranged for payment" of the liquidity amounts, not even that "Barclays has paid" those amounts. Four minutes later the early termination notice was sent. Mr. Lafleur-Ayotte learned that Barclays purported to terminate the Devonshire swap sometime after 9 a.m. when he was on his way to the Goodmans' offices to sign documents for the large Crawford restructuring of other Quanto administered trusts. He was not able to review the notices received from Barclays until after signing the closing documents.

[294] In my view, Barclays acted unreasonably in moving with the haste that they did. They should have waited for a reasonable time to ensure at least that the funds had reached Devonshire's bank account. But whether or not Barclays acted reasonably, I find that Barclays failed to make payment of the outstanding liquidity amount before purporting to terminate the swap contracts. As Barclays was not a non-defaulting party, it had no right under section 6(a) of the ISDA Master Agreement to deliver its notice of early termination when it did.

14. Did Barclays act in breach of a duty of good faith?

[295] Devonshire contends that Barclays owed obligations of good faith to Devonshire that were breached.

[296] Canadian courts have not recognized a stand-alone duty of good faith that is independent from the terms expressed in a contract or from the objectives that emerge from those provisions. The implication of a duty of good faith has not gone so far as to create new, unbargained for rights and obligations. Nor has it been used to alter the express terms of the contract reached by the parties. Rather, courts have implied a duty of good faith with a view to securing the performance and enforcement of the contract made by the parties, or as it is sometimes put, to ensure that parties do not act in a way that eviscerates or defeats the objectives of the agreement that they have entered into. See *Transamerica Life Canada Inc. v. ING Canada Inc.* 68 O.R. (3d) 457 (C.A) at para. 53 per O'Connor A.C.J.O. and *Nareerux Import Co. v. Canadian Imperial Bank of Commerce*, [2009] O.J. No 4553 (C.A.) at para. 69 per Blair J.A.;

[297] Courts have used the doctrine of good faith to police the bargain the parties have already made and to supervise performance of their contractual obligations. Even where good faith is not pleaded, in many contexts courts have held that one contracting party owes the other an implied duty to carry out its obligations or to exercise any discretion given by the contract in good faith. See *Transamerica, supra,* at para. 87 per Laskin J.A. and *CivicLife.com Inc. v. Canada (Attorney General)*, [2006] O.J. No 2474 (C.A.) at para 49, per Weiler J.A.

[298] Contracts in which performance is dependent upon the exercise of discretion on the part of one of the parties are contracts that are characterized by an implied duty of good faith

performance. In such circumstances, the discretion must be exercised reasonably and in good faith and in light of the purposes for which it was conferred. See *Nareerux, supra*, per Blair J.A. at para. 71 and John D. McCamus, *supra*, at p. 791.

[299] Devonshire's claims relating to bad faith to some extent center on the events leading to the termination of the trades and to some extent on things that occurred before then.

[300] Regarding the latter, Devonshire contends that it was in bad faith for Barclays not to explain its failure to make the liquidity payments in August 2007. I do not accept that Barclays had any such obligation and in any event it clearly took the position with Devonshire that in its view a market disruption event had not occurred. I see no obligation on the part of Barclays at that time to tell Devonshire that it was acquiring notes from bank sponsored ABCP trusts.

[301] Regarding the negotiations between Barclays and the Devonshire noteholders, Devonshire points to the provisions in the documentation requiring Barclays to negotiate in good faith towards a restructuring. In the Montreal Accord, to which Barclays was a signatory, as well as major Devonshire noteholders, Barclays agreed to work in good faith with the other participants to bring about a timely implementation of the long-term proposal contained in it. Under the Montreal Accord, the negotiations leading to the large Crawford restructuring were carried out by the Investors' Committee. Whether, as Barclays asserts, this was merely an unenforceable agreement to agree is not the point, as there were contractual good faith obligations on Barclays. However, once the framework agreement in December 2007 was made by the other participants other than Barclays and Barclays dropped out of those negotiations, it is questionable whether a good faith obligation continued under the Montreal Accord in favour of the Devonshire noteholders.

[302] However, there was a contractual obligation on the part of Barclays with Devonshire contained in the Suspension Notice that Barclays was to comply with its obligations as a signatory under the Montreal Accord. This imported into its agreement with Devonshire an obligation of Barclays to work in good faith with the other participants, including the major noteholders of Devonshire, to bring about the timely implementation of the long-term proposal

contained in it. The extensions of the Montreal Accord standstills and the Suspension Notice continued to import this obligation.

[303] Thus even though Barclays may not have owed a duty of good faith directly to the Devonshire noteholders after it left the large restructuring negotiations, it owed a duty to Devonshire to carry out the negotiations with the Devonshire noteholders in good faith. This is understandable as it would not have made commercial sense to Devonshire to agree to the continuation of the standstills if Barclays was not dealing with the noteholders in good faith.

[304] I agree, however, with Barclays that a duty of good faith does not preclude self-interested behaviour and that a party under such a duty may be required to temper its self-interest, but not to avoid it. See *Shelanu Inc. v. Print Three Franchising Corp* (2003), 64 O.R. (3d) 533 (C.A.) at para. 69 for the proposition asserted by Barclays that so long as a party under a duty of good faith deals honestly and reasonably with the other side, its counterparty's interests are not necessarily paramount.

[305] Devonshire contends that Barclays initially booked its trade with Devonshire as a full recourse trade and that negotiations later premised on that booking had the effect of Barclays attempting to improve its economic position in the restructuring. I do not see this as any bad faith on the part of Barclays. Barclays was quite entitled in its negotiations with the Devonshire noteholders to attempt to improve its commercial position, just as the Devonshire noteholders were entitled to attempt to do the same.

[306] I agree, however, with Devonshire that in the closing days leading to the purported termination of the swap contracts by Barclays on January 13, 2009, Barclays breached its good faith obligations. Barclays decided to terminate the swaps for its own economic reasons, which a party under an ISDA Master Agreement is entitled to do. But in doing so in this case, it breached its obligation to not act in a way that defeated the objectives of the agreements that they entered into and to be honest and candid with Devonshire.

[307] Barclays took a number of steps leading to the termination of the swap contracts. The steps were taken pursuant to an obvious plan. It would be artificial to look at each step as

taken independently of the other steps. They were all part of a concerted effort. The plan began no later than January 8, 2009 when, as Mr. Lovisolo said, they intended to "blow up the box", meaning to terminate the trades, for the economic reasons that he expressed to Mr. Truell that day.

[308] Prior to the end of 2008, I do not think it can be said that Barclays was not negotiating in good faith with the Caisse, nor for that matter that the Caisse was not negotiating in good faith with Barclays. Each was asserting commercial positions in very difficult economic times that they were entitled to assert. However, in putting its ultimatum to the Caisse on January 8, 2009, Barclays in my view was not negotiating with the Caisse in good faith. It was reverting to a position taken for the most part eight months earlier in much different economic circumstances and it was not made with any expectation that it would be accepted by the Caisse. Rather, Barclays had to know that the Caisse would not accept it and Barclays had no intention other than to terminate the trades when that occurred. The ultimatum did not constitute good faith bargaining, but rather the first step in Barclays' termination and litigation strategy.

[309] The daily standstill agreements of January 8 and 9, 2009 prevented Devonshire from taking any steps to enforce its rights resulting from the failure of Barclays to make the liquidity payments arising from the market disruption event notices delivered by Devonshire on August 13, 14 and 15, 2007 and, in particular, extended the continuation of the standstill of the cure period in which Barclays would have to either make the payment or have an event of default occur. The timing was not coincidental but rather designed to permit payment of the outstanding liquidity amounts on January 13, 2009 just minutes before the early termination notices to be delivered to Devonshire that morning. These standstill extension agreements were induced by misrepresentation, as I have found, that was the antithesis of good faith actions in furtherance of the purposes of the agreements between Barclays and Devonshire. Devonshire was entitled to the true facts from Barclays, which it did not receive.

[310] Barclays contends that it was in an adversarial relationship with Devonshire and could not be expected to disclose to Devonshire in advance its litigation strategy. While this may

be true, once it made statements of fact to Devonshire, it was obliged to ensure that those facts were not misleading, either directly or by omission.

[311] The purpose of the obligation of Barclays to make a liquidity payment under Annex VI of the ISDA Master Agreement, as conceded by Mr. Howard in argument, was to provide Devonshire with funds to pay the holders of the Class A notes that were not rolling. When the liquidity payment was made by Barclays on the morning of January 13, 2009, it was not at all for that purpose. It was, as conceded by Mr. Howard, done to enhance the litigation strategy that was underway.

[312] The Liquidity Amount Notice that Barclays delivered to Devonshire that day stated that Barclays was not under any obligation to make the payment and that while Barclays had arranged for the payment to be made, Barclays reserved the right to demand the return of the funds "subject to resolution of dispute". The litigation that Barclays commenced moments later claimed the return of the funds. The liquidity provisions in Annex VI of the ISDA Master Agreement did not provide for any Liquidity Amount Notice of the kind delivered by Barclays or provide for any conditional payment. The payment in these circumstances could not be used by Devonshire to pay any noteholders and was not an unconditional payment in accordance with the ISDA Master Agreement.

[313] Barclays contends, however, that as long as the time to make the payment was preserved by the extension agreements, it could make it. However, apart from the fact that the payment was not made in accordance with the contractual provisions governing Barclays, it was not only the making of the payment in itself that is the issue, but it being part of a strategy that included a misrepresentation of the facts in order to extend the time to make the payment and the fact that the payment was not going to achieve the purpose it was designed and contracted for because of the imminent termination of the trades by Barclays and the imminent litigation to follow. The payment was not a good faith exercise with a view to securing the performance and enforcement of the contract made by the parties, but rather one that defeated the objectives of the agreement. As was said in *Transamerica*, it is such circumstances that courts have implied a duty of good faith with a view to securing the performance and enforcement of the contract.

[314] Much the same can be said with respect to the notice of early termination that was delivered by Barclays. Under section 6 (a) of the ISDA Master Agreement, Barclays had a right in the event of a default to deliver such a notice, assuming that there were no other problems of the kind that I have found to have existed. According to *Transamerica* and the other authorities to which I have referred, a duty of good faith could not be used to alter the express terms of the contract, and I would not do so. It is not the delivery of the notice of early termination itself that is the issue, but rather the other matters to which I referred that were done in furtherance of the plan.

[315] Barclays relies on *Marathon Canada Limited v. Enron Canada Corp*., (2008), 97 Alta. L.R. (4^{th}) 137 (Q.B.), aff'd (2009), 99 Alta. L.R. (4^{th}) 213 (C.A.) for the proposition that termination of an agreement in accordance with its terms is not a breach of good faith. I do not think that the case goes so far as to state the point categorically, but rather suggests there may be instances that could be in breach of such an obligation of good faith. In that case, the trial judge stated that exercising one's contractual right of termination is not evidence of a breach of good faith. On appeal, the Alberta Court of Appeal declined to consider this issue. The Court did state, however:

> We need not address this issue except to point out that the trial judge made no findings of fact that Enron was a vulnerable party, or that there was lack of good faith by Marathon, or that Marathon took an unfair opportunistic advantage for a "disingenuous" motive, or that Marathon ran roughshod over reasonable contractual expectations that existed in the Agreement. Although suggestions like this are braided into the appellant's arguments, there is no specific basis for an attack on good faith in the evidence and no specific challenge to the trial judge's finding on that issue. Under those circumstances, we do not need to address good faith.

[316] In the circumstances, assuming that there were not the other problems involving the steps taken by Barclays, such as electing not rely upon insolvency of Devonshire and failing to make timely payment, I would hold that for the reasons given Barclays breached its good faith obligations to Devonshire in executing its strategy commencing January 8, 2009. Thus for these reasons it cannot rely upon the January 8 and 9, 2009 extensions of the standstill agreements or

the conditional payment made to Devonshire on January 13, 2009. Thus for these reasons Barclays cannot rely on its notice of early termination on January 13, 2009.

15. Did Barclays have the right to terminate the ISDA Master Agreement?

[317] For the reasons given, Barclays did not have the right to rely on its early termination notice on the morning of January 13, 2009. In summary those reasons are (i) Barclays by its election is taken to have waived the right to rely on the insolvency of Devonshire as an event of default, (ii) Barclays failed to make timely payment to Devonshire on January 13, 2009 before delivering its notice of early termination and (iii) Barclays may not rely on the conditional payment it made by reason of its breach of its good faith obligations.

[318] The delivery of the notice of early termination and the other steps taken, including the litigation that immediately followed, constituted a repudiation by Barclays of the ISDA Master Agreement and related agreements. Repudiation can be by words or conduct evincing an intention not to be bound by the contract. Such an intention may be evinced by a refusal to perform, even though the party refusing mistakenly thinks that he is exercising a contractual right. See Waddams, *The Law of Contracts*, *supra*, at para. 620.

16. Did Devonshire have the right to terminate the ISDA Master Agreement?

[319] At 2:22 p.m. on January 13, 2009 Devonshire delivered a notice of early termination of the swap contracts and designated that date as the early termination date. Devonshire's termination notice stated that an event of default, namely Barclays' alleged failure to pay the liquidity amounts that had been demanded on August 13 and 14, 2007, for which a notice of default had been delivered on August 14, 2007, had occurred under section 5(a)(i) of the ISDA Master Agreement with Barclays as the defaulting party.

[320] For the purposes of this stage of the trial, it is agreed that the market disruption notices delivered by Devonshire were valid and that Barclays was in default under those notices, without prejudice to the position of Barclays that its payment on January 13, 2009 cured any default.

[321] I have held that the time during which Barclays could cure recommenced on Friday, January 9, 2009. The remaining two days of the three day period therefore expired at the close of business on Monday, January 12, 2009. Therefore an event of default under section 5(a)(i) occurred at the close of business on January 12, 2009. I have also held that Barclays's payment on January 13, 2009 did not cure its default. Thus Barclays for the purposes of this trial was a defaulting party under section 6(a) and Devonshire had the right to deliver its early termination notice designating January 13, 2009 as the termination date.

[322] In its notice, Devonshire stated that the Suspension Notices did not suspend the obligation of Barclays to remedy its failure to pay. While I have found to the contrary, I do not think the notice was invalid for that reason. The default was clearly identified, namely the failure to make the payments as required under the notices of August 13 and 14 and the default notice of August 14, 2007. What was provided was far more information that the notice that had been sent earlier that day by Barclays which only referred to the section of the ISDA Master Agreement relied on by Barclays.

[323] While I have held that Devonshire was insolvent on January 13, 2009, I have also held that Barclays had elected to waive reliance on Devonshire's insolvency. Thus for the purposes of section 6(a) of the ISDA Master Agreement, Devonshire is a non-defaulting party entitled to deliver notice of termination to Barclays.

[324] If Devonshire were not able to deliver a notice of early termination under section 6(a), by its notice it made clear that it regarded the contract as at an end and thus accepted the repudiation of Barclays. The option to "accept" a repudiation can be exercised by communicating to the repudiating party that the other regards the contract as at end. The communication need not be by words if it can reasonably be inferred from the circumstances. See Waddams, *The Law of Contracts, supra*, at para. 623.

17. Settlement on Barclays default

[325] The principles to be used in determining payments that are to be made as a result of an early termination are in some instances easily understandable and in other instances quite complex due to the complexity of the various agreements that are in play in this case.

[326] Section 6(e) of the ISDA Master Agreement sets out a detailed set of alternative formulae for the purpose of determining the amounts to be paid on early termination. In relation to termination on the basis of an event of default, four different formulae are specified: First Method and Market Quotation, First Method and Loss, Second Method and Market Quotation, Second Method and Loss. In the Amended and Restated Schedule, Barclays and Devonshire selected Second Method and Market Quotation to apply.

[327] Section 6(e)(i)(3) of the ISDA Master Agreement contemplates that where Second Method and Market Quotation applies, amounts, referred to as settlement amounts, may be owing both by the defaulting party to non-defaulting party and by the non-defaulting party to the defaulting party. This was referred to by Flaux J. in *Britannia Bulk* as a method of calculating close out positions on the termination of the contracts. Depending on the amounts owed by one to the other, the final payment could be one to be paid by the defaulting party to the non-defaulting party, or vice versa.

[328] However, section 11 of Part I of the Amended and Restated Schedule to the ISDA Master Agreement and section 2.2(c) of an Intercreditor Agreement between Barclays and Devonshire both provide that if an early termination date is designated by Devonshire due to an event of default of Barclays, any settlement amount payable to Barclays shall be subordinated to amounts specified in another contract entitled Series A Supplemental Indenture, which is an agreement made by Devonshire with CIBC Mellon, the Indenture Trustee for the Devonshire noteholders, (the “Trust Indenture”). The Trust Indenture provides for the priority of payments to be made by the trustee in the event of a default. This provision is referred to by the parties as the “waterfall” provisions.

[329] One of the amounts to which any settlement amount payable to Barclays for its losses under the ISDA Master Agreement is subordinated is the amount of the principal and interest owing to Devonshire's noteholders.

[330] The uncontradicted evidence is that the outstanding principle and interest owing to the Devonshire noteholders as at January 13, 2009 was $718,687,020.60. Of the approximately $71 million paid by Barclays on January 13, 2009, $67.3 million may be considered to have been "liquidity notes" issued to Barclays, which if the case would mean there would be $786,018,937.73 of notes outstanding in principal and interest.

[331] As of January 13, 2009 Devonshire had approximately $112 million plus the $71 million liquidity payment made that day for a total of $183 million. If Barclays was in default, Devonshire is also entitled to the return of the $600 million plus interest posted as collateral, subject to the contention of Barclays that the $67.3 million it paid on January 13, 2009 is to be deducted from the $600 million. . Devonshire says that as a practical matter, as the value of Devonshire's assets after payment of the settlement amount by Barclays will still be less than the amounts owing to the noteholders for principal and interest, there is no need to determine Barclays' claim against such assets, as there would be no assets left to satisfy such a claim.

[332] Barclays contends that its claim (i.e. "Loss" amount due to Barclays from Devonshire) should be calculated, and that such amount should be deducted from Devonshire's claim of loss. If this were correct, and Barclays' claimed loss of $1.2 billion were upheld, it would mean that nothing would be required to be paid by Barclays to Devonshire.

[333] I do not accept that submission. It is based on Barclays's reading of the definition of "Loss" in the ISDA Master Agreement. However, it ignores the language of section 2.2(c) of an Intercreditor Agreement. It would make no commercial sense to provide that amounts to be paid to Barclays on its default for its loss are to be subordinated to the settlement amount payable to Devonshire, including amounts owing to Devonshire's noteholders, but that the settlement amount payable to Devonshire is to have deducted from it the Barclays loss. Such a result would eviscerate the effect of the Intercreditor Agreement.

[334] Under the Market Quotation method of determining loss chosen by the parties in the ISDA Master Agreement, loss is to be determined with reference to quotations to be obtained from other market participants that would have the effect of preserving for the party not in default the economic equivalent of any payment that would be paid after the termination, had the termination not occurred. However, if less than three quotations are provided by other market participants, it is deemed that the Market Quotation cannot be determined.

[335] In this case, Devonshire requested but failed to obtain any response from other market participants. Devonshire's request to market participants was made on February 9, 2009. Barclays is critical of this late date for the request, as section 6(d)(i) of the ISDA Master Agreement requires a party to make its calculation of loss on or soon as practicable following the early termination date. However, taken that Barclays had commenced its action on the morning of January 13, 2009 Devonshire would have needed time to consider with its legal advisors how to respond, and this delay does not seem unreasonable.

[336] If a Market Quotation cannot be determined, the loss must be calculated by the party not in default. "Loss" is defined in the ISDA Master Agreement to mean, in the case of a claim by Devonshire,

> "Loss" means… an amount that [Devonshire]… <u>reasonably determines in good faith to be its total losses and costs </u>(or gain, in which case as expressed in a negative number) … including any loss of bargain…Loss includes losses and costs (or gains) in respect of any payment …required to have been made …on or before the relevant Early Termination Date and not made… A party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets".(underlining added)

[337] Devonshire determined its loss to be the outstanding amounts owing for principal and interest on the Devonshire notes plus approximately $1 million for Unpaid Amounts. It relies on the evidence of Mr. Lafleur-Ayotte who testified that the ability to repay noteholders in full was what Devonshire lost with the termination of the swaps on January 13, 2009. Devonshire did not calculate any loss payable to Barclays because of the Intercreditor Agreement provisions subordinating any payment owing to Barclays. In my view, this method was reasonable.

[338] Pursuant to the Intercreditor Agreement, Devonshire is entitled to be paid the $600 million delivered by it to Barclays at the outset of the transaction as security for its contingent obligation to Barclays if there were credit defaults in the underlying portfolio against which Barclays bought credit protection. It is agreed that Devonshire is entitled to be paid $1,061,916.48 as an Unpaid Amount as defined in the ISDA Master Agreement, if Barclays' calculations as to its loss are accepted. The parties differ, however, as to whether Barclays is entitled to deduct from those amounts the liquidity payment of approximately $67.3 million in principal which it paid to Devonshire on January 13, 2009.

[339] That issue depends on the interpretation of the Market Disruption Support Amounts provisions in Annex VI, the Special Provisions Annex, to the ISDA Master Agreement. These provisions provided Barclays with an election as to how it would fund a liquidity call made by Devonshire in the event of a market disruption event. Barclays could (i) pay the amount of the liquidity call to Devonshire from the $600 million originally posted by Devonshire as security for its obligations, referred to as a "Synthetic Liquidity Arrangement" or (ii) purchase new Class A, Series A notes from Devonshire ("liquidity notes") in the amount of the liquidity call, referred to as a "Traditional Liquidity Arrangement". If Barclays did not notify Devonshire of its election, the Traditional Liquidity Arrangement was deemed to apply. Barclays was entitled to fulfill its obligation under (i) or (ii) in such portions as it elected, provided that if the Traditional Liquidity Arrangement applied, the proportion of the amount to be paid by way of such Traditional Liquidity Arrangement was not to be less than $75 million.

[340] The Liquidity Amount Notice delivered by Barclays on January 13, 2009 was silent as to whether Barclays elected a Synthetic Liquidity Arrangement or a Traditional Liquidity Arrangement as the method of payment. Devonshire therefore takes the position that Barclays is deemed to have used (ii), i.e. deemed to have acquired liquidity notes under a Traditional Liquidity Arrangement. If this is the case, Barclays may not deduct the $67.3 million liquidity payment from the $600 million to be paid to Devonshire.

[341] Barclays takes the position that as the liquidity payment was less than $75 million, it cannot be taken to have elected a Traditional Liquidity Arrangement and that the

payment is to be treated as a Synthetic Liquidity Arrangement. In that case, the $67.3 million would be deductible from the $600 million to be paid to Devonshire.

[342] The material part of the Market Disruption Support Amounts provision in the Special Provisions Annex provides:

> Barclays may elect to pay such CP Redemption Amount [the liquidity call] …either by (i) returning to [Devonshire] that part of the Initial Seller Payment [the $600 million]…"a **Synthetic Liquidity Arrangement**" equal to the [liquidity call] or (ii) purchasing new Class A Series A Notes ('**Liquidity Notes**") from [Devonshire] in an amount equal to such [liquidity call]that are due and payable in full in 30 calendar days…(a "**Traditional Liquidity Arrangement**"). [Barclays] shall notify [Devonshire] of its election not later than 2:30 p.m. …on the business day such market disruption notice is effective, and <u>if [Barclays] fails to make such election, then clause (ii) shall be deemed to apply. [Barclays] may fulfill its obligation to pay any [liquidity call] pursuant to clause (i) or (ii)…in such proportions as it elects, provided, if Traditional Liquidity Arrangement applies, then the proportion of the [liquidity draw] paid by way of such Traditional Liquidity Arrangement shall not be less than $75,000,000…</u>Buyer and Seller acknowledge and agree that such amount and percentage was specifically negotiated by the parties and represents a fair and equitable percentage of risk that buyer would retain in respect of Traditional Liquidity Arrangement. If buyer has paid all are part of the CP Redemption amount pursuant to a Synthetic Liquidity Arrangement (the sum of such amounts being the "**Synthetic Liquidity Amount**"), Buyer may elect, at any time that the Synthetic Liquidity Amount has not been repaid to Buyer, to purchase Liquidity Notes from Seller pursuant to a Traditional Liquidity Arrangement in a principal amount up to the amount of such Synthetic Liquidity Amount that has not been so repaid. In such circumstances, Liquidity Notes in the relevant principal amount shall be delivered free to the Buyer and the purchase price of such Liquidity Notes will not be paid to Devonshire but will be retained by the Bank and shall be applied to reduce the Synthetic Liquidity Amount. (underling added)

[343] On a literal reading of this provision, the requirement that a Traditional Liquidity Arrangement shall not be less than $75 million applies only if Barclays has elected to pay part or all of the liquidity calls by way of a Traditional Liquidity Arrangement. On this reading, as Barclays did not make any election, the fact that the liquidity payment was only $67.3 million makes no difference and Devonshire would be right in its argument that the liquidity payment is

deemed to be a Traditional Liquidity Arrangement with issuance of Class A notes to Barclays rather than a Synthetic Liquidity Arrangement as claimed by Barclays.

[344] Barclays contends that the $75 million minimum required for it to acquire liquidity notes was put in for the protection of Devonshire noteholders. The terms of the liquidity notes permitted Barclays to designate an early termination date if not paid in 30 days, which would not be in the other noteholders' interests, even if Barclays had only a small amount of these notes. For that reason, the $75 million minimum was inserted as a protection to Devonshire so that before Barclays was to be permitted to acquire liquidity notes, and be in a position to terminate the swap transactions if not paid within 30 days, it would have to commit at least $75 million of its own money so that if it subsequently terminated the transactions, it would face a loss pro rata with the other noteholders. In other words, the $75 million minimum was meant to ensure that Barclays would have a substantial economic interest in the transactions and therefore have to think twice before terminating the swap transactions for failure of the notes to be paid in 30 days.

[345] Devonshire argues that there was reason for a Traditional Liquidity Arrangement if Barclays did not make an election. This derives from the fact that a Synthetic Liquidity Arrangement benefits Barclays in that the use of a Synthetic Liquidity Arrangement leads to a reduction in the amount of collateral available to protect remaining noteholders without a corresponding risk transfer of the swap contracts to Barclays. The use of a Traditional Liquidity Arrangement, on the other hand, puts Barclays in the position of Series A noteholders, therefore transferring the risk of the underlying transactions back to Barclays for the amount of these notes. In order to avoid this risk transfer, which is built in the very structure of the agreements it has entered into with Devonshire, Barclays had and should have the burden of making such an election. Devonshire therefore says that the $75 million threshold is protection negotiated by Devonshire as a limit on the ability of Barclays to elect between Traditional and Synthetic Liquidity Arrangements.

[346] The Special Provisions Annex gave an election to Barclays to determine how it wanted to fund a liquidity call. The purpose of the deeming provision that a Traditional Liquidity

Arrangement would apply if Barclays failed to make an election is somewhat puzzling. In the normal course one would have thought that Barclays would decide what arrangement it wanted and elect accordingly.

[347] The $75 million proviso was obviously not for Barclays' benefit. It was inserted to protect Devonshire. What purpose it would serve for the proviso to apply only to an election by Barclays to have a Traditional Liquidity Arrangement needs to be considered.

[348] I have difficulty with the argument of Devonshire. I can see that if a Traditional Liquidity Arrangement were more beneficial to Devonshire than to Barclays, as Devonshire asserts, a presumption that the arrangement would be a Traditional Liquidity Arrangement if Barclays did not make an election would be in Devonshire's interest. However, if a Traditional Liquidity Arrangement were better for Devonshire, there would be no benefit to Devonshire in requiring Barclays to have a minimum $75 million in order to have a Traditional Liquidity Arrangement. The $75 million is not a limit on the ability of Barclays to elect, as contended by Devonshire, but a minimum threshold.

[349] Whatever its purpose, the $75 million threshold was inserted to restrict Barclays' election. If it applied only to a situation in which Barclays elected a Traditional Liquidity Arrangement but not in a situation in which Barclays failed to make an election, Barclays could avoid the restriction by simply failing to make an election. That would make no commercial sense and the parties could have not intended such a result.

[350] Devonshire also argues that the circumstances at the time of the creation of the agreements dictate that the liquidity payments be treated as being under a Traditional Liquidity Arrangement. The liquidity arrangements contemplated in the Special Provisions Annex were subject to daily limits as to the amount of notes that were to mature on any day. The aggregate amount of liquidity that could be requested on any day could not exceed 25% of the Initial Limit of each transaction, being $100 million for Transaction 1 and $105 million for Transaction 2, i.e. it could not exceed $51.25 million. Thus the minimum threshold of $75 million for each Transaction could never be reached on any day, and the election of Barclays had to be made by 2:30 p.m. on the day of the liquidity call. Thus, if the purpose of the threshold was to deem any

payment that was less than $75 million to be a Synthetic Liquidity Arrangement, there never could have been any Traditional Liquidity Arrangement and the deeming provision would have no purpose.

[351] Devonshire contends therefore that the only commercially reasonable meaning to be given to the provision is that the $75 million threshold was not a daily threshold, but a cumulative one. In other words, once Barclays elected to make payments by way of a Traditional Liquidity Arrangement, it had to continue to make any further funding by way of a Traditional Liquidity Arrangement until it had funded at least $75 million by way of Traditional Liquidity Arrangement. One difficulty with this argument is that the provision does not say what Devonshire contends. Also, if another market disruption event did not occur, Barclays would be in a position to require payment of the liquidity notes it acquired within 30 days and terminate the swaps, which would not be in the other noteholders interests.

[352] Barclays contends that in order to take advantage of a Traditional Liquidity Arrangement, it would have to fund at least $75 million of liquidity over several days by way of a Synthetic Liquidity Arrangement. Once the minimum of $75 million were reached, it could convert the Synthetic Liquidity Arrangement to a Traditional Liquidity Arrangement under the mechanism provided for in the provision. While that mechanism as drafted does not refer to a $75 million minimum, Barclays presumably would say that it was the intention that the minimum referenced earlier in the provision was applicable. This argument of Barclays at least has the advantage that a conversion from a Synthetic Liquidity Arrangement to a Traditional Liquidity Arrangement was specifically referred to in the provision. A requirement that once a Traditional Liquidity Arrangement for less than $75 million was elected by Barclays, further funding up to the $75 million had to be by way a Traditional Liquidity Arrangement, as argued by Devonshire, was not referred to in the provision.

[353] Like other provisions in the contractual arrangements that are at issue, the reading of this Market Disruption Support Amounts provision in the Special Provisions Annex is tortured, which does little credit to the myriad of lawyers that were involved in the drafting process.

[354] Taking all of this into account, I interpret the clause in question to mean that if Barclays elects a Traditional Liquidity Arrangement, or if Barclays is deemed to have elected a Traditional Liquidity Arrangement by not notifying Devonshire of its election, the $75 million proviso applies to prevent Barclays from acquiring liquidity notes under a Traditional Liquidity Arrangement. Thus I hold that Barclays funded the liquidity call under a Synthetic Liquidity arrangement and that it is entitled to deduct the payment of $67.3 million from the amount payable to Devonshire.

[355] Accordingly, Devonshire is entitled to receive $532,668,082 as the Base Calculation Amount as well as the Unpaid Amounts claimed[10], together with interest. If the interest cannot be agreed, the parties may make written submissions as to the appropriate interest.

[356] The measure of damages that Devonshire would be entitled to for Barclays' repudiation of the ISDA Master Agreement in the event Devonshire had no right to deliver a notice of early termination would in my view be the same as the settlement amount Devonshire is entitled to.

18. Settlement on Devonshire default

[357] In view of the fact that I have held that Barclays was in default on January 13, 2009 and that any amounts payable to Barclays on the termination are subordinated to amounts payable to Devonshire by reason of the Intercreditor Agreement, it is perhaps not necessary to consider this issue. However, in light of the arguments, I will deal with it.

[358] There are two major issues. The first is the amount of Barclays' Loss as defined by the ISDA Master Agreement. The second is the collateral Barclays is entitled to look to that is held by Devonshire, and in particular whether Barclays is limited to the $600 million posted by Devonshire as collateral at the outset of the transactions, or is also entitled to look to all of the

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[10] If Barclays' calculations of loss were accepted, Barclays acknowledges this amount to be $1,061,916.48. If as the result of this decision the parties do not agree on the proper amount of the Unpaid Amounts, further written submissions may be made.

assets of Devonshire, which including the payment of approximately $71 made by Barclays on January 13, 2009, totaling as of that date approximately $183 million.

[359] Barclays claims that it was Devonshire's default that led to the termination of the two swaps on January 13, 2009 and that the loss suffered by Barclays is $1.2 billion. Barclays sent a statement of this amount to Devonshire on January 29, 2009.

(a) Evidence of Leslie Rahl

[360] Devonshire attacks the claimed loss. It relies in part on the evidence of Leslie Rahl, who was conceded by Mr. Howard to be an expert in "the general derivates area".[11] Barclays contends, however, that much of her evidence is inadmissible, and attacks it as well on the basis that her opinion is biased. The evidence of Ms. Rahl was put in by agreement that it was subject to objection by Barclays. I was provided with written argument by both sides and it was left that a ruling on the motion by Barclays to exclude all or part of her evidence would be dealt with as part of this judgment.

[361] Admissibility of an expert's evidence is to be determined taking into account the principles enunciated in cases such as *R. v. Mohan*, [1994] 2 S.C.R. 9 and *R. v. Abbey* (2009), 97 O.R. (3d) 330. While a court should exercise a gatekeeper function, particularly if there is a jury, in my view that is of less importance in this case in which there is no jury and which, by agreement of the parties, the evidence has been heard and tested on cross-examination. See *Masters' Association of Ontario v. Ontario (A.G.),* [2001] O.J. No. 1444 (Div.Ct.).

[362] Ms. Rahl has over 30 years experience in the derivatives market in a wide range of capacities, including as a derivatives trader and manager of a $100 billion derivatives division at Citibank. She has also sat on the board of directors of ISDA and chaired the committee responsible for drafting the original 1987 ISDA Master Agreement. She has been a director of Fannie Mae and chair of its risk policy and capital committee. She currently is a director of CIBC and a member of its risk committee and a director of the International Association of Financial Engineers. She has undertaken valuations of complex structured products for special

purpose vehicles and reviewed collateralized debt obligation valuation practices for several institutional clients.

[363] Barclays contends that Ms. Rahl has interpreted the contracts in issue and impermissibly expressed legal conclusions, purported to make findings of fact on contested issues and provided opinions for which there is no foundation. I do not intend to go through all of these arguments other than to say that in my view they are overstated. The core of her evidence concerns the proper method to determine loss under the swap contracts, which in this case is to be “reasonably determined in good faith”. The experts called by Barclays, whose evidence was not challenged as inadmissible, also provided evidence of the proper method to value the loss to Barclays of the Devonshire swaps. These experts differed, as might be expected. Inevitably they dealt with contractual rights and obligations. What is “reasonable” in a complex case such as this is something that certainly can be the subject of expert evidence. In the end, of course, what the contracts in question mean is a matter for the court. To the extent the opinions of Ms. Rahl are based on any faulty legal assumptions or factual assumptions not proven, their reliability will be negatively affected.

[364] There is no basis, in my view, to attack the evidence of Ms. Rahl as biased. She was no more an advocate than were the experts called by Barclays. She gave her evidence in a professional manner and made concessions where appropriate. She stuck to her guns when she felt it appropriate to do so, which in no way could be taken to be an advocate for her client in any pejorative sense. If anything, I found Dr. Hull, Barclays lead expert, to be far more argumentative than should have been the case, to the point that his opinions must be treated carefully.

[365] It is not practicable to examine all of the various parts of the evidence of Ms. Rahl, as Barclays invites me to do, to determine admissibility. Rather, in my view, her evidence should be admitted, subject to determining what weight should be given to it.

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[11] Barclays approached Ms. Rahl to retain her for this case, not knowing she had already been retained by Devonshire.

(b) Valuation date

[366] Devonshire says that while ordinarily, if there had been no Suspension Notice or standstill, January 13, 2009 would be an appropriate date for the valuation. However, because of the Suspension Notice and the effect of the without prejudice suspension of the Default Notice contained in it, the date of valuation should be August 16, 2007, the date of the Suspension Notice. Alternatively, Devonshire says that it would be reasonable to value Barclay's loss as of November 27, 2007 or, using a discounted cash flow analysis plus risk premium, as of January 13, 2009.

[367] In this case, the default relied on by Barclays was the insolvency of Devonshire caused by its failure to pay on its notes, which Barclays claimed began the moment notes were not paid on August 13, 2007.

[368] Ms. Rahl testified that market practice on a default is to determine the economics of a transaction as of a date that is closely tied to the date of default. She noted that a party would want to terminate the transaction as quickly as possible in order to avoid being exposed to market movements where there is a risk that the counterparty may not reimburse it. She also testified that this uncertainty would make it difficult to know what kinds of hedging decisions to make. Further, she testified that large gaps between the date of default and valuation would result in this risk having to be built into the price of transactions or would change the way that banks and others currently calculate risk. In her market experience, she had never heard of any circumstances where a valuation of a swap occurred at a time not at or near the time of default.

[369] Ms. Rahl also is of the view that the effect of Suspension Notice and the seventeen month standstill severely impacted the swaps, including the effect on value of the stop-loss provision and the liquidity facility, and that to fairly value Barclays' loss, a valuation date of August 16 or November 27, 2007 would better reflect the economic circumstances of the swaps.

[370] It is undoubted that the ISDA Master Agreement does not contemplate a standstill such as seen in this case. Dr. Hull agreed that the ISDA agreements do not contemplate

a standstill, that he had never seen a standstill like this nor a calculation of loss performed with a date seventeen months after a default. He agreed that in normal circumstances a default, termination and calculation of loss would follow quickly together in time and that it makes sense to calculate loss at or near the time of default and termination. Mr. Draycott, another expert called by Barclays, said the same thing and he too had never had any experience where a termination happened seventeen months after a default.

[371] Devonshire relies on the Suspension Notice which provided that it "suspends without prejudice the effect of the Default Notice…" Devonshire contends that in order to give the without prejudice nature of the Suspension Notice some meaning, Barclays' loss should be valued as of the date of the Suspension Notice. Devonshire further contends that the requirement that the Loss determination must be made "reasonably" imposes at least one limit: if the choice of a valuation date produces an unreasonable result, then a valuation date that does produce a reasonable result must be used instead.

[372] I have difficulty with this argument. Devonshire essentially says that the reference to "without prejudice" means without harm being caused to it. Without prejudice in a legal setting has a fairly standard meaning, and it is not "without harm". If that is what was intended, it would in my opinion have taken more precise language than was used.

[373] Devonshire relies on a U.S. bankruptcy case of *In re Lehman Brothers Holdings, Inc.*, Case No. 08-13555 (JMP), Bankruptcy, SDNY, September 15, 2009 (transcript), at 99-113 [*Metavante*]. I do not think it assists Devonshire. In that case, Metavante was a counterparty with Lehman on a contract swapping fixed for floating rate interest payments. The contract was as ISDA Master Agreement. On the bankruptcy of Lehman, Metavante took the position that it did not have to continue making payments to the estate of Lehman because of section 2(a)(iii) of the ISDA Master Agreement. It was held that because of U.S. bankruptcy law, as Lehman had not decided whether to assume or reject the contract, an executor contract, Metavante was required to continue making payments. Metavante argued that the safe haven provisions of the U.S. Bankruptcy Code, which gave it the right to terminate the swap contract, did not require it to terminate. It was held, however, that while those provisions gave a party the right to terminate to

contract, it was contrary to the Bankruptcy Code to ride the market for a period of one year while taking no action. The case says nothing of whether absent the safe harbor provisions of the U.S. Bankruptcy Code, a party under an ISDA Master Agreement can or cannot sit on its hands after an event of default before delivering an early termination notice under section 6(a).

[374] While there is a reasonableness requirement involved in establishing a loss under an ISDA Master Agreement, I do not think that it is permissible on that ground to change the valuation date to a date other than as prescribed. The definition of Loss in the ISDA Master Agreement provides that a party will determine its Loss as of the relevant Early Termination Date or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably practicable. If the loss calculation is determined to be commercially unreasonable, that may require a different calculation of loss, but it would not permit the valuation date to be changed.

[375] For the purpose of determining Barclays' loss on the assumption that Devonshire was in default and Barclays was a non-defaulting party, I see no basis to ignore the contractual requirement for the valuation to be made as of January 13, 2009.

(c) Loss as of January 13, 2009

[376] As stated, the parties chose Second Method and Market Quotation to apply in the event of a default.

[377] Under the Market Quotation method, quotations are to be requested by the non-defaulting party from third-party market participants for an amount to be paid to or by such party for a transaction that would have the effect of preserving the economic equivalent of any payment or delivery that but for the early termination of the swaps would have been required after the date of termination. If fewer than three quotations are provided, it will be deemed that the Market Quotation cannot be determined. Market quotation is defined, in part, as follows:

> **"Market Quotation"** means, with respect to one or more Terminated Transactions and a party making the determination, an amount determined on the basis of quotations from Reference Market-makers. Each quotation will be for an amount, if any, that would be paid to such party (expressed as a negative number) or by such party (expressed as positive number) in consideration of an agreement

> between such party … and the quoting Reference Market-maker to enter into a transaction (the "Replacement Transaction") that would have the effect of preserving for such party the economic equivalent of any payment or delivery … by the parties … respect of such Terminated Transaction or group of Terminated Transactions that would, but for the occurrence of the relevant Early Termination Date, have been required after that date. … If more than three quotations are provided, the Market Quotation will be the arithmetic mean of the quotations, without regard to the quotations having the highest and lowest values. If exactly three such quotations are provided, the Market Quotation will be the quotation remaining after disregarding the highest and lowest quotations. For this purpose, if more than one quotation has the same highest value or lowest value, then one of such quotations shall be disregarded. If fewer than three quotations are provided, it will be deemed that the Market Quotation in respect of such Terminated Transaction or group of Terminated Transactions cannot be determined.

[378] On January 13, 2009, the date of termination, Barclays sent requests for firm quotations to four market makers in the CDS market (UBS, Deutsche Bank, Goldman Sachs and Bank of America). Only UBS responded with a quote of $2.18 billion. This was an "indicative" quotation which meant that it was not a firm or binding offer. As no quotations as required were provided to Barclays, it was deemed that the Market Quotation could not be determined.

[379] The definition of Settlement Amount provides that if Market Quotation cannot be determined or would not in the reasonable belief of the party making the termination produce a commercially reasonable result, Loss is to apply. "Loss" is defined in the ISDA Master Agreement, in part:

> "**Loss**" means, with respect to this Agreement or one or more Terminated Transactions, as the case may be, and a party, the Termination Currency Equivalent of an amount that party reasonably determines in good faith to be its total losses and costs (or gain, in which case expressed as a negative number) in connection with this Agreement or that Terminated Transaction or group of Terminated Transactions, as the case may be, including any loss of bargain, cost of funding or at the election of such party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or re-establishing any hedge or related trading position (or any gain resulting from any of them). Loss includes losses and costs (or gains) in respect of any payment or delivery required to have been made (assuming satisfaction of each applicable condition precedent) on or before the relevant Early Termination Date and not made ... A party will determine its Loss as of the relevant Early Termination Date or, if that is not reasonably practicable, as of the earliest date thereafter as is reasonably

> practicable. A party may (but need not) determine its Loss by reference to quotations of relevant rates or prices from one or more leading dealers in the relevant markets.

[380] Firth, *Derivates Law and Practice*, *supra*, states at para. 11-161 that the party calculating its loss must use commercially reasonable procedures and that the result must be commercially reasonable.

[381] Mr. Lee was responsible for the calculation of the "Loss", the amount which Barclays claims is its damages. He testified that Barclays proxied the Market Quotation process which he described as an attempt to find what the replacement cost was, assuming Barclays stood in the place of one of the dealers that it asked to bid. The valuation date was January 13, 2009, the early termination date.

[382] The definition of Loss in the ISDA Master Agreement states that it is an amount that the party "reasonably determines in good faith to be its total losses". In this case, it appears that the Barclays lawyers had considerable influence in how the loss was to be calculated. On cross-examination, Mr. Lee said this was the first time he had done a loss calculation under the Loss definition. He was asked why he calculated the loss as he did. He said he did not recall and then said "This was in concert with legal. We had ongoing discussions as to how to run the process and I followed their lead". If legally the method used by Barclays was required, little harm was done. But if not, in these circumstances, where the lead was taken by lawyers rather than commercial actors in the market, considerable caution must be placed on any argument that so long as Barclays considered its loss calculation to be reasonable, that should be accepted.

[383] As seen, the definition of Market Quotation is an amount to be paid to or by the party seeking the quotations that would have the effect of preserving for such party the economic equivalent of any payment or delivery in respect of the terminated swap that but for the early termination, would have been required after that date. In the case of Barclays and Devonshire, had the swaps not been terminated, the only payments that would have been required were the monthly premiums to be paid by Barclays to Devonshire for the credit protection of the underlying synthetic bond portfolio. The liquidity protection for which Devonshire paid monthly premiums to Barclays had terminated. At the time the swap contracts were made, it was not

expected that there would be any defaults in the underlying bonds that would require payments during the life of the contracts from Devonshire to Barclays. This is because the swaps were "super senior" swaps in which the credit protection was for the tranche of losses that had an attachment point of 15 % for the first transaction and 16% for the second. Even at the date of the early termination, it was not expected that there would be any future material loss in the underlying bond portfolio that would give rise to any payments from Devonshire to Barclays. There would also have been delivery of collateral required to be made by Devonshire in the event that Barclays' mark to market figures increased in the future, or a reduction in the event that they decreased.

[384] The theory of whether there would be a loss or gain on early termination depended on whether, in the language of the market, the swaps were "in the money" or "out of the money" to a party. In this case whether Barclays was in or out of the money on the swaps at any time depended on the amount it was paying to Devonshire for credit protection. The amount that is paid for credit protection at any time in the market depends upon the market's view of risk of loss in the bond portfolio against which the protection is bought. Under the swap contracts between Barclays and Devonshire, Barclays was paying 61 basis points on a notional amount of protection of $6 billion worth of bonds.

[385] If the market's appetite for risk increased at a later date, narrowing market spreads, the market price for protection on those bonds would decrease below 61 basis points and Devonshire would be said to be in the money as against Barclays as it would be receiving more than the market would have required on a new contract. Barclays would gain on an early termination at that time as it no longer would have to pay more than the market price for the protection, and this gain would be measured by the amount someone would have to pay to Barclays to take over Devonshire's position. On the other hand, if the market's appetite for risk decreased at a later date, and margins widened, as dramatically happened because of the market turmoil by the time of the early termination in this case, the market price for protection on the bonds would have increased above the 61 basis points that Barclays was paying, and Barclays would be said to be in the money as it would be paying less than what the market would have required on a new contract at that time. The value of Barclays's loss caused by the early

termination would be the amount someone would have to be paid by Barclays to replace Devonshire.

[386] Of the $1.2 billion claimed as a loss, $1.02 billion represents what Mr. Lee said was the market value of the two swaps (not including the risk on the ABS portfolio of the underlying portfolio) based on a model used by Barclays. The balance consists of various theoretical incremental hedge costs that would have been made, assuming Barclays was starting from a clean plate, i.e. starting a new swap agreement with a new party.

[387] The value of $1.02 billion was obtained from a proprietary model developed by Barclays which it used on a daily basis to obtain what it calls a mark to market value of its various trading positions. This model is of a type that was referred to by the experts as a Gaussian copula model. Inputs to the model were made daily by Barclays traders. Mr. Lee testified that the mark to market derived from the model is a representation of the market value of a derivative at a point in time. It calculated the market value by using mid-market values that did not include a risk premium for the trade.

[388] A further $185 million of the claimed Loss related to hypothetical hedging costs that the Barclays model recommended for the replacement trade. The hedges were credit default swap hedges, to reflect the "offer side" price Barclays would have to pay above the mid-market mark to market value derived from the Barclays model, interest rate hedges, foreign-exchange hedges, correlation hedging and a charge referred to as a "quanto" charge. The final $13.7 million of the claimed Loss represented the hypothetical replacement cost of credit protection on the underlying ABS portfolio.

[389] Thus, Barclays calculated its loss caused by the early termination to be what it said was the market value of the swaps of $1.02 billion, based on its model that it uses, plus theoretical hedging costs for a total of $1.2 billion.

[390] Mr. Lee’s calculation of loss was supported by Dr. Hull, who is a professor of derivatives and risk management at U of T’s Joseph L. Rotman School of Management. He used different models, looked at various indexes and information and concluded that Barclays’s

valuation of the bond portfolio protection was reasonable. He valued the ABS protection and the incremental hedging costs at a little less than Barclays, saying his assumptions were conservative, and concluded that the amount due to Barclays was $1.082 billion. He opined that Barclays followed the required procedures and that its estimate of loss of $1.2 billion was reasonable.

[391] Barclays' method of calculating its loss was also supported by Mr. Anthony Draycott who at one time was a derivatives trader and since 2007 has been a consultant involved in residential mortgage backed securities and exposures created as a result of synthetic exposures to residential mortgage backed securities. Mr. Draycott has no experience in transacting leveraged super senior derivative credit transactions. His opinion is that the only appropriate way to value a loss given the default of a counterparty is to estimate the cost of replacing the contract and that financial institutions would do that only by using mark to market models like that used by Barclays.

[392] Professor Hull stated, and Ms. Rahl agrees, that assets can be valued in two broad ways: (1) using the valuations of related assets; or (2) estimating expected cash flows and discounting them to the present. They agree that market practice is normally to use the first approach, and in particular, by the use of a Gaussian copula model. Ms. Rahl refers to this as a mark to model method. Dr. Hull refers to it as a mark to market model. Mr. Draycott says that the only way to value the contract in question here is to use a mark to market model.

[393] In this case, for several reasons, Ms. Rahl's opinion is that a mark to model method of calculating loss as of January 13, 2009 does not lead to a commercially reasonable valuation and that a discounted cash flow valuation is more reasonable. The key difference between the experts is whether, in the circumstances of this case, a mark to model or cash flow-based valuation is justifiable as of January 13, 2009.

[394] Barclays relies heavily on statements in U.K. cases to the effect that the Market Quotation measure and the Loss measure are intended to lead to broadly the same result, and argues that therefore a proxy for the Market Quotation method of calculating the settlement amount should be used.

[395] In *Peregrine Fixed Income Limited (in liquidation) v. Robinson Department Store Public Company Limited plc.* [2000] Lloyd's Rep. Bank. 304 (Q.B.)(Commercial Div.), the issue was the gain that had to be paid by the non-defaulting party Robinson to the defaulting party Peregrine under an interest rate swap contract for the future payments that Robinson was relieved of as a result of the termination of the contract due to Peregrine having gone into liquidation which under the contract automatically terminated the contract. The defaulting party had already performed the whole of its side of the bargain. The present value of future payments that would have been paid by Robinson to Peregrine but for the termination was $87 million, whereas the quotations obtained under Market Quotation was only $9.5 million, the reason being that Robinson was also under financial stress and the market considered its risk of default to be high and thus substantially discounted what it would have to pay to take over the payments to be made by Robinson. Moore-Brick J. concluded that the Market Quotation method did not produce a commercially reasonable result and that the gain was to be calculated using the Loss method.

[396] In the course of his reasons, Moore-Brick J. accepted submissions from Peregrine that his reading of the ISDA Master Agreement indicated that the Market Quotation measure and the Loss measure were intended to lead to broadly the same result. He stated:

> Loss is defined in terms which make it clear that loss of bargain is one of the principal heads of damage intended to be covered and both Section 6(e)(i)(3) and Section 6(e)(iv) indicate that the Market Quotation measure and the Loss measure are intended to lead to broadly the same result.

[397] Section 6(e)(i)(3) does not deal with this issue. I am not sure that it can be said that section 6(e)(iv) leads to the categorical statement that the two measures are intended to lead to broadly the same result, such that as claimed by Barclays, the Loss method must calculate loss by using a proxy for the Market Quotation method. Section 6(e)(iv) was inserted to prevent an argument that the Market Quotation method was not to be a penalty. It provides:

> (iv) **Pre-Estimate**. The parties agree that if Market Quotation applies an amount recoverable under this Section 6(e) is a reasonable pre-estimate of loss and not a penalty. Such amount is payable for the loss of bargain and the loss of protection against future risks and except as otherwise provided in this Agreement neither party will be entitled to recover any additional damages as a consequence of such losses.

[398] If the Loss method required the loss to be calculated by using a proxy for the Market Quotation method, as contended by Barclays, one would have expected there would have been a similar clause dealing with the Loss method to prevent an argument that it too was a penalty. There is no such clause. This is understandable as the definition of Loss, unlike the definition of Market Quotation, does not prescribe any method to calculate Loss other than it must be reasonable. It deals with heads of loss.

[399] Professor Hull testified on cross-examination that he always assumed that the Loss method was a proxy for the Market Quotation method, but was reluctant to say that the definition of Loss directed that as he said he was not an expert at reading legal documents and legal definitions. When pressed, he said he would rely on the last sentence of the definition. That sentence, however, makes clear that unlike the Market Quotation method, a party in determining its loss under the Loss method need not use quotations from leading dealers in the market. Ms. Rahl too testified on cross-examination that the practice and expectation is that Loss is a proxy for Market Quotation and that in normal circumstances one would expect that they would normally arrive at similar results. Her evidence was for several reasons the circumstances were not normal.

[400] While it may be understandable in a legal context to say that the two measures are intended to lead to broadly the same result in a case such as the case before Moore-Brick J. in *Peregrine* in which the Market Quotation method led to three firm bids being received, and to conclude that the bids from the Market Quotation method led to a commercially unreasonable result as opposed to the Loss method, the case said nothing about how the Loss calculation should be made. The figure for Loss was agreed, being the present value of the future stream of payments that would not have to be made by Robinson because of the default of Peregrine. That method of valuation of Loss was not at all an attempt to use some model to proxy the Market Quotation method of valuing the gain.

[401] I have difficulty with unequivocal statements such as that made by Gloster J. in *Pioneer Freight Futures Company Ltd. (in liquidation) v. TMT Asia Ltd.*, [2011] EWHC 778 (Comm.) that it is plain that Market Quotation and Loss purport to broadly achieve the same

result. There is little in the inch thick book of "Key Agreements" before me that can be said to be plain. The definitions of Market Quotation and Loss are quite different and to say that they are intended to lead to the same result because the word "bargain" is contained in the no penalty provision for Market Quotation and also in the definition of Loss is to my mind too simplistic.

[402] For the Market Quotation method to work requires clearly that there be a liquid market in the particular swap product. Parties to the ISDA Master Agreement who choose the Market Quotation method, such as Barclays and Devonshire, agree that on the termination of a contract, settlement will be made on the basis of what the liquid market tells them is the amount needed to replace the economic equivalent of any payment and delivery that would have been required to be made but for the termination. But if there is no liquid market for the swaps, as was the case as no firm bid was available, does it follow that the contract means that the loss as defined in Loss is to achieve the same broad result as Market Quotation and that a proxy for Market Quotation is therefore to be used? How could one necessarily know what that broad result of Market Quotation was? If there were evidence of a market for the swaps, such as say two bids having been received, if might be possible to say that the two methods were intended to lead to the same result, but if not, how can one be so sanguine as to say that they were.

[403] It may be just as commercially logical to think that the contract was meant to say that if there is a market price for the particular swap identified by leading market makers, settlement will be made on the basis of that market price. However, if a market price cannot be identified, the parties are left to determine the settlement amount by looking at the actual commercially reasonable loss or gain incurred. It makes little sense, in my view, for a party to say that there is no identifiable market price, because no one will make a firm bid, i.e. there is no market for the swap, and so we will use some construct to come up with a price as if there were a market and call that construct the market value of our loss. That would be making an assumption that there is a functioning market, and if there is no functioning market, I see no basis to construct one. The definition of Loss certainly does not indicate that in its language.

[404] What principles should be used in determining Loss? The ISDA Master Agreement defines Loss, and it is that definition which governs.

[405] Assuming that Barclays was entitled to terminate the swap contracts, its loss of bargain on early termination would be the value to Barclays of the contracts at the time of the termination. If the Market Quotation method could be used and at least three quotations were received, what the value of the terminated swaps was would be easily determinable.

[406] Without a Market Quotation determination, as in this case, Barclays in my view must establish on a balance of probabilities that the market in fact would have been prepared to enter into a transaction to replace Devonshire on its swap contracts on the terms asserted by Barclays in its claim for Loss in this case. If Barclays is unable to establish that, then Loss must be determined on some other basis.

[407] The construct of the $1.2 billion claim was based on a Gaussian copula model utilized by Barclays. How that model works and what goes into it is, to say the least, quite complex. That is clear from the reports of Professor Hall and Ms. Rahl. The dollar figure that Barclays derived from its model does not seem to be seriously in dispute as a figure derived from a model based approach. Professor Hull and Ms. Rahl each did a model analysis and both concluded that Barclays' figure was reasonable. Ms. Rahl, of course, did not think that a model analysis was appropriate if the valuation date was to be January 13, 2009. If a Gaussian copula model approach is accepted as the right method to value, no one can seriously quarrel with Barclays' number.

[408] However, the fact that a model can be used to derive a price for a transaction for which there is no actual market price available, as in the case of Devonshire, does not necessarily mean that it is the price that the swaps in question would trade for in the market, particularly when we know that the swaps in question did not attract a firm bid in the market at the time. I do not accept the assertion of Mr. Lee that there was a market for the Devonshire swap contracts. No firm bids were received.

[409] I accept Ms. Rahl's evidence that the market for products such as the Devonshire swaps was a highly illiquid market. Professor Hull's evidence was that he had not done any analysis of whether there was liquidity for this product and he was not sure if it was liquid or not.

[410] Mr. Lee did say that the inputs for the Barclays model were readily observable throughout 2008 and 2009, but on the evidence before me the fact that single name CDS or indexes of tranche risks traded does not necessarily mean that the indicated value that the model threw out was a value at which the Devonshire swaps would have traded on January 13, 2009. In this regard, Mr. Lee admitted that the Barclays model did not take into account the fact that the Devonshire swaps had triggers giving Barclays the right to make calls for more collateral. The triggers for collateral calls in the Devonshire swaps as negotiated in 2006 were triggers that the Devonshire investors such as the Caisse were no longer prepared to accept in the restructuring negotiations. Mr. Lee also admitted that the model did not take into account the fact that the Devonshire swaps were non-recourse, a feature he admitted would be relevant to someone wanting to step into the shoes of Devonshire. He admitted that someone such as UBS would want to be paid more if the swap were full recourse than if it were non-recourse. He also admitted that the model did not take into account the stop-loss feature that permitted Devonshire to terminate the swaps if a collateral call were made, although he questioned the value of that as Barclays could also terminate the swaps if a collateral call was not met by Devonshire.

[411] Ms. Rahl's opinion is that although Barclays' loss calculation methodology could be considered mathematically accurate in evaluating a standalone collateralized swap obligation, it does not value the transaction with all of the features laid out in the transaction documentation. In this I agree and accept her view to the extent of Mr. Lee's admissions as to what was not included in the Barclays' model.

[412] It is one thing to say that using a Gaussian copula model is standard market practice to value a trade, as Mr. Lee, Professor Hull and Mr. Draycott said, but that does not necessarily make it appropriate in all circumstances.[12] Professor Hull did not say he had seen

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[12] In his opening, Mr. Howard said that it is Barclays' contention that the parties were contractually required to value the trades at any point in time by using the Barclays model when determining if the market had moved to the point that collateral calls were triggered that would require Devonshire to post more collateral and that this contractual provision required the model to be used to value the trade on an early termination. This argument was not made in Barclays' written or oral submissions at the end of the case. The provision in question is contained in an annex to the ISDA Master Agreement called the Seller CSA, dealing with collateral calls, in which Exposure is defined as the amount that would be payable to Barclays as determined by Barclays in its sole discretion using its proprietary correlation model. My reading of the documents is that while Devonshire agreed to the use of Barclays' model for the purposes of determining whether collateral calls could be made, that provision did not purport to say

such a model used to value a synthetic swap contract for determining Loss in circumstances in which it was not possible to use the Market Quotation because no bids were received, nor did he say that he had seen it used during an illiquid market.

[413] Mr. Draycott's report was to the effect that a market maker such as Barclays values its contracts on a periodic basis using a mark to market model. He said that market makers assemble portfolios of derivative transactions with offsetting market risks in order to avoid creating an aggregate P & L that is exposed to market risk. The methodology used to value these transactions is a mark to market model. What Mr. Draycott was talking about was the method of calculating the value of contracts during their currency, and not when there has been a termination and not in circumstances of a highly illiquid market. His report said that he understood, which I took him to mean that he did not have firsthand experience, that the purpose of a valuation caused by the event of default was to determine the actual, or estimated cost to the non-defaulting party of replacing the terminated derivative transaction. On his cross-examination he said that default of a derivative counterparty is an extremely rare occurrence and that there have been very few in history. He said he had done dozens of valuations of a derivative product on voluntary terminations, but what those were or in what circumstances was not said.

[414] Mr. Draycott said in his report that there was a market for the Devonshire swap contracts on January 13, 2009. He also said that although there were few trades in bespoke tranches similar to the Devonshire swaps in January 2009, it was possible to observe market inputs. He relied on the bid from USB. He did not realize at the time of his report that the bid was not a firm bid and acknowledged his error on cross-examination. He also relied on the fact that Barclays bought some of the Devonshire notes from noteholders in 2008 at prices he said were determined by a valuation of the transactions in place between Barclays and Devonshire. On cross-examination, he said that was based on an assumption that the parties would have based the price on what the transaction was worth. He acknowledged that he did not take into account what else the parties might have been considering, such as whether there was any value to

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that the model had to be used to value the swaps in the event of early termination. To have done so would have been inconsistent with the direction that Market Quotation was to be used if possible.

National Bank settling over what value may have been in the notes. In my view Mr. Draycott was overreaching in his statements that there was a market for the Devonshire swaps in January, 2009 and that there were observable market inputs. Mr. Draycott was not a trader in the market at that time and had no experience with swaps such as the Devonshire swap contracts. I do not accept his evidence that there was such a market or observable inputs.

[415] In this case, the ABCP market in January 2009 had been frozen and in turmoil for seventeen months and the collapse of Lehman Brothers and other financial institutions had caused the worst financial crisis in the market in 2008 since at least the 1930s. The terms of the Montreal Accord restructuring twice had to be changed in the latter part of December 2008. It is hardly surprising that no firm bid to replace Devonshire in the swap contracts that it had with Barclays was received. It is clear that the market did not have an appetite for it.

[416] The Caisse, the largest investor in the Canadian ABCP market, was no longer prepared in January 2009 to accept the original 2006 Devonshire trade terms. The Caisse, like other investors in the Montreal Accord restructuring, demanded a moratorium on collateral calls for 18 months, a cap on collateral calls that could be made afterwards and a change in the trigger for collateral calls from mark to market to spread/loss triggers, which Barclays did not want. If the Caisse would no longer live with the 2006 terms of the Devonshire swaps, it is unlikely that any other investor would have agreed to those terms. The lack of any firm bid in January 2009 when Barclays sought firm bids from four leading market dealers was an indication of that.

[417] While under the Barclays valuation scenario, $1.02 billion would be paid to an investor replacing Devonshire, the investor would be required to post $600 million collateral as Devonshire had done at the outset, and also post an additional $900 million collateral. This was because of the increase in Barclays's mark to market figures that had occurred by January 13, 2009 and the increase of the trigger point to 16.5%. If those figures increased, further collateral would have to be posted by the new investor.

[418] Barclays contends that an investor would have been prepared to post $1.5 billion in collateral, just as Devonshire did in 2006 by putting up $600 million in collateral. If that occurred, and if the marks continued to increase after January 13, 2009 due to the market

upheaval and uncertainty at the time, the replacement investor would be obliged to post more of its own money as collateral. Selling notes to other investors by the new investor to raise money to meet the increasing collateral calls would in all likelihood not have been available as an option to the new investor. The sophisticated investors in the Devonshire notes would not accept the terms of the original swaps and it is unlikely anyone else would either. The market upheavals of 2008 in particular made such terms unmarketable, as became clear to Barclays in its negotiations with the Caisse in 2008. If other investors would not be prepared to accept such terms, why would a new investor dealing directly with Barclays be any different? If a collateral call made by Barclays was not met, Barclays would be in a position to terminate the swaps and claim a loss that if accepted, might eat up the collateral already posted by the new investor. There is certainly no evidence at all that any replacement investor would likely be ready to put up $1.5 billion in collateral in the market as it existed in January 13, 2009, and accept such a risk, even if it received $1.02 billion up front. The money up front was not for the purpose of the investor having money available for collateral calls, but to compensate for the lower basis points it would receive rather than what Barclays mark to market figures said should be earned.

[419] In his evidence, Mr. Lee said that if a bidder such as UBS had said they would step into Devonshire's shoes for a payment of $850 million, Barclays would have accepted the bid. However, there is no evidence at all that UBS or any other investor would have been prepared to post $1.5 billion in collateral with an upfront payment of $850 million. The "indicative" or non-binding bid from UBS was for a payment of $2.18 billion to be paid to UBS, and Professor Hull agreed that it was not a commercially reasonable bid from Barclays' point of view either. His view, understandably, was that Barclays would not want to run the risk that the trigger point for a collateral call might move from 16.5%, where it was at on January 13, 2009, to 17% and see UBS refuse to put up more collateral and keep the difference between the $2.18 billion paid to it and the $1.5 billion in collateral it had put up.

[420] Barclays points to evidence given by the Ms. Rahl on her cross-examination that in the absence of the standstill agreement, she would have probably done what Mr. Lee and Professor Hull had done. Her view, however, was that the standstill had economic consequences, including having to value the Devonshire swaps on January 13, 2009 in highly illiquid times.

[421] Barclays also points to Ms. Rahl's evidence that in order to purchase equivalent protection in January 13, 2009, Barclays would have had to pay over $1 billion on an unsecured basis. That is not evidence, in the context of her evidence as a whole, that she was of the view that such a contract would be made. Her evidence was to the opposite effect. Her view was that on the construct of the Devonshire swap contract terms, a replacement investor would receive $1 billion and be required to initially post $600 million. It would then be obliged to pay a further $900 million in collateral because of the movement in the mark to market figures. The request for firm bids by Barclays provided for this additional amount to be paid "immediately on the effectiveness of the Transactions". If it failed to post the further $900 million, Barclays would have lost the difference between the $1 billion it paid out and the $600 million it received in collateral. Her view was that Barclays would never make such a deal. She was not challenged on this. Even if, as Barclays contended in argument, it would never have closed the replacement trade with a new investor unless the total $1.5 billion were paid by the investor on closing, there was no evidence from Ms. Rahl or anyone else that such a replacement trade was likely to occur.

[422] In my view, Barclays has not established that the model that it used valued the Devonshire swaps with its conditions as they existed from the time the swaps were agreed in 2006. What a different model might have calculated is of course not before me.

[423] Nor am I satisfied that Barclays has established on a balance of probabilities that its claimed loss of $1.2 billion is a value that the market in fact would have placed on the Devonshire swaps and that its loss calculation is commercially reasonable. While its model indicated that its Devonshire swaps were in the money, and that their value was $1.2 billion, the evidence does not support such a real value. It is an artificial construct. Barclays has not established that the swaps had the replacement value it claims they had at the time it decided to terminate the Devonshire swaps in January, 2009.

[424] What then is the measure of Barclays' loss on this transaction?[13] One is driven to consider the cash flow analysis of Ms. Rahl.

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[13] Barclays led evidence from Ms. Franke, a director in its product control group in London as to the accounting treatment of the Devonshire swaps in its books. Barclays acknowledges that her evidence is not relevant to the

[425] Ms. Rahl's opinion was that the most appropriate method was to determine Barclays loss based on the actual and real-world projected losses of the underlying synthetic portfolio over the remaining life of the trades had they remained in place. She calculated the loss to Barclays using a cash flow analysis. Her reasons for using a cash flow analysis rather than using a mark to model method of calculating the loss were severely criticized as being contrary to market practice. She acknowledged that the usual practice was to use a mark to market model, and said but for the standstill agreement and its adverse economic effect on what would have been the normal way the Devonshire trades worked she would likely have done the same thing.

[426] Ms. Rahl used models of the kind that are ordinarily used by market participants in structured finance to project cash flows and by investors to decide whether to buy or sell trades as these models provide what she referred to as a real-world estimate of loss. This method differs from using implied estimates taken from market data that contain market perception driven risk premiums. She used models developed by Standard & Poor's and Moody's Investor Services to predict losses on the underlying portfolio of bonds. She did this analyzing the Devonshire II portfolio as it was the riskier of the two. She concluded that the expected losses over the life of the trade that would exceed the attachment point for the trades, given expected defaults as of January 13, 2009, was $12,347. Professor Hull agreed that rating agencies such as Moody's use of historical data to reach a conclusion of expected losses was a recognized way of calculating real world financial losses. Mr. Draycott does not dispute that Ms. Rahl used the rating agencies' models as they intended them to be used, but he like Professor Hull disputed their relevance.

[427] I accept Ms. Rahl's opinion that these models are used by market participants as she described. I also accept Ms. Rahl's evidence that during the period in question many financial institutions used credit loss projections for mortgage backed securities, collateralized debt obligations and other structured products because the variance between fundamental analyses and market quotes diverged so dramatically as market quotes reflected an illiquid or dislocated market.

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calculation of the Settlement amount, and I do not take it into account. The accounting treatment cannot establish what the Barclays loss was.

[428] Ms. Rahl then added to her de minimus figure of $12,347 a risk premium. Her evidence was that market spreads for a credit default swap imply a loss that is generally much higher than the real-world loss market participants would actually expect. She said that the difference between the real-world estimate of loss and the market implied estimate of loss is the market risk premium. Her opinion was that the events of late 2008 and early 2009 resulted in extraordinarily high and temporary risk premiums that did not reflect the likely losses in the future. She therefore used which she referred to as a "normalized" risk premium, which she derived by averaging the risk premiums in the CDS markets in August and November 2007. She also looked forward to the risk premium in the CDS market in April 2010 and determined that it was at the same level as her average of August and November 2007. Assuming that using a normalized risk premium is appropriate, I do not see anything wrong with looking at what happened after January 13, 2009 if it is used to consider the reasonableness of the assumptions that she made in using data prior to that date. It would not be appropriate to use it as a hind sight basis for her opinion, and I think it can be fairly said that she did not do so.

[429] The risk premiums that Ms. Rahl derived in August and November 2007, and also in January 2009, were taken from mark to model valuations of the Devonshire II underlying bond portfolio. These valuations valued the swaps in August 2007 at $107 million, in November 2007 at $157 million and in January 2009 at $544 million. By subtracting the expected cash flow losses of nil in August and November, 2007 and $12,347 in January, 2009, she calculated the risk premiums at $109 million in August 2007, $157 million in November 2007 and $544 million in January 2009. She averaged the August and November 2007 figures to “normalize’ the risk premiums to get a risk premium of $132 million for the Devonshire II portfolio, as compared to the risk premium for that portfolio in January 2009 of $544 million. She then assumed the risk premium for the Devonshire I portfolio would be no higher and likely lower than Devonshire II as it was a slightly less risky portfolio, and used a normalized risk premium for it using the Devonshire II risk premium of $132 million. The total risk premium she calculated was therefore $264 million.

[430] Ms Rahl then added this total normalized risk premium of $264 million to the expected cash flow loss above the attachment point of $12,347 to get a total loss of $264 million.

[431] I have some difficulty with this theory. If a reasonable forecast on a cash flow basis of what Barclays has lost by the termination of the swaps is the key, I do not understand why the loss is not the present value of the expected loss of $12,347. Dr. Hull agrees that the alternative cash flow method of valuing an asset is to estimate the cash flow and then discount that cash flow at an appropriate discount rate. He said nothing of adding some risk premium. Ms. Rahl herself said in her report that one could argue that the cash flow projection is the loss. She went on to say, however, that to be conservative, she would add a normalized risk premium to the cash flow.

[432] However, the theory of what Barclays' actual loss is would not lead one to add a risk premium to an expected cash flow loss, based on a mark to model basis, which Ms. Rahl says is not an appropriate way to value in January 2009, let alone a premium of $264 million on $12,347. I do not understand the conceptual basis for doing so. In my view, the loss to Barclays is the present value of $12,347, which I will call $12,000 dollars as it is not known when the expected losses of the underlying portfolio would exceed the attachment points of 16 and 15 % on the two swaps.

[433] If Barclays had incurred costs in closing hedges as a result of the early termination, it would be entitled to those costs. However it led no evidence of such costs.

[434] It was Ms. Rahl's view that there should be deducted from the amount of the Barclays loss the liquidity payments that she says would have been made if Barclays had not breached its obligations in July 2007 and made the liquidity payments requested by Devonshire. Her view is that the full amount of the liquidity line would have been demanded and paid by November, 2007 because of the market conditions, and this amount should be deducted from whatever Barclays' loss is calculated to be. I would not make such a deduction. The loss of Barclays is calculated as of January 13, 2009 on the assumption it was entitled to terminate the swaps on that day, and by then the liquidity facility had expired. I understand Ms. Rahl's opinion that the standstill agreement changed the dynamics of the swaps as contracted for, which no one questions, but that was agreed. I would not make the deduction.

(d) Mitigation issues

[435] In light of my decision on the quantum of Barclays' loss, these issues are of little importance. However as they were fully argued and evidence was led, I will deal with them.

[436] Devonshire takes the position that Barclays had an obligation to mitigate its loss and that there were losses that Barclays could reasonably have avoided by taking appropriate hedging strategies in 2007 to avoid any losses above the collateral that was pledged by Devonshire to Barclays. It says that in a determination of Loss, the ISDA Master Agreement contemplates a measure of damages precisely mirroring the ordinary common law damages payment. Loss is defined to include:

> an amount that party reasonably determines in good faith to be its <u>total losses and costs … including any loss of bargain</u>, cost of funding or, at the election of such party but without duplication, loss or cost incurred as a result of its terminating, liquidating, obtaining or re-establishing any hedge or related trading position…

[437] Devonshire says that compensating a contracting party for the loss of bargain on the termination of a contract is precisely what the common law measure of damages is meant to achieve. S.M. Waddams, *The Law of Contracts*, states at paras. 698-699 that loss of bargain is the fundamental expectation measure of damages in contract law: the party is placed back in the place they would have been had the contract been performed.

[438] Firth, *supra*, at para. 11.140 dealing with Loss states:

> The contractual measure of damages applies for this purpose, i.e. the objective is to ascertain what amount is necessary to put that party in the position it would have been in if the terminated transactions had been fully performed.

[439] The obligation to act reasonably to avoid loss is often referred to as a duty to mitigate. It is a corollary to the requirement that the party claiming damages cannot be compensated for a loss that it could reasonably have avoided. At common law, loss that could reasonably be avoided cannot be regarded as having been caused by the breach. In case of doubt, the plaintiff will usually receive the benefit, because it does not lie in the mouth of the defendant to be overly critical of good faith attempts by the plaintiff to avoid difficulty caused by the

defendants wrong. See S.M. Waddams, *supra*, at para. 15.140 and *Koch Marine Inc. v. D'Amica Societa di Navigazione A.R.L. (the "Elena d'Amico")* [1980] 1 Lloyd's Rep 75 at p. 89 (QB per Robert Goff J.)

[440] Firth, *supra*, further states at para. 11.148:

> The determining party's duty to act reasonably and in good faith probably means that the Loss must be determined on the assumption that the determining party has taken reasonable steps to minimise any costs or losses it suffers as a result of the termination of the transactions. Equally, if the determining party has actually avoided such costs or losses, this probably has to be reflected in the computation, even if the steps it took went beyond what was reasonably required. Such an approach is similar to the common law rules on mitigation to the assessment of damages for breach of contract.

[441] Barclays points to the provision in the Second Method and Market Quotation provisions that the parties chose which provides for a settlement of amounts owing by the defaulting party to the non-defaulting party and vice versa, and asserts that the common law of damages plays no part. It relies on dictum of Moore-Bick J. in *Peregrine,* approved by Flaux J. in *Britannia Bulk* that the fact that a non-defaulting party must account to the defaulting party for any gain clearly deprives an event of default of most of its characteristics as a breach of contract. Barclays also refers to a comment by Flaux J. that it is a misconception to seek to equate the Loss provision with what the position would be if the non-defaulting party had a claim for damages at common law.

[442] I agree with Barclays to the extent that the ISDA Master Agreement contemplates payments by a non-defaulting party to a defaulting party, the common law position that only the party that breaches a contract is liable to pay has been modified by contract. But that does not, in my view, necessarily mean that common law contractual principles are entirely abrogated.

[443] Barclays also contends that the parties expressly contracted out of the necessity of mitigation. It relies on two provisions of the Amended and Restated Master Credit Derivatives Confirmation Agreement and its Annex 1. The first provides:

> Barclays Bank PLC does not guarantee the performance of or otherwise stand behind the reference entities or reference obligations referred to herein and is under no obligation to make good losses suffered as a result of credit events with respect to any such reference entity or reference obligation. Barclays Bank PLC is not required to hold any reference obligations and no inference may be drawn from this document that Barclays Bank PLC holds any such reference obligations or has any credit exposure to any reference entity. Devonshire acknowledges and agrees to the foregoing.

[444] The second provides:

> The parties confirm that no Transaction is intended to be and no Transaction constitutes a contract of surety, insurance, guarantee or indemnity. The parties acknowledge that <u>the payments to be made by the Seller</u> [Devonshire] will be made independently and are not conditional upon the Buyer [Barclays] sustaining or being exposed to risk or loss and that the rights and obligations of the parties hereunder <u>are not dependent upon the Buyer</u> owning or having any legal, equitable or other interest in the Reference Obligations <u>or mitigating any actual loss suffered</u>. (underlining added)

[445] I do not see the first clause as having anything to do with mitigation. It and the second clause are part of the structure of the “synthetic” nature of the credit default swaps, in which Barclays has no ownership interest in the underlying portfolio in which it is buying credit protection. The “payments” referred to in the second clause are clearly payments to be made by Devonshire to Barclays on the happening of Credit Events, i.e. when losses on the underlying portfolios reach the attachment point and credit protection payments become due. The reference to Barclays not having to mitigate any actual losses suffered can only be in reference to those payments and to losses suffered on the underlying bond or ABS portfolio that gives rise to the credit protection payment. It has nothing to do with the measure of Loss in the ISDA Master Agreement.

[446] Barclays also asserts that a duty to mitigate arises only on a breach, and that the breach here was on January 13, 2009. Thus there could be no obligation to mitigate before then. In this case, however, the breach relied on was the insolvency of Devonshire, which Barclays pleaded began on August 13, 3007 when notes that were not rolling became due. Barclays cannot

resile from that pleading. The fact that Barclays waited until January 13, 2009 to declare a default would not preclude any duty to mitigate in the face of an earlier breach.

[447] Hedging is a technique employed by market practitioners to neutralize the risks of a particular trade. Devonshire relies on the evidence of Ms. Rahl that a prudent manager of a CDS trading desk would have frozen the Devonshire trade as an economic hedge as of August, 2007. She testified that once the standstill came into place in August 2007, Barclays should have unwound or bought back trades that amounted to hedges on the Devonshire CDS protection in excess of the collateral. This would have had the economic effect for Barclays of it not facing any exposure above the capped amount regardless of the resolution of the standstill situation.

[448] Ms. Rahl further testified that even if the hedges had not been frozen at the amount in August 2007, in light of the stop loss provision, at the very least Barclays should have capped the trade once the atop loss trigger was hit in November 2007. The 5% trigger had been breached by then and Barclays had clearly not been able, and was not entitled under the Montreal Accord, to receive any additional collateral.

[449] On his cross-examination, Mr. Draycott agreed that it would be prudent for a trader to adjust his hedges if he had an expectation that the mark-to-market might not be recovered on a default.

[450] Devonshire asserts that Barclays should have realized at the latest by November 27, 2009 that it would have no access to more collateral and that it should have protected itself from losses higher than the collateral it had access to by appropriate hedging. Barclays should have recognized that with a built-in recourse cap, the trade could not possibly be worth more than that to Barclays and, as a result, its reasonable good faith estimate of loss could not have exceeded the collateral.

[451] Barclays contends that because of the way it ran its hedging, it would not be possible to isolate hedges related to Devonshire and deal with them individually. Mr. Lee testified that Devonshire was hedged throughout as part of a bespoke correlation book that

contained approximately 500 bespoke tranche trades, 50,000 single name CDS trades, and several hundred interest rate and currency swaps all together having a $200 billion notional size.

[452] Although the trade was viewed by Barclays' personnel as non-recourse, it did not initially book it as such. Barclays' internal trade approval noted that the trade was to be booked as a full-recourse CSO and that this was "viewed as acceptable without adjustment under current market conditions", but that if a collateral call trigger was likely "an adjustment to these sensitivities may be deemed necessary to account for the impact of the non-recourse feature." That trade approval made the "maintenance of daily sensitivity adjustments in this situation … a condition for approval."

[453] Ms. Rahl testified that she understood this trade approval to mean that a trader may have to reduce his or her hedges to account for the non-recourse nature of the transaction. Ms. Rahl also noted that the reference to daily sensitivity adjustments meant that the precise mechanism to achieve appropriate hedging would have to be adjusted to reflect the fact that there was a stop loss on any collateral call trigger. She testified that she understood this document to approve an exception to usual practice and that she would expect a financial institution to keep track of these kinds of conditions or requirements, at least on a monthly, if not a daily, basis. Her evidence on this was not contradicted by anyone from Barclays. It confirms that Barclays knew from the outset that it might have to make appropriate adjustments to its hedging to reflect a non-recourse possibility.

[454] Barclays relies upon evidence given by Ms. Rahl on cross-examination as an admission that hedging should not be considered. She stated:

> Q. And I'm going to turn to the subject of hedging. Would you agree with me that the ISDA practice is that market quotation and loss are calculated without reference to either the existence of hedges or lack of hedges?
> A. Based on our standing understanding, yes.
> Q. And you're aware, I don't want to get into the precedent thing again, but you are aware that there's legal cases' deciding that issue to that effect?
> A. Yes.
> Q. And if someone were completely unhedged or a speculator or badly hedged, that makes [no] difference in the calculation of the replacement value?
> A. I would agree with you but not everybody would.

Q. For the moment I'm content if you do.
A. I do.

[455] I take this evidence to relate to the calculation of value of a replacement transaction as referred to in the definition of Market Quotation. I did not understand this evidence to be any admission by Ms. Rahl that in calculating a Loss, it was not appropriate to consider the strategies that should have been used to mitigate expected losses.

[456] Barclays relies on *Australia and New Zealand Banking Group Ltd. v. Société Générale*, unreported, September 21 1999 at p. 7, aff'd [2000] 1 All E.R. 682 (C.A.) as authority for the proposition that the definition of Loss did not include losses or gains on hedges that were not bound up in the early termination of the transaction. I do not read that case as assisting Barclays. Société Générale unsuccessfully argued that the amount due to be paid to the bank on early termination should be reduced by the losses it had incurred on hedges that it had entered into with a third party Russian Bank, the losses being caused by the collapse of the Russian currency and a banking moratorium being imposed. It was held by Aikens J., and upheld by the Court of Appeal, that the Loss provisions did not intend that losses resulting from the identity or particular circumstances of the counterparty to the hedge were covered by the words "loss. . . incurred as a result of [the Affected Party] terminating [or] liquidating . . . any hedge". He held that such a result would be unlikely because it would throw any risk associated with identity or circumstances of the particular counterparty to the hedge upon the other party to the contract. That is not the issue here.

[457] What puzzles me about the mitigation issue in this case is its practical effect. Barclays cannot recover more the available collateral, whether it is limited to the initial $600 million posted by Devonshire, as I have found, or also includes the extra cash of Devonshire in its bank account that Barclays asserted was the case. The effect of the mitigation argument of Devonshire is that the loss claimed by Barclays should have been capped by hedging strategies so that the loss was not in excess of what Barclays could collect on a termination of the trades.

[458] In the circumstances, I see little purpose in deciding this mitigation issue. However, in my view the position of Devonshire should be accepted. I accept the views of Ms.

Rahl that Barclays should have taken steps no later than November 27, 2007 to hedge the Devonshire transactions to limit its losses to what it could look to collect from Devonshire.

[459] There is another mitigation issue, however, that would have been of some importance had I found Barclays' Loss to be what it claimed. In 2008 Barclays purchased approximately $220 million in face value of Devonshire notes for nominal consideration from Citibank, Desjardins and National Bank. Devonshire contends that through the purchase of these notes, Barclays mitigated $220 million worth of risk should Devonshire be in default. Accordingly, if Devonshire defaulted but retained assets, Barclays would share in approximately a third of the amount that would be returned to noteholders. Accordingly, Devonshire contended that any Loss amount payable to Barclays must be adjusted accordingly. Otherwise there would be double recovery.

[460] On December 12, 2008 Mr. Lee was doing calculations on potential losses on the notes held by the Caisse and the small investors. His document referred to the notional exposure amount of each of the trades being $2 billion, rather than the original $3 billion. The reason was because of the purchase of the notes with a face value of $200 million, which represented a notional exposure of $2 billion, and Mr. Lee described this purchase in different ways, as "buying back the risk" , being "a hedge for our original $6 billion trade" and "equivalent to a sell of protection".

[461] Barclays counters this by contending that Devonshire confuses Barclays' management of its risk and the determination of Barclays' Loss. It says that the purchase of the notes was a hedge of the Devonshire trades, but the fact that Barclays reduced its risk through this hedge does not affect the replacement cost of the trades, which were left fully intact until terminated on January 13, 2009. It said that it paid for the credit protection right up to the termination (although it claims it back on its interpretation of the waterfall provisions in the Trust Indenture).

[462] No matter how the purchase of the Devonshire notes from Citibank, Desjardins and National Bank was described internally, it seems to me that if Barclays were entitled to payment from Devonshire collateral on of a settlement on a Devonshire default for its Loss, and

were able as well to recoup payment on the notes it acquired in Devonshire because Devonshire had more collateral than the settlement amount to be paid to Barclays, it would amount to Barclays obtaining double recovery for its loss. To this extent, if Barclays Loss is less than the available collateral plus Devonshire's cash, there should be a deduction from Barclays' Loss calculation of the amount it will receive from its Devonshire notes so that the Loss payable to Barclays is net of the amount it will receive on its Devonshire notes.

[463] As I have found Barclays loss to be $12,000, well less than the available collateral, Barclays will more than recover this amount by reason of its notes and thus its loss will be reduced to nil.

(e) Barclays' recourse

[464] In light of the result, the issue of what assets Barclays had recourse to is moot. However, in light of the arguments made and evidence led, I will deal with it.

[465] It is common ground that if Devonshire is the defaulting party under the ISDA Master Agreement, Barclays is entitled to set off amounts due to it from Devonshire against the initial payments of $600 million made by Devonshire.

[466] Barclays contended that it was entitled as well to be paid from the "residual assets" of Devonshire, being $183 million plus accrued interest held by Devonshire in its bank accounts. This amount is made up of $75 million returned to Devonshire in October 2007 that had previously been paid to Barclays as a result of a move in the Barclays marks, the balance of the monthly credit protection payments made to Devonshire by Barclays under the ISDA Master Agreement from August 2007 to January 2009, which totalled approximately $37 million and the $71 million payment made to Devonshire on January 13, 2009.

[467] Barclays' assertion is based on its interpretation of language in the Series A Supplemental Indenture ("Trust Indenture"). When one looks at the document and the myriad of clauses that are unintelligible without looking at definitions that are also complex, it does no credit to the drafters in the law firms who negotiated back and forth. Clear, simple drafting was lost in the process.

[468] The Trust Indenture contains what has been referred to as a "waterfall", or priority, of payments to be made by the indenture trustee CIBC Mellon Trust Company, from money to be paid to the trustee. The first priority is to cover costs of the trustee. The second is "in or towards payment and satisfaction of any Related Permitted Liens". Barclays contends that the amount to be paid to it by Devonshire on the default by Devonshire is a Related Permitted Lien.

[469] Barclays relies upon the following definition of "Devonshire Financial Contract" from section 1.1(i) of the Series A Supplemental Indenture:

> "**Devonshire Financial Contract**" means the credit derivatives transactions evidenced by an ISDA master agreement between the Trust and the Bank, or their respective successors and permitted assigns, together with the related schedule, master confirmation agreement (including the credit support annexes and special provisions annex (the "**Liquidity Agreement**") and transaction supplements thereunder), confirmations of any other transactions thereunder and custodial agreements, as the same may be amended, restated, replaced, supplemented or otherwise modified from time to time, which, for greater certainty, (i) shall be a Related Asset Interest, Related Programme Agreement, Related Securitization Agreement and, with respect to the Liquidity Agreement, a Related Liquidity Agreement (ii) in respect of which the Bank shall be a Related Originator and a Related Specified Creditor and, with respect to the Liquidity Agreement, a Related Liquidity Provider, <u>and the obligations of the Trust to the Bank under the Devonshire Financial Contract, including the security, lien and hypothec thereunder, shall be Related Obligations Secured and a Related Permitted Lien, (iii) but shall not be a Related Hedging Transaction</u>." (underlining added)

[470] Barclays reads the underlined language to say that the obligations of Devonshire to Barclays under the swap transactions resulting from the termination by Barclays shall be both Related Obligations Secured and a Related Permitted Lien. That is, the obligation is both an obligation and a lien.

[471] To understand the argument, it is necessary to look to a number of definitions in section 1.1 of the Trust Indenture:

> "**Obligations Secured**" means all present and future debts, expenses, liabilities and obligations, direct or indirect, absolute or contingent, due, owing or accruing due or owing from time to time by the Trust to the Specified Creditors in their

> capacity as such. For greater certainty, amounts owing to any Specified Creditors by the Trust, at any time, shall include (i) the unpaid face amount of any Notes issued on a discount basis; (ii) the principal amount owing at such time, together with the accrued and unpaid interest on interest bearing Notes or Borrowings; (iii) accrued fees, whether or not then due and payable; and (iv) obligations to deliver or return collateral or other credit support under Programme Agreements.
>
> . . .
>
> "**Permitted Liens**" means, in respect of any Series of Notes and the Related Collateral, such liens or other encumbrances expressly permitted in any of the Related Programme Agreements.
>
> . . .
>
> "**Related**" is used in reference to the Notes of a particular Series or in the case of Notes forming part of a Multiple Issue Series, such Notes or a Transaction funded by such Notes, as applicable, and means, when used in conjunction with:
>
> . . .
>
> "**Obligations Secured**" all Obligations Secured relating to the holders of such Notes and to Related Specified Creditors under the Related Programme Agreements, the Related Series Expenses and Related General Expenses or in the case of a Multiple Issue Series and a transaction financed or refinanced thereby, the obligations secured to the holders of the Notes of such Multiple Issue Series and to the Related Specified Creditors under the Related Programme Agreements the Related Issue Series and the Related General Expenses;
>
> . . .
>
> "**Permitted Liens**" Permitted Liens under a Related Programme Agreement;

[472] Devonshire says that these sections use the words "obligation" and "lien" in a sense which is consistent with their ordinary meaning. "Obligation" connotes amounts owing, whereas "lien" connotes some form of proprietary interest that secures an obligation. The definitions do not contemplate that something can, at one and the same time, be an obligation and a lien. The definition of Related Permitted Liens leads back to the definition of Permitted Liens which is defined as "such liens or other encumbrances". There is no mention in either the definition of Permitted Liens or Related Permitted Liens to "obligations". The definition of Related Obligations Secured leads back to the definition of Obligations Secured which is defined as "all present and future debts, expenses, liabilities and obligations". There is no mention in

either the definition of Related Obligations Secured or Obligations Secured that such definitions could encompass liens.

[473] Under the ISDA Master Agreement and related agreements, Barclays holds collateral posted by Devonshire initially, being the $600 million, and any other collateral posted by Devonshire as the result of a collateral call by Barclays under the Seller Credit Support Annex, of which there is none. None of the $183 million cash of Devonshire that Barclays seeks to access is covered by any security agreement and thus is not a "lien or other encumbrance expressly permitted in any of the Related Programme Agreements", being the definition of a Permitted Lien.

[474] Devonshire points out that under the waterfall provisions in the Trust Indenture, there are payments to be made to Barclays that would be unnecessary if Barclays were to be entitled to be paid as it contends as second place in the waterfall.

[475] The waterfall provides for the payment of money by the indenture trustee as follows;

> (a) First, in payment or reimbursement in the following order or priority:
>
> (i) To each of the Indenture Trustee and the Issuer Trustee of the Related Proportionate Share of all fees and expenses …
>
> (b) **Second, in or towards payment and satisfaction of any Related Permitted Liens;**
>
> (c) **Third,** in and towards payment of the following Related Obligations Secured then owing in the following order of priority:
>
> (i) **The fees and expenses due and payable to Related Liquidity Providers** in connection with the provision of services and facilities under the Related Liquidity Agreements; and
>
> (ii) The fees and expenses due and payable to Related Servicers in respect of the Related Collateral;
>
> (d) **Fourth**, in or **towards the payment of unpaid interest and/or accrued discount on the Series A Notes** and the Related Borrowings, all amounts owing to counterparties under the Related Hedging Transactions and the Related

Proportionate Share (the transactions giving rise to the Related Collateral being the only Transaction with respect to the Series A Notes) of all amounts required to be paid by the Trust under the Financial Services Agreement and in accordance with the priorities established thereunder, pro rata, and thereafter **amounts owing in respect of principal on such Series A Notes and the Related Borrowings, pro rata;**

(e) Fifth, by deposit to the Series A Reserve Account to the extent of the Series A Reserve Amount;

(f) **Sixth, in or towards the payment and satisfaction of all amounts due to the Bank under the Devonshire Financial Contract which have been subordinated pursuant to the Intercreditor Agreement**;

(g) Seventh, in or towards payment of all amounts required to be paid by the Trust to the Related Agents under the Related Agency Agreements, pro rata;

(h) Eighth, in or toward payment of the following Related Obligations Secured then owing in the following order of priority:

(i) The Related Proportionate Share of all amounts required to be paid by the Trust to the Administrative Agent under the Administration Agreement;

(ii) All other amounts properly incurred and owing by the Trust and which are solely attributable to the Related Collateral, the Related Obligations Secured or the Related Programme Agreements and not otherwise specified in this Section 3.1;

(iii) The Related Proportionate Share of all other amounts properly incurred and owing by the Trust which are not solely attributable to any Related Collateral, Related Obligations Secured or Related Programme Agreements and not otherwise specified in this Section 3.1 including, without limitation, all amounts owing to counterparties under Hedging Transactions; and

(iv) The Related Proportionate Share of all amounts required to be paid by the Trust to the Issuing and Paying Agent under this Indenture.

The balance in the Related Collateral Account following the application of monies in accordance with the foregoing shall be remitted to the Trust. [Emphasis added]

[476] Devonshire contends that if it is the case that all obligations owing to Barclays are covered by Related Permitted Liens in second priority in the waterfall, there would be no need

for the waterfall to provide for (i) Barclays' fees and expenses as liquidity provider in third place in the waterfall, or (ii) payment on notes acquired by Barclays for liquidity advances under a Traditional Liquidity Arrangement in fourth place in the waterfall or (iii) amounts owning to Barclays that were subordinated to the noteholders in accordance with the Intercreditor Agreement in sixth place in the waterfall. I accept this. It would be inconsistent for these other priorities to be provided to Barclays if all obligations owing to Barclays were covered in the second place in the waterfall under Related Permitted Liens.

[477] It is no answer for Barclays to say that it did not need the third priority for its fees and expenses as liquidity provider as it deducted them from payments it made to Devonshire for credit protection. The priority was presumably put in for a purpose, and the issue is as to the interpretation of the relevant provisions. It is no answer for Barclays to say that if it acquired Devonshire notes as a liquidity provider, it would be entitled to the interest and payments on the notes under the waterfall as a noteholder and that Devonshire's obligations would be independent of the ISDA Master Agreement. Obligations under the liquidity provisions in Annex VI are not independent of the ISDA Master Agreement; they are part of it, and are included in the definition of Devonshire Financial Contract relied on by Barclays as obligations of Devonshire to Barclays. It is no answer for Barclays to say that the amounts due to it that were subordinated under the Intercreditor Agreement, i.e. if Barclays is in default, relates to a settlement amount. That would be an obligation of Devonshire to pay under the ISDA Master Agreement, and if Barclays is right as to the reach of Related Permitted Liens which ranks second in priority in the waterfall, it would give Barclays priority over what it has subordinated in the Intercreditor Agreement. None of these priorities to Barclays in the third, fourth or sixth ranking in the waterfall would be required if Barclays is correct in its interpretation of the Devonshire Financial Contract provision.

[478] Devonshire contends that the maxim *reddendo singular singulis* should be used in the interpretation of the definition of Devonshire Financial Contract in the Trust Indenture. The part relied on by Barclays at the end of the definition is:

> and the obligations of the Trust to the Bank under the Devonshire Financial Contract, including the security, lien and hypothec thereunder, shall be Related

> Obligations Secured and a Related Permitted Lien, (iii) but shall not be a Related Hedging Transaction.

[479] Black's Law Dictionary, 8th edition, defines the maxim *reddendo singular singulis* as "Each must be put in each separate place. That is, the several terms or items apply distributively, or each to its proper object". In other legal dictionaries it is said to mean "by rendering each his own", or to "refer each to each". Of course, Latin maxims can be an aid to interpretation of contractual or statutory provisions, but they are to be applied with caution. In this case, I think the maxim is helpful.

[480] I accept the interpretation of Devonshire. I interpret the provision to mean that obligations of Devonshire to Barclays under the ISDA Master Agreement and related agreements shall be Related Obligations Secured and any security or lien under those agreements shall be a Related Permitted Lien. I cannot accept that the intention of the agreement was by the few words at the end of the definition of Devonshire Financial Contract relied on by Barclays to make obligations owed to Barclays to be a Related Permitted Lien to stand in second place in the waterfall. Had the parties intended what is contended by Barclays, they ought to have expressed it far more clearly. The tenor of the Trust Indenture as a whole is contrary to Barclays' interpretation, and contrary to the separate notions of an obligation being an obligation and a lien being a lien.

[481] Both parties referred to evidence to assist an interpretation in the event the clause was held to be ambiguous, including evidence of negotiations and actions taken after the agreements were made. In my view, the provision can be interpreted without reference to such evidence and I have not considered it.

19. Conclusion

[482] The parties have understandably asked me not to make any order directing payments of any kind, and I do not do so. Apart from anything else, there is still the issue of whether the issues that were bifurcated need to be dealt with. The parties may discuss this with me at a 9:30 a.m. appointment.

Newbould J.

Released: September 7, 2011

CITATION: Barclays Bank v. Metcalfe &Mansfield 2011 ONSC 5008
COURT FILE NO.: CV-09-0370103
DATE: 20110907

ONTARIO

SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

B E T W E E N:

BARCLAYS BANK PLC

Plaintiff

- and -

METCALFE & MANSFIELD ALTERNATIVE INVESTMENTS VII CORP., *in its capacity as Trustee of* DEVONSHIRE TRUST, THE BANK OF NEW YORK, *as Custodian*, and CIBC MELLON TRUST COMPANY, *in its capacity as Indenture Trustee*

Defendants

REASONS FOR JUDGMENT

NEWBOULD J.

Released: September 7, 2011