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JSR/30848/1

HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Dear Sirs

Letter before action by (1) X Y Z and (2) A B

Claim for loss and damages caused by HM Treasury in the process of the acquisition of HBOS plc by Lloyds TSB plc during the period September 2008 – January 2009

A. Introduction

1. This is a letter before action and is written to you in compliance with the requirements of the Civil Procedure Rules and particularly Sections II, III and IV of the "Practice Direction – Pre-Action Conduct" (the "Practice Direction"). These sections deal with the courts' approach in relation to all types of proceedings and the principles governing the conduct of the parties in cases not subject to a specific pre-action protocol. We attach a copy for your convenience.
2. Our clients were shareholders in Lloyds TSB Plc ("LTSB") prior to its acquisition of HBOS Plc ("HBoS)" (the "acquisition"). They are currently shareholders of Lloyds Banking Group Plc "LBG", which came into existence as a result of the acquisition. They suffered both loss and damage in the process. Our instructions are that those losses were caused by Her Majesty's Treasury. In this letter references to "you" or the "defendant" are to HM Treasury. This letter explains the basis of this contention and is a demand for compensation. If the liability is not met we shall issue proceedings against you.
3. Without confining the legal basis for your liability (which we will review upon consideration of your response to this letter) our clients hold you vicariously responsible for the actions and/or omissions perpetrated by Sir Nicholas Macpherson (the Permanent Secretary to the Treasury) ("Sir Nicholas") on or about 3 November 2008 when he made a statement in the LTSB Circular dated 3 November 2008 (the "LTSB Circular") at page 246, paragraph 1 of Part XII (the "Statement"). For your convenience we attach a copy of the LTSB Circular.
4. The Statement reads:

"*Nicholas Macpherson (acting in his capacity as permanent secretary to HM Treasury) (the 'HM Treasury responsible person') accepts responsibility for the information contained in this document relating to HM Treasury, including any statements of expectation or intention on the part of HM Treasury. To the best of the knowledge and belief of the HM Treasury Responsible Person (who has taken all reasonable care to ensure that such is the case), the information contained in this document for which he is responsible is in accordance with the facts and does not omit anything likely to affect the import of such information.*"

5. Information in the document relating to HM Treasury and for which Sir Nicholas was responsible was incorrect. At the time of making the Statement Sir Nicholas was aware that the Bank of England ("BoE") had made an advance of £25.4bn to HBoS during or about October 2008. This material fact was not disclosed in the LTSB Circular. Having assumed a duty of care towards shareholders of LTSB by making the Statement, it was the duty of Sir Nicholas to disclose that fact.
6. The gist of the claim against HM Treasury is that in not making the disclosure Sir Nicholas misled LTSB shareholders, and specifically our clients.

7. Our instructions are further that the involvement of HM Treasury in the acquisition of HBoS by LTSB infringed the peaceful possession of our clients' shares in contravention of the European Convention of Human Rights ("ECHR") read with the Human Rights Act 1998 entitling our clients to compensation. In addition our clients assert an equitable remedy based on promissory estoppel as more fully set out below. These claims will be brought in the alternative to other claims, as more fully described in Section D hereof.

B. The provisions of the Practice Direction

8. There is no prescribed pre-action protocol for the claims made by our clients against you. The position is accordingly governed by the Practice Directions. We set out below those portions of the Practice Directions which are important to note. You are nevertheless advised to consult the entire Practice Direction before responding to this letter.

9. Before starting proceedings the parties should:

(1) exchange sufficient information about the matter to allow them to understand each other's position and make informed decisions about settlement and how to proceed;

(2) make appropriate attempts to resolve the matter without starting proceedings, and in particular consider the use of an appropriate form of ADR in order to do so.

10. The Practice Directions require that parties should act in a reasonable and proportionate manner in all dealings with one another. In particular, the costs incurred in complying should be proportionate to the complexity of the matter and any money at stake. The parties must not use the Practice Direction as a tactical device to secure an unfair advantage for one party or to generate unnecessary costs.

11. Before starting proceedings:

(1) the claimant should set out the details of the matter in writing by sending a letter before claim to the defendant. This letter before claim is not the start of proceedings; and

(2) the defendant should give a full written response within a reasonable period, preceded by a written acknowledgment of the letter before claim.

12. Your acknowledgement of this communication is required within 14 days (if your full response has not been received before then). Your full response is required within 90 days from date hereof.

13. Your acknowledgement should comply with the Practice Direction in all respects and:

(1) should state whether an insurer is or may be involved;

(2) should state the date by which you (or the insurer/s) will provide a full written response and if it is a date later than 90 days from date hereof:

a. you should give reasons why a longer period is needed;

b. if the reason is that you are seeking advice you should state that fact; from whom the advice is sought; and when you expect to have received that advice or be in a position to provide a full response.

(3) may request further information to enable you to provide a full response.

14. Your full written response should –

(1) accept the claim in whole or in part; or

(2) state that the claim is not accepted; and

unless you accept the whole of the claim, the response should –

(3) give reasons why the claim is not accepted, identifying which facts and which parts of the claim (if any) are accepted and which are disputed, and the basis of that dispute;

(4) state whether you intend to make a counterclaim against our client (and, if so, provide information equivalent to this letter before claim);

(5) state whether you allege that our client was wholly or partly to blame for the problem that led to the dispute and, if so, summarise the facts relied on;

(6) state whether you agree to our proposals below for Alternative Dispute Resolution ("ADR") and if not, state why not and suggest an alternative form of ADR (or state why none is considered appropriate);

(7) list the essential documents on which you intend to rely;

(8) enclose copies of documents requested by us below, or explain why they will not be provided; and

(9) identify and ask for copies of any further relevant documents, not in your

possession and which the defendant wishes to see.
15. We shall respond to your reply within 14 days after receipt thereof.
16. The Practice Direction further requires that starting proceedings should be a step of last resort, and proceedings should not normally be started when a settlement is still actively being explored. Although ADR is not compulsory, the parties should consider whether some form of ADR procedure might enable them to settle the matter without starting proceedings. The court may require evidence that the parties considered some form of ADR. We propose that the parties should agree to submit the dispute to mediation. A mediator/s should be agreed between the parties, position papers and documents exchanged and a private and confidential mediation should be undertaken by the parties as soon as is practicable after we have provided our client's response as provided for in paragraph 6 above.
17. Documents provided by one party to another in the course of complying with this letter must not be used for any purpose other than resolving the matter, unless the disclosing party agrees in writing.
18. Our clients are required to say whether they have entered into a funding arrangement and we advise you in this regard that they have joined Lloyds Action Now Association, a voluntary non-incorporated association of erstwhile shareholders in LTSB. A copy of the Constitution of the Association, comprising of the Rules and Methodology of the Association is attached. Our client will, at the appropriate time, be able and prepared to put up reasonable security for costs in the event that it becomes necessary to issue proceedings. This is not an issue that we are prepared at this stage to deal with beyond what is stated in this paragraph. Should there be any development regarding funding arrangements before you provide your full response, we will let you know thereof.
19. We provide the following information to you:
(1) the claimants' full names are above;
(2) the basis on which the claim is made, a summary of the facts on which the claim is based, what our client demands from you and how our client's financial loss is calculated, is set out below.
20. We presume that you will be legally represented but you should note that:
(1) the court has powers to impose sanctions for failure to comply with this letter; and
(2) ignoring this letter before claim may lead to our clients starting proceedings and may increase your liability for costs.
21. We shall provide the documents and/or explanations reasonably requested by you within as short a period of time as is practicable or explain in writing why the documents will not be provided.
22. Documents specifically requested.
Without derogating from the general obligation that you have, in accordance with the Practice Directions, to answer this letter fully and substantively and to provide documentation, we request copies of the following specific documentation and information:-
(1) The Advice provided by Sir Nicholas to the Chancellor of the Exchequer during or about October 2008 (the existence of which was revealed by him on or about 15 December 2009 as per a Bloomberg report, a copy of which is annexed hereto) regarding the propriety of making publicly known the loans made or other financial assistance provided by HM Treasury and/or the Bank of England ("BoE") to Royal Bank of Scotland ("RBS") (approximately £36bn) and HBoS (approximately £25.4bn) during or about October 2008;
(2) All internal memoranda in HM Treasury relevant to the Advice for the period 16 September 2008-19 January 2009.
(3) A copy of the written agreement, if any, in terms whereof the loan and/or financial assistance was granted to HBoS;
(4) Details of any government guarantees for certain wholesale funding issuance of HBOS any time during the period 16 September 2008 to 19 January 2009 which were linked to the capital raised by HBOS in January 2009;
(5) All correspondence (including letters, facsimile transmissions and e-mails or any other electronically stored communications) between the Chancellor of the Exchequer and/or HM Treasury (represented by whomsoever at the time) on the

one hand and HBoS (represented by whomsoever, including the board of directors or any individual director) on the other hand regarding the £25.4bn advance and/or financial assistance between the period 16 September 2008 and December 2009;
(6) All correspondence (including letters, facsimile transmissions and e-mails or any other electronically stored communications) between:
a. the Chancellor of the Exchequer and/or HM Treasury (represented by whomsoever at the time) on the one hand; and
b. LTSB (represented by whomsoever, including the board of directors or any individual director) on the other hand;
regarding the £25.4bn advance and/or financial assistance to HBoS between the period 16 September 2008 and December 2009;
(7) Copies of all minutes of meetings or notes made during any meeting (whether stored as hard copies or in electronic form) attended by the Chancellor of the Exchequer and/or HM Treasury (or any employee, adviser or legal representative) on the one hand and HBoS (represented by whomsoever, including the board of directors or any individual director) on the other hand regarding the £25.4bn advance and/or financial assistance granted to HBoS between the period 16 September 2008 and December 2009;
(8) Without derogating from the foregoing, all records of discussions between HM Treasury and LTSB referred to in paragraph 1 of Part III of the LTSB Circular;
(9) Copies of all correspondence between LTSB and HBoS (in whichever form or format) regarding the £25.4bn advance and/or financial assistance between the period 16 September 2008 and December 2009 in the possession of HM Treasury;
(10) Copies of all correspondence between HM Treasury and/or Sir Nicholas on the one hand and HBoS, any of its directors or employees or any of its advisers named in the HBoS Circular dated 13 November 2008 on the other hand between the period 16 September 2008 and 13 November 2008 regarding the statement in the HBoS Circular at paragraph 1(c) Part 13 p284 with a content similar to the Statement:
"*Nicholas Macpherson (acting in his capacity as Permanent Secretary to HM Treasury) (the 'HM Treasury Responsible Person') accepts responsibility for the information contained in this document relating to HM Treasury, including any statements of expectation or intention on the part of HM Treasury. To the best of the knowledge and belief of the HM Treasury Responsible Person (who has taken all reasonable care to ensure that such is the case), the information contained in this document for which he is responsible is in accordance with the facts and does not omit anything likely to affect the import of such information.*"
(11) Copies of all correspondence between HM Treasury and/or Sir Nicholas on the one hand and LTSB and any of its directors or employees or any of its advisers named in the LTSB Circular dated 3 November 2008 between the period 16 September 2008 and 3 November 2008 regarding the statement in the LTSB Circular dated 3 November 2008 at page 246 paragraph 1 part XII (additional information) which read as follows:
"*Nicholas Macpherson (acting in his capacity as permanent secretary to HM Treasury) (the 'HM Treasury responsible person') accepts responsibility for the information contained in this document relating to HM Treasury, including any statements of expectation or intention on the part of HM Treasury. To the best of the knowledge and belief of the HM Treasury responsible person (who has taken all reasonable care to ensure that such is the case), the information contained in this document for which he is responsible is in accordance within effects and does not omit anything likely to affect the import of such information.*"
(12) Any drafts of the Statement, whether in hard copy or electronic form preceding the ones which were published in the respective HBoS and LTSB Circulars;

(13) All documents evidencing the making of the advance of £25.4bn and the date of the receipt of the funding by HBoS;
(14) Copy of the Implementation Agreement between LTSB and HBOS dated 18 September 2008, as amended and restated on 13 October 2008;
(15) Copy of the HBOS Placing and Open Offer Agreement entered into with effect from 13 October 2008 between HBoS, Morgan Stanley, Dresdner Kleinwort and HM Treasury;
(16) Copy of the Placing and Open Offer Agreement entered into with effect from 13 October 2008 between LTSB, HM Treasury, Citigroup Global Markets Limited, Citigroup Global Markets UK Equity Ltd, Merrill Lynch and UBS.

23. By following the above procedure, the parties will have a genuine opportunity to resolve the matter without needing to start proceedings. At the very least, it should be possible to establish what issues remain outstanding so as to narrow the scope of the proceedings and therefore limit potential costs and, if having completed the procedure, the matter has not been resolved, then we should undertake a further review of your and our client's respective positions to see if proceedings can still be avoided.

C. Relevant background facts and circumstances

General

24. In relation to the various causes of action the following background facts and circumstances are relevant. We appreciate that you are familiar with the bulk thereof yet we find it expedient to do so in order to put our clients' claims in perspective.

25. Patterns of lending, particularly interbank lending, were disturbed since summer 2007 when fear of counter-parties' liquidity resulted in instability and volatility in the international financial markets.

26. The UK Government stepped in to address the situation by taking certain steps in an endeavour to stabilise the situation. The Banking (Specific Provisions) Act 2008 ("the BSP Act") was introduced with effect from 21 February 2008, operative for one year only. The nationalisation of Northern Rock and the mortgage book business of Bradley & Bingley were effected in terms of the BSP Act. The BSP Act was substituted by the Banking Act 2009. Despite the existence of the BSP Act during the period September 2008 to January 2009 (during which the facts pertinent to the causes of action pursued herein arose) government did not purport to act in terms thereof when the salvation of HBOS was sought by means of the acquisition thereof by LTSB. Neither were the retrospective powers provided for in the Banking Act 2009 utilised for that purpose.

27. Despite this volatility LTSB retained its AAA credit rating during 2008. RBS and HBoS were ostensibly in serious financial trouble by the summer of 2008. The Government had to deal with this state of affairs against the background of the huge commitments incurred in respect of the Northern Rock and Bradley & Bingley nationalisations.

28. By early September 2008 Fannie Mae and Freddie Mac were placed in conservatorship and Lehman Bros failed spectacularly. On 18 September 2008 LTSB and HBOS announced that HBOS had received an approach from LTSB with a view to it acquiring HBOS.

29. On 8 October 2008 HM Government, after consultation with BoE and the Financial Services Authority ("FSA") announced that it was bringing forward specific and comprehensive measures to ensure the stability of the financial system and to protect ordinary savers, depositors and borrowers. Conspicuously absent from the parties government wished to protect, were shareholders of affected banks (despite the fact that many shareholders had invested in LTSB as a form of saving for retirement)The following salient facts emerged from the announcement (press release annexed):

(1) In its provision of short-term liquidity the BoE would extend and widen its facilities in whatever way necessary to ensure the stability of the system. At least £200 billion would be made available to banks under the special liquidity scheme. In addition government would establish a facility, which would make available Tier 1 capital in appropriate form (expected to be preference shares or PIBS) to eligible institutions. Eligible institutions were UK incorporated banks (including UK subsidiaries of foreign institutions which have had a substantial business in the UK and building societies).
(2) Following discussions convened by HM Treasury several banks, including LTSB

and HBOS, confirmed their participation in a government supported recapitalisation scheme.
(3) Participating institutions committed to the Government that they would increase their total Tier 1 capital by £25 billion. This was an aggregate increase and individual increases would vary from institution to institution. In order to facilitate this process the Government would be making available £25 billion to be drawn on by these institutions if desired to assist in this process as preference share capital or PIBS and was also willing to assist in the raising of ordinary equity if requested to do so.
(4) In addition to this the Government stood ready to provide an incremental minimum of £25 billion of further support for all eligible institutions, in the form of preference shares, PIBS or, at the request of an eligible institution, as assistance to an ordinary equity fund raising
(5) The amount to be issued per institution would be finalised following detailed discussions. If the Government was to provide the capital, the issue would carry terms and conditions and reflect the financial commitment being made by the taxpayer.
(6) The Government would take decisive action to reopen the market for medium term funding for eligible institutions that raise appropriate amounts of Tier 1 capital. Specifically the Government would make available to eligible institutions for an interim period as agreed and on appropriate commercial terms, a government guarantee of new short and medium term debt issuance to assist in refinancing maturing, wholesale funding obligations as they fell due
(7) To qualify for this support the relevant institution had to raise Tier 1 capital by the amount and in the form the Government considered appropriate whether by government subscription or from other sources. It was being made available immediately to inter alia LTSB and HBOS.
30. On 13 October 2008 the boards of both LTSB and HBOS announced that they would participate in the proposed government funding. HBOS undertook to raise £11.5 billion and LTSB £5.5 billion of new capital.
31. Only in December 2009 was it publicly disclosed that BoE, with the knowledge of HM Treasury, had advanced an amount of £25.4 billion to HBOS during October 2008. This fact was not made public at any stage before:
(1) the respective Circulars were published;
(2) the LTSB shareholders had to consider approving the acquisition;
(3) LTSB shareholders who considered partaking in the scheme of the acquisition had to make informed decisions regarding the purchase of new shares or the disposal of existing shareholdings.
32. It was however known to the tripartite authorities and the boards of LTSB and HBOS.
33. In his evidence earlier this year to a parliamentary Select Committee LBG CEO Eric Daniels said the following in replies to questions posed:-
“Mr Fallon: But you did not disclose the £25 billion.
Mr Daniels: Correct.
Mr Fallon: Why was that?
Mr Daniels: It was not felt to be necessary because the fact that the amount of funding was substantial, the fact that HBOS was completely dependent on it and the fact that HBOS would not be able to operate without it was viewed as more than sufficient”.
34. Sir Nicholas has confirmed that he advised the then Chancellor of the Exchequer to disclose this pivotal fact and that he produced a written Advice to this effect (which is not in the Claimants’ possession but a copy of which is requested in paragraph B.13a above). The Chancellor rejected this advice and insisted that the loan of £62 billion of taxpayer backed emergency funding for RBS (£36bn) and HBOS (£25.4bn) be kept secret ostensibly in an effort to ensure the success of the proposed government funding announced on 8 October 2008.
35. This was done in apparent disregard of the interests of shareholders of LTSB, who collectively have lost in excess of £14bn. Knowledge of the £25.4bn loan would have had a

considerable influence on the decisions which LTSB shareholders had to take, namely whether to consent to the acquisition, or purchase shares under circumstances where there was such a material black hole in the financial position of HBOS which had to be filled by government funding and/or to take up the share offer explained in the LTSB Circular and the subsequent LTSB Prospectus and/or to decide whether or not to retain LTSB shares at all. In particular, it should have been clear not only that this substantial funding would become a liability of LBG upon completion of the acquisition, but that it was indicative of the desperate financial status in which HBOS had found itself. It should have been foreseeable that such weakness, once detected by the markets, would have had a vastly detrimental effect on the share price of LBG. In the event and very shortly after consummating the deal government "bail outs" totalling almost £20bn had to be doled out with the suspension of dividends.
36. Most importantly, it would have been apparent that disclosure of this fact before the acquisition would seriously jeopardise the acquisition thereby risking the failure of HBoS and resulting either in its bankruptcy or its nationalisation. Instead, by keeping the £25.4bn funding secret, the likelihood of the approval of the acquisition was vastly improved, but at the potential expense of the LTSB shareholders who would become shareholders in LBG with all the toxic baggage of HBoS attached to the new entity.
37. Circulars announcing the acquisition and the terms thereof were issued by LTSB on 3 November 2008 and by HBOS on or about 13 November 2008. By that time the making of the £25.4 billion advance was, seen in retrospect, a *fait accompli*. None of the Circulars disclosed this fact.
The HBoS Circular (copy attached)
38. At present we do not assert that relief can be obtained on behalf of our clients against HBoS or its directors at the time (although they were ostensibly complicit in allowing the omission regarding their loan book to be published to LTSB shareholders) but it is nevertheless valuable to highlight a few matters evident from its circular. It sought to raise the sum of £11.5 billion by a placing an open offer of approximately 7,5 billion shares at 113.6p per open offer share and a HM Treasury preference share subscription of 3 million shares at £1,000 each. After completion of this process, the ordinary HBoS shares would be swapped at a ratio of 0.605 for one LTSB share.
39. Not surprisingly, the HBoS board expressed the view that the transaction would be beneficial to its own shareholders.
40. At paragraph 2, page 14, it is stated that on 18 September 2008 the boards of HBoS and LTSB (with the support of the Government) announced that they had reached agreement on the terms of the recommended acquisition of HBoS by LTSB. This is unambiguous confirmation of the material intervention of government in the restructuring of the respective banks prior to 18 September 2008.
41. As stated above in paragraph B.13k, a statement similar to the Statement appears at Paragraph 1(c) of part 13 at page 284.
The LTSB Circular (copy attached)
42. Reference has been made to the Statement appearing herein in Section A above.
43. The information in the Circular relating to HM Treasury and for which Sir Nicholas took responsibility appears *inter alia* in the following passages of the LTSB Circular:
(1) It is a recurrent theme that if the resolutions on which the placing and open offer or the acquisition are conditional were not approved or for some other reason the placing and open offer agreement was terminated or the acquisition did not complete, the proposed government funding would not be available to Lloyds TSB (See letter to shareholders p11 and the passage at p20 to the following effect:
"Accordingly, the placing and open offer and the acquisition are interconditional. If the resolutions on which the placing and open offer or the acquisition are conditional are not approved or for some other reason the placing and open offer agreement is terminated or the acquisition does not complete, HM Treasury has stated that, in that event, it would expect Lloyds TSB to take appropriate action to address its capital position in the light of the policy objectives set out in HM Treasury's announcement of 8 October 2008 on financial support to the banking industry"
(see also p41, paragraph 2.1; p47, paragraph 1);

(2) The depth of HM Treasury's extraordinary involvement in the acquisition process appears from the fact that HM Treasury was party to the placing and open offer agreement effective as of 13 October 2008 entered into between Lloyds TSB, HM Treasury, Citigroup Global Markets Limited, Citigroup Global Markets UK Equity Limited, Merrill Lynch and UBS (paragraph 9.1.3); and had the right, in its discretion, to waive certain conditions (p19, *p*54, paragraph 3);
(3) Although the information (p20) correctly deals with the fact that upon completion of the acquisition and the HBOS preference shares scheme, HM Treasury would be owning £4 billion enlarged group HMT preference shares and that the enlarged group would need to repurchase or redeem an aggregate of £4 billion of new preference shares before payment of dividends on ordinary shares could resume, this passage appears to indicate the total exposure of LBG to HM Treasury upon completion of the acquisition. However, it misrepresented the total exposure which LBG would have had. It was an appropriate opportunity for Sir Nicholas to divulge the existence of the £25.4bn funding to HBoS which would become a liability of LBG.
(4) The same duty arose if regard is had to paragraph 12.2 (p266) where the massive funding which had occurred during October 2008 was simply ignored:
"HBOS GROUP" : Save for the £4 billion net cash proceeds raised by HBOS in its rights issue in July 2008 and as disclosed in the sections headed "Group Overview", "Divisional Review" and "Outlook" in part XII ("HBOS Interim Management Statement 3 November 2008") of this document, which sets out the current trading, trends and prospects of the HBOS group, ***there has been no significant change in the financial or trading position of the HBOS group since 30 June 2008****, the date to which HBOS' last published interim financial information (which is set out in part IX ("Historical Financial Information Relating to HBOD PLS") of this document) was prepared."*
This clearly called for correction by HM Treasury.
(5) A further example of a misrepresentation which required of Sir Nicholas to make the necessary disclosure is found at:
a. p22: In calculating the core tier 1 ratio no account has been taken of the trading performance of Lloyds TSB or HBOS **or of other transactions** by Lloyds TSB or **HBOS** since 30 June 2008, including the sale by HBOS of Bank West and St Andrews, except for the equity placing completed by Lloyds TSB on 19 September 2008; and
b. p271, in relation to HBoS:
"The proposed placing of £8.5 billion additional equity and £3 billion 12% preference shares in January 2009, subject to shareholder approval, would be equivalent to an increase in the relevant capital ratios at that time of some 340 BPS for tier I and 250 BPS for core tier I. Most importantly, this injection of capital is linked to the provision of government guarantees for certain wholesale funding issuance. This materially strengthens the group's funding position following deposit outflows in September and in the first half of October, which have now slowed significantly."
(6) A shareholder would have been justified to infer that aid in the form of government guarantees had been provided and that it (and nothing else) strengthened the group's funding position. Nothing is said of the vast amount of BoE funding of £25.4bn without which HBoS would probably have been constructively insolvent. Sir John Gieve (Deputy Governor BoE) said that after the demise of Lehman Bros "we knew straight away that the British banks most in doubt Bradford and Bingley and HBOS would be in the firing line the next day". It is a clear omission for which HM Treasury should be held liable. Patently misleading is the passage at p33 which deals with the future funding assistance by the Government and which spells out that "how and when such measures will be implemented are uncertain". It unambiguously creates the impression that such funding is only prospective

whereas HM Treasury knew at that stage that substantial funding had already been granted to HBoS and would be subsumed into LBG debt.
(7) Under circumstances where (at p38, paragraph 1.14) mention is made that *"The State aid rules aim to prevent companies from being given an artificial or unfair competitive advantage as a result of governmental assistance"* it would have been the ideal situation to disclose that HBoS was indeed enjoying a competitive advantage by burying its disastrous financial position under the £25.4bn BoE funding.

The LTSB Prospectus and Supplementary Prospectus

44. Parts III and V of the LTSB Circular are incorporated in the text of the prospectus (page 18, paragraph 1.14 and page 62 paragraph B). Warnings of the consequences of noncompliance with the acquisition and taking up of shares were repeated. (paragraph2.1, page 21, pages 43 and 54). There is no mention of the £25.4 billion issue.
45. The supplementary prospectus issued in December 2008 also failed to disclose the existence of the £25.4bn advance.

Inferences to be drawn from the background circumstances

46. By the time the circulars were published in early November 2008, Sir Nicholas not only had knowledge of the £25.4 billion advance made to HBOS during October 2008 but he advised the Chancellor to disclose this fact, as he was astute to place on record as soon as the information was made public. Although Sir Nicolas did not on that occasion request a Ministerial Direction, he clearly recognised that the Chancellor was not acting lawfully by keeping the loans secret. The Government is responsible and liable for the cloak of secrecy surrounding this very material fact and the election to maintain secrecy most likely adversely affected LTSB shareholders' attitude to vote in favour of the acquisition (or to take up shares on offer or to dispose of shares in LTSB or not to dispose of current shareholdings).
47. It is further apparent that HM Treasury placed inordinate pressure on LTSB and its shareholders by persistently requiring the strengthening of LTSB's capital position and warning about the lack of government support should the acquisition not complete. It placed LTSB shareholders in an unenviable position.
48. Our instructions are that the acquisition was prompted not by sound business considerations but upon the insistence of HM's Government which did not only encourage the acquisition but actively promoted and facilitated it, inter alia by sidestepping EU competition laws that stood in the way of the deal. It was important for HM Government to achieve this result in order to avoid the bankruptcy or nationalisation of HBoS and to limit the Government's further direct financial involvement in the salvaging of the banking sector. In fact the insistence that LTSB itself would not be viable without state funding, too, was misleading. The lawful, correct, proper and honest course would have been (as Dr Vincent Cable suggested to the Chancellor in the House of Commons) to put HBOS into public ownership and then allow LTSB to consider an acquisition rather than permitting and encouraging LTSB shareholders to agree to an acquisition that was not what it seemed. With the change in government the concerns expressed by Dr Cable ought to have become the concerns of government. We reiterate the necessity of early and effective ADR.
49. Our instructions are that HM Treasury pursued this course of action regardless of the interests of LTSB shareholders. In particular, after BoE had made the £25.4bn advance, which was indicative of the serious liquidity crisis experienced by HBoS during October 2008 and failed to make public disclosure thereof, it allowed the transaction to proceed regardless of the foreseeable devastating effect the acquisition would have on LTSB shareholders.
50. Our clients are of the view that the shareholders in banks which were in serious financial trouble might not have been deserving of protection. However, in this instance the interests of shareholders of acquiring banks were not taken into account. As matters turned out the shareholders of LTSB footed the bill of HM Treasury's attempts to salvage one insolvent bank, HBoS. That cannot be justified. In his speech in the House on 25 November 2009 (Hansard vol 501 column 534) the Chancellor of the Exchequer asserted that the actions taken by HM Government during the credit crunch resulted in no savers in UK Banks or building associations having lost money. This is incorrect - many of LTSB's shareholders were entitled to believe that their investment in a AAA rated bank was tantamount to a

secure investment serving as retirement or other savings. They (and many of them were employees of LTSB or are employees of LBG) were savers and they have lost substantial sums.

D. The legal basis of the claims that our clients assert against you.

Summary of causes of action

51. As presently advised the causes of action are – based on intentional or alternatively negligent misrepresentation - that:

(1) Our client Mr Z purchased new shares in LTSB, the issuance of which was foreshadowed in the LTSB Circular. Had the truth been disclosed in the Circular or otherwise regarding the existence of the £25.4bn advance to HBoS it is likely that the acquisition would not have been approved and that he would not have committed himself to purchasing shares.

(2) Our client Mrs B was a shareholder in LTSB but was persuaded by the misleading Circular to retain her shares. Had she known the truth, and had the acquisition been approved by the LTSB shareholders, she would have sold her shares. She lost the opportunity to do so because she was unaware of the truth.

Each of our clients will claim the following causes of action in the alternative:

(1) A claim in equity based on equitable estoppel.

(2) A claim under the provisions of the European Human Rights Convention ("EHRC") and the UK Human Rights Act 1998 for losses sustained by virtue of the fact that LTSB shareholders were deprived of the peaceful possession of their property (shares) in order to save HBoS and the UK financial system.

52. With this background in mind we deal with the essence of the claims against you.

53. Misrepresentation

(1) A claim under the law relating to misrepresentation for losses suffered as a result of purchasing shares in reliance on information published of and concerning the proposed acquisition; and

(2) A claim under the law relating to misrepresentation for persons who held shares but were persuaded not to sell their shares in reliance on information published of and concerning the proposed acquisition

54. Since these claims have a lot in common we deal with them jointly. The gist of these causes of action is the blame to be attached to HM Treasury represented by Sir Nicholas in making the Statement in the context of the Circular (dealt with in Section A above). The Statement constitutes an assumption of a duty of care by HM Treasury to the addressees of the LTSB Circular, the shareholders.

55. In breach of that duty HM Treasury did not avail itself of the opportunity to disclose the crucially material fact of the advance of £25.4bn. On the available instructions it is difficult to avoid the inference that this non-disclosure was deliberately made, in fact it has been conceded that the information was kept secret: Sir Nicholas thought that it was the right thing to do yet did not do so. Mervyn King the Governor BoE said, when disclosing the loans more than a year after they had been made that he was "now able to disclose" the loans and in Parliament the Chancellor of the Exchequer confirmed that disclosure of the "extraordinary support" made on a "confidential basis" to HBOS required "fine" timing.

56. We would prefer not to file Particulars of Claim in Court making out a case based on fraud but as presently instructed we see how this can be avoided. There can be no doubt that the fact of the £25.4bn loan was not only being kept secret for the possible advantage of the UK banking system, but was deliberately kept secret so that LTSB shareholders were not put off the proposed acquisition of HBOS,

57. If you disagree with us in this regard you will provide a full and detailed reasoning as to why we should not so plead our clients' cases.

58. In the alternative HM Treasury was negligent in not making the disclosure. The nondisclosure misled shareholders into believing that the capital support given by the Government was disclosed in the Circular and was limited to the Government providing capital by taking up preference shares in HBoS and underwriting the ordinary share issue and by giving certain prospective commitments regarding guarantees.

59. Had the truth been revealed, shareholders would have been able to draw their own conclusions regarding the real state of the finances of HBOS and would probably have

concluded (as would our clients) that a loan of that magnitude was indicative of a financial position much worse than that demonstrated in the LTSB Circular and that, in fact, HBOS was insolvent and/or that the effect of the advance would have had a seriously detrimental effect on LTSB shareholder values in LBG after the acquisition. This is borne out by the fact that, to keep LBG afloat, the Government had to resort to "bail-outs" totalling almost £20bn which resulted in the suspension of dividends.

60. It is no answer to say that it was the duty of the directors of the bank to disclose the loans. Our clients say that you misled LTSB shareholders. Of course the question is begged, taking into account the absolute determination to keep the loans secret, whether the directors of LTSB and HBOS were coerced into making the bland statement which certainly did not reveal the true state of affairs (and for which they will be brought to book) rather than stating the full and true facts. Put another way – did the directors not reveal the truth because they were told not to?

61. The misrepresentation had at least the following consequences:

(1) It materially misstated the financial position of HBoS;

(2) It resulted in the approval of the acquisition; and/or

(3) It resulted in our client Mr Z committing himself to take up shares on offer by LTSB and keeping his shares which he had had prior to the acquisition;

(4) It resulted in our client Mrs B accepting that the risk of keeping her existing shares was low and persuading her not to dispose of her shares prior to or shortly after the acquisition.

62. In consequence of the misrepresentations our clients have suffered losses equating to £2.50 per new share acquired in the case of Mr Z and £1.50 per share in the case of both Mr Z and Mrs B.

63. The loss suffered by Mr Z firstly equals the difference between the position he would have been in had the acquisition not proceeded on the one hand and the position he found himself in by keeping his own shares and by acquiring new shares. On the basis of a projection of the LTSB share price if no acquisition had occurred the shares would have been worth approximately £3.00 per share. The position he found himself in having acquired the shares was that, as the parlous state of HBoS financial position was realised by the market, the actual share price dropped to some 50p (and even lower to 22p). The per share loss is accordingly calculated as £2.50 per new share acquired.

64. The further loss suffered by Mr Z and the loss suffered by Mrs B is premised on the basis that, had the truth been known and the acquisition nevertheless approved, they forfeited the opportunity to dispose of their shares, which they would have done had they known the truth. Such sale would have occurred at a price of approximately 200p per share during November 2008. Having held on to the shares, they suffered a loss calculated as being the difference between the price they would have obtained and the market price shortly after the acquisition which price level continues at present.

65. HM Treasury's misrepresentation regarding the £25.4bn loan to HBOS by not disclosing same in the Circular, is causative regarding losses arising both from the vote in favour of acquisition and regarding losses arising from shareholders' decisions regarding their ownership of shares.

Averments to be made by Mr Z and Mrs B in the Particulars of Claim

66. The gist of the averments that will be made by Mr Z should it become necessary to commence with proceedings are the following:

(1) Prior to the acquisition Mr Z purchased 34,000 ordinary shares in LTSB on 13th November 2008;

(2) He paid a sum of £2.03 per share;

(3) These shares converted to an equal number of LBG shares after the acquisition;

(4) He is still the beneficial owner of these shares;

(5) The shares are now worth approximately 50p per share;

(6) He read or saw or heard various reports in the media of and concerning the proposed merger of LTSB with HBoS;

(7) He read the LTSB and HBOS circulars and understood them to recommend the acquisition whilst it had set out the prospect of acquiring further shares;

(8) He read the prospectus of LTSB in relation to the share offer;

(9) He appreciated that HBOS was financially stressed;
(10) He understood and accepted that the proposed acquisition would be beneficial to the LTSB shareholders;
(11) He was unaware of the fact that HBOS was just prior to the proposed merger, bankrupt and in jeopardy of being nationalised;
(12) He was unaware of the fact that the state had loaned a sum of £25.4 bn to HBOS;
(13) He understood the Statement, read in the context of the LTSB Circular, as an assurance by HM Treasury that the whole truth of the funding by HM Treasury to HBoS had been revealed in the Circular;
(14) He believed and understood that as a LTSB shareholder he would acquire equity in LBG equating to 54% of LBG, his shareholding in LTSB being pro rated to the total LTSB shareholding in LBG;
(15) The misrepresentation was intended to induce shareholders to vote in favour of the acquisition and was further intended to encourage shareholders to take up shares in the new issue and it indeed had that effect;
(16) Had he known that HBOS was parlous to the extent that it was and that the Government had loaned £25.4bn to HBOS to keep it afloat, he would not have purchased new shares in LTSB but would have sold his existing shareholding instead;
(17) Had the acquisition not taken place, they would have been worth approximately £3.00 per share.
(18) In consequence of the foregoing Mr Z has suffered losses in the sum of £2.50 per share in respect of old shares and £1.50 in respect of new shares; a total thus of £85,000, which he hereby claims from HM Treasury.
67. The gist of the averments to be made by Mrs B are:
(1) Mrs B owned 837 ordinary shares in LTSB prior to its acquisition of HBoS;
(2) The shares were, prior to merger of LTSB and HBOS worth £3.00, on a projected basis whilst it traded during November 2008 at a price of approximately £2.00 per share;
(3) The shares, which were converted to LBG shares as a result of the acquisition, are now worth approximately 50p per share;
(4) Mrs B still owns these shares;
(5) Paragraphs 7-15 of Mr Z's averments are repeated in respect of Mrs B;
(6) The misrepresentation induced shareholders to vote in favour of the acquisition and was further intended to encourage shareholders to take up shares in the new issue; it further induced her to believe that had that been the situation, it would be prudent to keep her shares although she would not/could not take up the new share offer;
(7) Had she known that HBOS was parlous to the extent that it was and that the Government had loaned £25.4bn to HBOS to keep it afloat, she would have sold his existing shareholding instead;
(8) If she had sold her shares in November 2008 she was likely to have done so at a price of £2.00 per share.
(9) In consequence of the foregoing she has suffered losses in the sum of £1.50 per share a total thus of £1,255.50, which she hereby claims from HM Treasury;
68. Alternatively, Mrs B lost the chance to sell her shares in LTSB by virtue of the foregoing.
69. As a consequence of which she has suffered losses in the sum of £1.50 per share a total thus of £1,255.50, which sum, or such other sum as may be just and equitable, she hereby claims from you.
Claim in equity based on equitable estoppel
70. This claim will be pleaded in the alternative to the claims outlined above.
71. It is premised on the basis that shareholders confronted with the Circular and thereafter the prospectus could accept that on a fair value basis of both LTSB and HBOS it would result in a 54/46 split of interests once the acquisition was complete. In fact HBOS was in such a parlous state that it would not have able to keep afloat without government funding. This

situation was carried forward to LBG upon completion of the acquisition. It resulted in governmental rescues of LBG in early 2009, severely diluting the value of shares in LBG. An AAA rated bank (LTSB) was converted into one making losses, with the Government as the major shareholder and financial saviour.

72. This created an iniquitous situation for the LTSB shareholders which cries out for compensation in equity. Although compensation in equity is in the court's discretion, we consider that a point of departure is the actual damages suffered as calculated in respect of the claim based on misrepresentation and we claim payment of a like amount under this alternative claim.

A claim under the provisions of the ECHR and the Human Rights Act 1998

73. Article 1 of Protocol No 1 to the ECHR guarantees the right to property in the following terms:

"*Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a state to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.*"

74. Our clients' contentions in this regard follows. This will constitute an alternative claim both in respect of Mr Z and Mrs B.

75. First, the Government's conduct constitutes an interference with our clients' peaceful possession and enjoyment of their shares. Such conduct comprised *inter alia* of one or more or all of the following:

(1) The insistence that LTSB acquire HBoS;
(2) The insistence that payment of dividends be suspended;
(3) The barely veiled threat that LTSB would be left to their own devices to raise capital in the event of the acquisition failing;
(4) The effective manipulation of the LTSB shareholders' vote regarding the acquisition by withholding the material information regarding the £24,5bn advance to HBoS;
(5) Placing the interests of the LTSB shareholders on the sacrificial altar of saving HBoS.

76. The Government's conduct was not informed by legislation.

77. The state's interference with the right to peaceful enjoyment of possessions shall be allowed only if:

(1) it is prescribed by law;
(2) it is in the public interest; and
(3) it is necessary in a democratic society.

78. All three conditions must be fulfilled cumulatively. Should any one of them not have been met, there will have been a violation of the ECHR.

79. Clearly the Government did not meet all three requirements: whilst we accept that they purported to act in the public interest in its endeavour to save the UK banking system its interference was not prescribed by law.

80. Our clients claim in this respect is the monetary loss suffered, calculated in the same manner as the calculation made in the Misrepresentation claim.

Draft allegations regarding claim under ECHR

Mr Z

(1) Prior to the acquisition Mr Z purchased 34,000 ordinary shares in LTSB on 13 November 2008;
(2) He paid a sum of £2.03 per share;
(3) These shares converted to an equal number of LBG shares after the acquisition;
(4) He is still the beneficial owner of these shares;
(5) The shares are now worth approximately 50p;
(6) He was/is entitled to the peaceful enjoyment of property, viz his shares in LTSB/LBG.
(7) Mr Z's peaceful possession of his property was disturbed by the following

acts or omissions by HM Treasury:
a. The insistence that LTSB acquire HBoS;
b. The insistence that payment of dividends be suspended;
c. The barely veiled threat that LTSB would be left to their own devices to raise capital in the event of the acquisition failing;
d. The effective manipulation of the LTSB shareholders' vote regarding the acquisition by withholding the material information regarding the £24,5bn advance to HBoS;
e. By placing the interests of the LTSB shareholders on the altar of saving HBoS.
(8) In so depriving him of his possessions the state did not act in a manner which was:
a. prescribed by law;
b. in the public interest; and
c. necessary in a democratic society;
and in consequence HM Treasury has contravened Article 1 of Protocol No 1 to the EHRC.
(9) Had it not been for the foregoing, it is unlikely that the acquisition would have been approved by LTSB shareholders and Mr Z would still have had possession of his shares at a value of approximately £3.00 per shares and would have earned dividends since January 2009
81. In consequence of the foregoing, Mr Z has suffered losses in the sum of £2.50 per share a total thus of £85,000 which he hereby claims from HM Treasury

Mrs B.

(1) Prior to the acquisition Mrs B purchased 837 ordinary shares in LTSB;
(2) These shares converted to an equal number of LBG shares after the acquisition;
(3) She is still the beneficial owner of these shares;
(4) The shares are now worth approximately 50p;
(5) She was/is entitled to the peaceful enjoyment of property, viz her shares in LTSB/LBG.
(6) Her peaceful possession of her property was disturbed by the following acts or omissions by HM Treasury:
a. The insistence that LTSB acquire HBoS;
b. The insistence that payment of dividends be suspended;
c. The barely veiled threat that LTSB would be left to their own devices to raise capital in the event of the acquisition failing;
d. The effective manipulation of the LTSB shareholders' vote regarding the acquisition by withholding the material information regarding the £24,5bn advance to HBoS;
e. By placing the interests of the LTSB shareholders on the altar of saving HBoS.
(7) In so depriving him of his possessions HM Treasury did not act in a manner which was:
a. prescribed by law;
b. in the public interest; and
c. necessary in a democratic society;
and in consequence HM Treasury has contravened Article 1 of Protocol No 1 to the EHRC.
(8) Had it not been for the foregoing, it is unlikely that the acquisition would have been approved by LTSB shareholders and Mrs B would still have had possession of her shares at a value of approximately £3.00 per shares and would have earned dividends since January 2009
82. In consequence of the foregoing, Mrs B has suffered losses in the sum of £2.50 per share a total thus of £2,092.50, which she hereby claims from HM Treasury.

E. CONCLUDING REMARKS

83. We await:
(1) Your acknowledgement by 18/06/2010; and

(2) Your detailed and full response by 03/08/2010.

Yours faithfully
Winckworth Sherwood LLP
DT 020 7593 5181
DF 020 7593 0306
jrai@wslaw.co.uk

Mr Eric Daniels
25 Gresham Street
London
EC2V 7HN

Dear Mr Daniels
Letter before action by (1) X Y Z and (2) A B
Claim for loss and damages caused by the directors of Lloyds TSB plc in relation to the merger of that bank with HBOS plc
A. Introduction
1. This is a letter before action and is written to you in compliance with the requirements of the Civil Procedure Rules and particularly Sections II, III and IV of the "Practice Direction – Pre-Action Conduct" (the "Practice Direction"). These sections deal with the courts' approach in relation to all types of proceedings and the principles governing the conduct of the parties in cases not subject to a specific pre-action protocol. We attach a copy for your convenience.
2. Our clients were shareholders in Lloyds TSB Plc ("LTSB") prior to its acquisition of HBOS plc ("HBoS)" (the "acquisition"). They are currently shareholders of Lloyds Banking Group Plc "LBG", which came into existence as a result of the acquisition. They suffered both loss and damage in the process. Our instructions are that those losses were caused by you.
3. Without confining the legal basis for your liability (which we will review upon consideration of your response to this letter) our clients hold you responsible for the fact that, while you were aware that the Bank of England ("BoE") had made an advance of £24.5bn to HBoS during or about October 2008, no mention of this loan was made in the Prospectus of 18th November and the LTSB Circular.
4. The gist of the claim is that in not making the disclosure you misled LTSB shareholders, and specifically our clients.
5. In addition our clients assert an equitable remedy based on promissory estoppel as more fully set out below. These claims will be brought in the alternative to other claims, as more fully described in Section D hereof
B. The provisions of the Practice Direction
6. There is no prescribed pre-action protocol for the claims made by our clients against you. The position is accordingly governed by the Practice Directions. We set out below those portions of the Practice Directions which are important to note. You are nevertheless advised to consult the entire Practice Direction before responding to this letter.
7. Before starting proceedings the parties should:
(1) exchange sufficient information about the matter to allow them to understand each other's position and make informed decisions about settlement and how to proceed;
(2) make appropriate attempts to resolve the matter without starting proceedings, and in particular consider the use of an appropriate form of ADR in order to do so.
8. The Practice Directions require that parties should act in a reasonable and proportionate manner in all dealings with one another. In particular, the costs incurred in complying should be proportionate to the complexity of the matter and any money at stake. The parties must not use the Practice Direction as a tactical device to secure an unfair advantage for one party or to generate unnecessary costs.
9. Before starting proceedings:

(1) the claimant should set out the details of the matter in writing by sending a letter before claim to the defendant. This letter before claim is not the start of proceedings; and
(2) the defendant should give a full written response within a reasonable period, preceded by a written acknowledgment of the letter before claim.
10. Your acknowledgement of this communication is required within 14 days (if your full response has not been received before then). Your full response is required within 90 days from date hereof.
11. Your acknowledgement should comply with the Practice Directions in all respects and:-
(1) should state whether an insurer is or may be involved and specifically provide:-
a. Your bankers' blanket policy of insurance;
b. Directors' and officers' policies of insurance;
c. Any policies of Before The Event Litigation Risk Insurance that you have;
d. Any policies of After The Event Litigation Risk Insurance that you have;
e. Any policies of insurance relating to the merger specifically;
f. All and any agreements, undertakings, guarantees/warrantees and the like that you have from any person or entity whomsoever, by which you are indemnified and held harmless in relation to claims arising from the exercise of your duties as an executive director of LTSB and/or LBG;
g. All and any agreements, undertakings, guarantees/warrantees and the like that you have from any person or entity whomsoever, by which you are indemnified and held harmless in relation to claims arising from the exercise of your duties as an executive director of LTSB and/or LBG in relation to the merger of LTSB and HBoS;
h. All and any agreements, undertakings, guarantees/warrantees and the like that you have from any person or entity whomsoever, by which you are indemnified and held harmless in relation to claims arising from the exercise of your duties as an executive director of LTSB and/or LBG in relation to the disclosures made in all or any of the Prospecti, announcements, circulars, press releases, statements to the press and the like in connection with the merger foresaid; and
i. All and any assurances, insurance, agreements, undertakings, guarantees/warrantees and the like that you have from any person or entity whomsoever, by which you are indemnified and held harmless in relation to claims arising from the exercise of your duties as an executive director of LTSB and/or LBG in relation to the non-disclosures of the loan of almost £26 billion by the State to HBoS and/or any other loans to HBoS made in all or any of the Prospecti, announcements, circulars, press releases, statements to the press and the like in connection with the merger foresaid; and
(2) should state the date by which you (or the insurer/s) will provide a full written response and if it is a date later than 90 days from date hereof:
a. you should give reasons why a longer period is needed;
b. if the reason is that you are seeking advice you should state that fact; from whom the advice is sought; and when you expect to have received that advice or be in a position to provide a full response.
(3) may request further information to enable you to provide a full response.
12. Your full written response should:
(1) accept the claim in whole or in part; or
(2) state that the claim is not accepted; and unless you accept the whole of the claim, the response should:
(3) give reasons why the claim is not accepted, identifying which facts and which parts of the claim (if any) are accepted and which are disputed, and the basis of that dispute;
(4) state whether you intend to make a counterclaim against our client (and, if so, provide information equivalent to this letter before claim);
(5) state whether you allege that our client was wholly or partly to blame for the problem that led to the dispute and, if so, summarise the facts relied on;

(6) state whether you agree to our proposals below for Alternative Dispute Resolution ("ADR") and if not, state why not and suggest an alternative form of ADR (or state why none is considered appropriate);
(7) list the essential documents on which you intend to rely;
(8) enclose copies of documents requested by us below, or explain why they will not be provided; and
(9) identify and ask for copies of any further relevant documents, not in your possession and which the defendant wishes to see.
13. We shall respond to your reply within 14 days after receipt thereof.
14. The Practice Directions further require that starting proceedings should be a step of last resort, and proceedings should not normally be started when a settlement is still actively being explored. Although ADR is not compulsory, the parties should consider whether some form of ADR procedure might enable them to settle the matter without starting proceedings. The court may require evidence that the parties considered some form of ADR. We propose that the parties should agree to submit the dispute to mediation. A mediator/s should be agreed between the parties, position papers and documents exchanged and a private and confidential mediation should be undertaken by the parties as soon as is practicable after we have provided our client's response as provided for in paragraph 6 above.
15. Documents provided by one party to another in the course of complying with this letter must not be used for any purpose other than resolving the matter, unless the disclosing party agrees in writing.
16. Our clients are required to say whether they have entered into a funding arrangement and we advise you in this regard that they have joined Lloyds Action Now Association, a voluntary non-incorporated association of erstwhile shareholders in LTSB. A copy of the Constitution of the Association, comprising of the Rules and Methodology of the Association is attached. Our client will, at the appropriate time, be able and prepared to put up reasonable security for costs in the event that it becomes necessary to issue proceedings. This is not an issue that we are prepared at this stage to deal with beyond what is stated in this paragraph. Should there be any development regarding funding arrangements before you provide your full response, we will let you know thereof.
17. We provide the following information to you:-
(1) the claimants' full name are as stated above;
(2) the basis on which the claim is made, a summary of the facts on which the claim is based, what our client demands from you and how our client's financial loss is calculated, is set out below.
18. We presume that you will be legally represented but you should note that:
(1) the court has powers to impose sanctions for failure to comply with this letter; and
(2) ignoring this letter before claim may lead to our clients starting proceedings and may increase your liability for costs.
19. We shall provide the documents and/or explanations reasonably requested by you within as short a period of time as is practicable or explain in writing why the documents will not be provided.
20. Documents specifically requested.
Without derogating from the general obligation that you have, in accordance with the Practice Directions, to answer this letter fully and substantively and to provide documentation, we request copies of the following specific documentation and information:-
(1) There are indications that LTSB loaned a sum of about £10 billion (or any other amount) to HBoS following the meeting in September 2008 and before the merger in February 2009:-
i. Please confirm or deny this;
ii. Please provide a copy of the agreements entered into between HBoS and LTSB in this regard – in the event that you admit this allegation.
(2) A copy of the accountants' reports in relation to the merger following the process of due diligence, as well as all drafts thereof in your possession, are required. To the extent that these documents are in your possession ex officio they are required in any event.
(3) A copy of the notes taken by you and/or on your behalf at and following and

consequent upon the meetings at the Treasury in September/October 2008 are required.
(4) Copies of all and any documents evidencing you expectations and/or undertakings received and/or calculations made regarding and/or discussions that you had as to your remuneration, incentives, bonuses and/or rewards following the merger are required.
(5) Copies of all correspondence between HM Treasury and/or Sir Nicholas Macpherson on the one hand and LTSB and any of its directors or employees or any of its advisers named in the LTSB Circular dated 3 November 2008 between the period 16 September 2008 and 3 November 2008 regarding the statement in the LTSB Circular dated 3 November 2008 at page 246 paragraph 1 part XII (additional information) which read as follows:
"*Nicholas Macpherson (acting in his capacity as permanent secretary to HM Treasury) (the 'HM Treasury responsible person') accepts responsibility for the information contained in this document relating to HM Treasury, including any statements of expectation or intention on the part of HM Treasury. To the best of the knowledge and belief of the HM Treasury responsible person (who has taken all reasonable care to ensure that such is the case), the information contained in this document for which he is responsible is in accordance within effects and does not omit anything likely to affect the import of such information.*"
(6) Any drafts of the Statement, whether in hard copy or electronic form preceding the ones which were published in the respective HBoS and LTSB Circulars;
(7) A copy of the *a postiori* report drafted following the merger.
21. In following the above procedure, the parties will have a genuine opportunity to resolve the matter without needing to start proceedings. At the very least, it should be possible to establish what issues remain outstanding so as to narrow the scope of the proceedings and therefore limit potential costs and, if having completed the procedure, the matter has not been resolved, then we should undertake a further review of your and our client's respective positions to see if proceedings can still be avoided.

C. Relevant background facts and circumstances

General

22. In relation to the various causes of action the following background facts and circumstances are relevant. We appreciate that you are familiar with the bulk thereof yet we find it expedient to do so in order to put our clients' claims in perspective.
23. Patterns of lending, particularly interbank lending, were disturbed since summer 2007 when fear of counter-parties' liquidity resulted in instability and volatility in the international financial markets.
24. The UK Government stepped in to address the situation by taking certain steps in an endeavour to stabilise the situation. The Banking (Specific Provisions) Act 2008 ("the BSP Act") was introduced with effect from 21 February 2008, operative for one year only. The nationalisation of Northern Rock and the mortgage book business of Bradley & Bingley were effected in terms of the BSP Act. The BSP Act was substituted by the Banking Act 2009. Despite the existence of the BSP Act during the period September 2008 to January 2009 (during which the facts pertinent to the causes of action pursued herein arose) government did not purport to act in terms thereof when the salvation of HBOS was sought by means of the acquisition thereof by LTSB. Neither were the retrospective powers provided for in the Banking Act 2009 utilised for that purpose.
25. Despite this volatility LTSB retained its AAA credit rating during 2008. RBS and HBOS were ostensibly in serious financial trouble by the summer of 2008. The government had to deal with this state of affairs against the background of the huge commitments incurred in respect of the Northern Rock and Bradley & Bingley nationalisations.
26. By early September 2008 Fannie Mae and Freddie Mac were placed in conservatorship and Lehman Bros failed spectacularly. On 18 September 2008 LTSB and HBOS announced that HBOS had received an approach from LTSB with a view to it acquiring HBOS.
27. On 8 October 2008 HM Government, after consultation with BoE and the Financial Services Authority ("FSA") announced that it was bringing forward specific and comprehensive

measures to ensure the stability of the financial system and to protect ordinary savers, depositors and borrowers. Conspicuously absent from the parties government wished to protect, were shareholders of affected banks (despite the fact that many shareholders had invested in LTSB as a form of saving for retirement or to provide for education etc). The following salient facts emerged from the announcement (press release annexed):
(1) In its provision of short-term liquidity the BoE would extend and widen its facilities in whatever way necessary to ensure the stability of the system. At least £200 billion would be made available to banks under the special liquidity scheme. In addition government would establish a facility, which would make available Tier 1 capital in appropriate form (expected to be preference shares or PIBS) to eligible institutions. Eligible institutions were UK incorporated banks (including UK subsidiaries of foreign institutions which have had a substantial business in the UK and building societies).
(2) Following discussions convened by HM Treasury several banks, amongst which LTSB and HBOS, confirmed their participation in a government supported recapitalisation scheme.
(3) Participating institutions committed to the Government that they would increase their total Tier 1 capital by £25 billion. This was an aggregate increase and individual increases would vary from institution to institution. In order to facilitate this process the Government would be making available £25 billion to be drawn on by these institutions if desired to assist in this process as preference share capital or PIBS and was also willing to assist in the raising of ordinary equity if requested to do so.
(4) In addition to this the Government stood ready to provide an incremental minimum of £25 billion of further support for all eligible institutions, in the form of preference shares, PIBS or, at the request of an eligible institution, as assistance to an ordinary equity fund raising.
(5) The amount to be issued per institution would be finalised following detailed discussions. If the Government was to provide the capital, the issue would carry terms and conditions and reflect the financial commitment being made by the taxpayer.
(6) The government would take decisive action to reopen the market for medium term funding for eligible institutions that raise appropriate amounts of Tier 1 capital. Specifically the Government would make available to eligible institutions for an interim period as agreed and on appropriate commercial terms, a government guarantee of new short and medium term debt issuance to assist in refinancing maturing, wholesale funding obligations as they fell due.
(7) To qualify for this support the relevant institution had to raise Tier 1 capital by the amount and in the form the Government considered appropriate whether by government subscription or from other sources. It was being made available immediately to inter alia LTSB and HBOS.
28. On 13 October 2008 the boards of both LTSB and HBOS announced that they would participate in the proposed government funding. HBOS undertook to raise £11.5 billion and LTSB £5.5 billion of new capital.
29. Only in December 2009 was it publicly disclosed that BoE, with the knowledge of HM Treasury, had advanced an amount of £25.4 billion to HBOS during October 2008. This fact was not made public at any stage before:
a. the respective Circulars were published;
b. the LTSB shareholders had to consider approving the acquisition;
c. LTSB shareholders who considered partaking in the scheme of the acquisition had to make informed decisions regarding the purchase of new shares or the disposal of existing shareholdings.
30. The loan was known to you specifically and to the tripartite authorities and the boards of LTSB and HBOS.
31. In your evidence earlier this year to a parliamentary Select Committee your said the following in replies to questions posed:
“Mr Fallon: But you did not disclose the £25 billion.

Mr Daniels: Correct.
Mr Fallon: Why was that?
Mr Daniels: It was not felt to be necessary because the fact that the amount of funding was substantial, the fact that HBOS was completely dependent on it and the fact that HBOS would not be able to operate without it was viewed as more than sufficient".

32. The loan of £62 billion of taxpayer backed emergency funding for RBS (£36bn) and HBOS (£25.4bn) was kept secret ostensibly in an effort to ensure the success of the proposed government funding announced on 8 October 2008.

33. This was done in apparent disregard of the interests of shareholders of LTSB, who collectively have lost in excess of £14bn. Knowledge of the £25.4bn loan would have had a considerable influence on the decisions which LTSB shareholders had to take, namely whether to consent to the acquisition, or purchase shares under circumstances where there was such a material black hole in the financial position of HBOS which had to be filled by government funding and/or to take up the share offer explained in the LTSB Circular and the subsequent LTSB Prospectus and/or to decide whether or not to retain LTSB shares at all. In particular, it should have been clear not only that this substantial funding would become a liability of LBG upon completion of the acquisition, but that it was indicative of the desperate financial status in which HBOS had found itself. It should have been foreseeable that such weakness, once detected by the markets, would have had a vastly detrimental effect on the share price of LBG. In the event and very shortly after consummating the deal government "bail outs" totalling almost £20bn had to be doled out with the suspension of dividends.

34. Most importantly, it would have been apparent that disclosure of this fact before the acquisition would seriously jeopardise the acquisition thereby risking the failure of HBoS and resulting either in its bankruptcy or its nationalisation. Instead, by keeping the £25.4bn funding secret, the likelihood of the approval of the acquisition was vastly improved, but at the potential expense of the LTSB shareholders who would become shareholders in LBG with all the toxic baggage of HBoS attached to the new entity.

35. Circulars announcing the acquisition and the terms thereof were issued by LTSB on 3 November 2008 and by HBOS on or about 13 November 2008. By that time the making of the £25.4 billion advance was, seen in retrospect, a *fait accompli*. None of the Circulars disclosed this fact.

The HBoS Circular (copy attached)

36. At present we do not assert that relief can be obtained on behalf of our clients against HBOS or its directors at the time but it is nevertheless valuable to highlight a few matters evident from its circular. It sought to raise the sum of £11,5 billion by a placing an open offer of approximately 7,5 billion shares at 113.6p per open offer share and a HM Treasury preference share subscription of 3 million shares at £1,000 each. After completion of this process, the ordinary HBoS shares would be swapped at a ratio of 0.605 for one LTSB share.

37. Not surprisingly, the HBOS board expressed the view that the transaction would be beneficial to its own shareholders.

38. At paragraph 2, page 14, it is stated that on 18 September 2008 the boards of HBoS and LTSB (with the support of the UK government) announced that they had reached agreement on the terms of the recommended acquisition of HBoS by LTSB. This is unambiguous confirmation of the material intervention of government in the restructuring of the respective banks prior to 18 September 2008.

The LTSB Circular (copy attached)

39. The information in the Circular relating to HM Treasury and for which Sir Nicholas took responsibility appears *inter alia* in the following passages of the LTSB Circular:

(1) It is a recurrent theme that if the resolutions on which the placing and open offer or the acquisition are conditional were not approved or for some other reason the placing and open offer agreement was terminated or the acquisition did not complete, the proposed government funding would not be available to Lloyds TSB (See letter to shareholders p11 and the passage at p20 to the following effect:

"Accordingly, the placing and open offer and the acquisition are interconditional. If the resolutions on which the placing and open offer or the acquisition are conditional are not approved or for some other reason the

placing and open offer agreement is terminated or the acquisition does not complete, HM Treasury has stated that, in that event, it would expect Lloyds TSB to take appropriate action to address its capital position in the light of the policy objectives set out in HM Treasury's announcement of 8 October 2008 on financial support to the banking industry"
(see also p41, paragraph 2.1; p47, paragraph 1*);*
(2) The depth of HM Treasury's extraordinary involvement in the acquisition process appears from the fact that HM Treasury was party to the placing and open offer agreement effective as of 13 October 2008 entered into between Lloyds TSB, HM Treasury, Citigroup Global Markets Limited, Citigroup Global Markets UK Equity Limited, Merrill Lynch and UBS (paragraph 9.1.3); and had the right, in its discretion, to waive certain conditions (p19, *p*54, paragraph 3)
(3) Although the information (p20) correctly deals with the fact that upon completion of the acquisition and the HBOS preference shares scheme, HM Treasury would be owning £4 billion enlarged group HMT preference shares and that the enlarged group would need to repurchase or redeem an aggregate of £4 billion of new preference shares before payment of dividends on ordinary shares could resume, this passage appears to indicate the total exposure of LBG to HM Treasury upon completion of the acquisition. However, it misrepresented the total exposure which LBG would have had. It was an appropriate opportunity for you, your codirectors and Sir Nicholas to divulge the existence of the £25.4bn funding to HBoS which would become a liability of LBG.
(4) The same duty arose if regard is had to paragraph 12.2 (p266) where the massive funding which had occurred during October 2008 was simply ignored:
"HBOS GROUP" : Save for the £4 billion net cash proceeds raised by HBOS in its rights issue in July 2008 and as disclosed in the sections headed "Group Overview", "Divisional Review" and "Outlook" in part XII ("HBOS Interim Management Statement 3 November 2008") of this document, which sets out the current trading, trends and prospects of the HBOS group, ***there has been no significant change in the financial or trading position of the HBOS group since 30 June 2008****, the date to which HBOS' last published interim financial information (which is set out in part IX ("Historical Financial Information Relating to HBOD PLS") of this document) was prepared."*
This clearly called for correction. None was forthcoming.
(5) A further example of a misrepresentation which required necessary disclosure is found at:
a. p22: In calculating the core tier 1 ratio no account has been taken of the trading performance of Lloyds TSB or HBOS **or of other transactions** by Lloyds TSB or **HBOS** since 30 June 2008, including the sale by HBOS of Bank West and St Andrews, except for the equity placing completed by Lloyds TSB on 19 September 2008; and
b. p271, in relation to HBoS:
"The proposed placing of £8.5 billion additional equity and £3 billion 12% preference shares in January 2009, subject to shareholder approval, would be equivalent to an increase in the relevant capital ratios at that time of some 340 BPS for tier I and 250 BPS for core tier I. Most importantly, this injection of capital is linked to the provision of government guarantees for certain wholesale funding issuance. This materially strengthens the group's funding position following deposit outflows in September and in the first half of October, which have now slowed significantly."
(6) A shareholder would have been justified to infer that aid in the form of government guarantees had been provided and that it (and nothing else) strengthened the group's funding position. Nothing is said of the vast amount of BoE funding of £25.4bn without which HBoS would probably have been constructively insolvent. Sir John Gieve (Deputy Governor BoE) said that after the demise of Lehman Bros

"we knew straight away that the British banks most in doubt Bradford and Bingley and HBOS would be in the firing line the next day". It is a clear omission for which you should be held liable. Patently misleading is the passage at p33 which deals with the future funding assistance by the Government and which spells out that "how and when such measures will be implemented are uncertain." It unambiguously creates the impression that such funding is only prospective whereas you knew at that stage that substantial funding had already been granted to HBOS and would be subsumed into LBG debt.

(7) Under circumstances where (at p38, paragraph 1.14) mention is made that *"The State aid rules aim to prevent companies from being given an artificial or unfair competitive advantage as a result of governmental assistance"* it would have been the ideal situation to disclose that HBoS was indeed enjoying a competitive advantage by burying its disastrous financial position under the £25.4bn BoE funding.

The LTSB Prospectus and Supplementary Prospectus

40. Parts III and V of the LTSB Circular are incorporated in the text of the prospectus (page 18, paragraph 1.14 and page 62 paragraph B). Warnings of the consequences of noncompliance with the acquisition and taking up of shares were repeated. (paragraph2.1, page 21, pages 43 and 54). There is no mention of the £25.4 billion issue.

41. The supplementary prospectus issued in December 2008 also failed to disclose the existence of the £25.4bn advance.

Inferences to be drawn from the background circumstances

42. By the time the circulars were published in early November 2008, you not only had knowledge of the £25.4 billion advance made to HBOS during October 2008 but you went along with the Government's election to maintain secrecy which adversely affected LTSB shareholders' attitude to vote in favour of the acquisition (or to take up shares on offer or to dispose of shares in LTSB or not to dispose of current shareholdings).

43. You knew that HM's Government not only encouraged the acquisition but actively promoted and facilitated it, inter alia by sidestepping EU competition laws that stood in the way of the deal.

44. Our instructions are that you pursued this course of action regardless of the interests of LTSB shareholders. In particular, after BoE had made the £25.4bn advance, which was indicative of the serious liquidity crisis experienced by HBoS during October 2008 and failed to make public disclosure thereof, it allowed the transaction to proceed regardless of the foreseeable devastating effect the acquisition would have on LTSB shareholders.

45. Our clients are of the view that the shareholders in banks which were in serious financial trouble might not have been deserving of protection. However, in this instance the interests of shareholders of acquiring banks were not taken into account. As matters turned out the shareholders of LTSB footed the bill of HM Treasury's attempts to salvage one insolvent bank, HBOS. That cannot be justified.

D. The legal basis of the claims that our clients assert against you.

Summary of causes of action

46. As presently advised the causes of action are – based on intentional or alternatively negligent misrepresentation –

(1) That our client Mr Z purchased new shares in LTSB, the issuance of which was foreshadowed in the LTSB Circular. Had the truth been disclosed in the Circular or otherwise regarding the existence of the £25.4bn advance to HBOS it is likely that the acquisition would not have been approved and that our client would not have committed himself to purchasing new shares.

(2) Our client Mrs B was a shareholder in LTSB but was persuaded by the misleading Circular to retain her shares. She could not/would not purchase new shares. Had she known the truth, and had the acquisition been approved by the LTSB shareholders, she would have sold her shares. She lost the opportunity to do so because she was unaware of the truth.

(3) Each of our clients will claim alternatively in equity based on equitable estoppel.

47. With this background in mind we deal with the essence of the claims against you.

48. Misrepresentation

(1) A claim under the law relating to misrepresentation for losses suffered as a result of purchasing shares in reliance on information published of and concerning the proposed acquisition; and
(2) A claim under the law relating to misrepresentation for persons who held shares but were persuaded not to sell their shares in reliance on information published of and concerning the proposed acquisition
Since these claims have a lot in common we deal with them jointly.
49. In breach of that duty you did not avail yourself of the opportunity to disclose the crucially material fact of the advance of £25.4bn. On the available instructions it is difficult to avoid the inference that this non-disclosure was deliberately made, in fact it has been conceded that the information was kept secret.
50. We would prefer not to file Particulars of Claim in Court making out a case based on fraud but
as presently instructed we seem compelled to do so. There can be no doubt – the fact of the loans was deliberately and calculatedly kept secret so that LTSB shareholders were not put off the proposed acquisition of HBOS.
51. If you disagree with us in this regard you will provide a full and detailed reasoning as to why we should not so plead our clients' cases.
52. In the alternative you were negligent in not making the disclosure. The non-disclosure misled shareholders into believing that the capital support given by the Government was disclosed in the Circular and was limited to the Government providing capital by taking up preference shares in HBOS and underwriting the ordinary share issue and by giving certain prospective commitments regarding guarantees.
53. Had the truth been revealed, shareholders would have been able to draw their own conclusions regarding the real state of the finances of HBOS and would probably have concluded (as would our clients) that a loan of that magnitude was indicative of a financial position much worse than that demonstrated in the LTSB Circular and that, in fact, HBOS was insolvent and/or that the effect of the advance would have had a seriously detrimental effect on LTSB shareholder values in LBG after the acquisition. This is borne out by the fact that, to keep LBG afloat, the Government had to resort to "bail-outs" totalling almost £20bn which resulted in the suspension of dividends.
54. The misrepresentation had at least the following consequences:
(1) It materially misstated the financial position of HBoS;
(2) It resulted in the approval of the acquisition; and/or
(3) It resulted in our client Mr Z committing himself to take up shares on offer by LTSB;
(4) It resulted in our client Mrs B accepting that the risk of keeping her existing shares was low and persuading her not to dispose of her shares prior to or shortly after the acquisition.
55. In consequence of the misrepresentations our clients have suffered losses equating to £2.50 per new share acquired in the case of Mr Z and £1.50 per share in the case of Mrs B.
56. The loss suffered by Mr Z firstly equals the difference between the position he would have been in had the acquisition not proceeded on the one hand and the position he found himself in by keeping his own shares and by acquiring new shares. On the basis of a projection of the LTSB share price if no acquisition had occurred the shares would have been worth approximately £3.00 per share. The position he found himself in having acquired the shares was that, as the parlous state of HBoS financial position was realised by the market, the actual share price dropped to some 50p (and even lower to 22p). The per share loss is accordingly calculated as £2.50 per new share acquired.
57. The loss suffered by Mrs B is premised on the basis that, had the truth been known and the acquisition nevertheless approved, she forfeited the opportunity to dispose of the shares, which she would have done had she known the truth. Such sale would have occurred at a price of approximately 200p per share during November 2008. Having held on to the shares, she suffered a loss calculated as being the difference between the price they would have obtained and the market price shortly after the acquisition which price level continues at present.

58. The misrepresentation regarding the £25.4bn loan to HBOS by not disclosing same in the Circular, is causative regarding losses arising both from the vote in favour of acquisition and regarding losses arising from shareholders' decisions regarding their ownership of shares.

Averments to be made by Mr Z and Mrs B in the Particulars of Claim

59. The gist of the averments that will be made by Mr Z should it become necessary to commence with proceedings are the following:

(1) Prior to the acquisition Mr Z purchased 34,000 ordinary shares in LTSB on 13th November 2008;

(2) He paid a sum of £2.03 per share;

(3) These shares converted to an equal number of LBG shares after the acquisition;

(4) He is still the beneficial owner of these shares;

(5) He read or saw or heard various reports in the media of and concerning the proposed merger of LTSB with HBOS;

(6) He read the LTSB and HBOS circulars and understood them to recommend the acquisition whilst it had set out the prospect of acquiring further shares;

(7) He read the Circular of LTSB in relation to the share offer;

(8) He appreciated that HBOS was financially stressed;

(9) He understood and accepted that the proposed acquisition would be beneficial to the LTSB shareholders;

(10) He was unaware of the fact that HBOS was just prior to the proposed merger, bankrupt and in jeopardy of being nationalised;

(11) He was unaware of the fact that the state had loaned a sum of £25.4 bn to HBOS;

(12) He understood the Statement, read in the context of the LTSB Circular, as an assurance by HM Treasury that the whole truth of the funding by HM Treasury to HBoS had been revealed in the Circular;

(13) He believed and understood that as a LTSB shareholder he would acquire equity in LBG equating to 54% of LBG, his shareholding in LTSB being pro rated to the total LTSB shareholding in LBG;

(14) The misrepresentation was intended to induce shareholders to vote in favour of the acquisition and was further intended to encourage shareholders to take up shares in the new issue and it indeed had that effect;

(15) Had he known that HBOS was parlous to the extent that it was and that the Government had loaned £25.4bn to HBOS to keep it afloat, he would not have purchased new shares in LTSB;

(16) Had the acquisition not taken place, they would have been worth approximately £3.00 per share.

(17) In consequence of the foregoing he has suffered losses in the sum £2.50 in respect per share; a total thus of £85,000, which he hereby claims from you.

(18) It may emerge that your conduct was calculated to benefit you personally:-

a. financially, in terms of bonus and/or salary; and/or

b. in a non pecuniary manner such as honours or prestige;

and in that event our client shall claim exemplary damages in addition to the above.

60. The gist of the averments to be made by Mrs B are:

(1) She owned 837 ordinary shares in LTSB prior to its acquisition of HBoS;

(2) The shares were, prior to merger of LTSB and HBOS worth £3.00, on a projected basis whilst it traded during November 2008 at a price of approximately £2.00 per share;

(3) The shares, which were converted to LBG shares as a result of the acquisition, are now worth approximately £00.50p;

(4) She still owns these shares;

(5) Paragraphs 5-16 of Mr Z's averments are repeated in respect of Mrs B;

(6) The misrepresentation induced shareholders to vote in favour of the acquisition and was further intended to encourage shareholders to take up shares in the new issue; it further induced her to believe that had that been the situation, it would be prudent to keep her shares although she would not/could not take up the new

share offer;
(7) Had she known that HBOS was parlous to the extent that it was and that the Government had loaned £25.4bn to HBOS to keep it afloat, she would have sold his existing shareholding instead;
(8) If she had sold his shares in November 2008 she was likely to have done so at a price of £2.00 per share.
61. In consequence of the foregoing she has suffered losses in the sum of £1.50 per share a total
thus of £1,255.50, which she hereby claims from you;
62. It may emerge that your conduct was calculated to benefit you personally:
(1) financially, in terms of bonus and/or salary; and/or
(2) in a non pecuniary manner such as honours or prestige;
and in that event our clients shall claim exemplary damages in addition to the above.
63. Alternatively, Mrs B lost the chance to sell her shares in LTSB by virtue of the foregoing.
64. As a consequence of which she has suffered losses in the sum of £1.50 per share a total thus
of £1,255.50, which sum, or such other sum as may be just and equitable, she hereby claims from you.
Claim in equity based on equitable estoppel
65. This claim will be pleaded in the alternative to the claims outlined above.
66. It is premised on the basis that shareholders confronted with the Circular and thereafter the prospectus could accept that on a fair value basis of both LTSB and HBOS it would result in a 54/46 split of interests once the acquisition was complete. In fact HBOS was in such a parlous state that it would not have able to keep afloat without government funding. This situation was carried forward to LBG upon completion of the acquisition. It resulted in governmental rescues of LBG in early 2009, severely diluting the value of shares in LBG. A AAA rated bank (LTSB) was converted into one making losses, with the Government as the major shareholder and financial saviour.
67. This created an iniquitous situation for the LTSB shareholders which cries out for compensation in equity. Although compensation in equity is in the court's discretion, we consider that a point of departure is the actual damages suffered as calculated in respect of the claim based on misrepresentation and we claim payment of a like amount under this alternative claim.

E. Concluding remarks

68. We await:
(1) Your acknowledgement by 18/06/2010; and
(2) Your detailed and full response by 03/08/2010.

Yours faithfully
Winckworth Sherwood LLP
DT 020 7593 5181
DF 020 7593 0306
jrai@wslaw.co.uk

Sir Victor Blank
Chippinghurst Manor
Chippinghurst

OXFORD
OX44 9JP

Dear Sir Victor

Letter before action by (1) X Y Z and (2) A B

Claim for loss and damages caused by the directors of Lloyds TSB plc in relation to the merger of that bank with HBOS plc

A. Introduction

1. This is a letter before action and is written to you in compliance with the requirements of the Civil Procedure Rules and particularly Sections II, III and IV of the "Practice Direction – Pre-Action Conduct" (the "Practice Direction"). These sections deal with the courts' approach in relation to all types of proceedings and the principles governing the conduct of the parties in cases not subject to a specific pre-action protocol. We attach a copy for your convenience.
2. Our clients were shareholders in Lloyds TSB Plc ("LTSB") prior to its acquisition of HBOS plc ("HBoS)" (the "acquisition"). They are currently shareholders of Lloyds Banking Group Plc "LBG", which came into existence as a result of the acquisition. They suffered both loss and damage in the process. Our instructions are that those losses were caused by you.
3. Without confining the legal basis for your liability (which we will review upon consideration of your response to this letter) our clients hold you responsible for the fact that, while you were aware that the Bank of England ("BoE") had made an advance of £24.5bn to HBoS during or about October 2008, no mention of this loan was made in the Prospectus of 18th November and the LTSB Circular.
4. The gist of the claim is that in not making the disclosure you misled LTSB shareholders, and specifically our clients.
5. In addition our clients assert an equitable remedy based on promissory estoppel as more fully set out below. These claims will be brought in the alternative to other claims, as more fully described in Section D hereof

B. The provisions of the Practice Direction

6. There is no prescribed pre-action protocol for the claims made by our clients against you. The position is accordingly governed by the Practice Directions. We set out below those portions of the Practice Directions which are important to note. You are nevertheless advised to consult the entire Practice Direction before responding to this letter.
7. Before starting proceedings the parties should:
(1) exchange sufficient information about the matter to allow them to understand each other's position and make informed decisions about settlement and how to proceed;
(2) make appropriate attempts to resolve the matter without starting proceedings, and in particular consider the use of an appropriate form of ADR in order to do so.
8. The Practice Directions require that parties should act in a reasonable and proportionate manner in all dealings with one another. In particular, the costs incurred in complying should be proportionate to the complexity of the matter and any money at stake. The parties must not use the Practice Direction as a tactical device to secure an unfair advantage for one party or to generate unnecessary costs.
9. Before starting proceedings:
(1) the claimant should set out the details of the matter in writing by sending a letter before claim to the defendant. This letter before claim is not the start of proceedings; and
(2) the defendant should give a full written response within a reasonable period, preceded by a written acknowledgment of the letter before claim.
10. Your acknowledgement of this communication is required within 14 days (if your full response has not been received before then). Your full response is required within 90 days from date hereof.
11. Your acknowledgement should comply with the Practice Directions in all respects and:-
(1) should state whether an insurer is or may be involved and specifically provide:-
a. Your bankers' blanket policy of insurance;
b. Directors' and officers' policies of insurance;
c. Any policies of Before The Event Litigation Risk Insurance that you have;
d. Any policies of After The Event Litigation Risk Insurance that you have;

e. Any policies of insurance relating to the merger specifically;
f. All and any agreements, undertakings, guarantees/warrantees and the like that you have from any person or entity whomsoever, by which you are indemnified and held harmless in relation to claims arising from the exercise of your duties as an executive director of LTSB and/or LBG;
g. All and any agreements, undertakings, guarantees/warrantees and the like that you have from any person or entity whomsoever, by which you are indemnified and held harmless in relation to claims arising from the exercise of your duties as an executive director of LTSB and/or LBG in relation to the merger of LTSB and HBoS;
h. All and any agreements, undertakings, guarantees/warrantees and the like that you have from any person or entity whomsoever, by which you are indemnified and held harmless in relation to claims arising from the exercise of your duties as an executive director of LTSB and/or LBG in relation to the disclosures made in all or any of the Prospecti, announcements, circulars, press releases, statements to the press and the like in connection with the merger foresaid; and
i. All and any assurances, insurance, agreements, undertakings, guarantees/warrantees and the like that you have from any person or entity whomsoever, by which you are indemnified and held harmless in relation to claims arising from the exercise of your duties as an executive director of LTSB and/or LBG in relation to the non-disclosures of the loan of almost £26 billion by the State to HBoS and/or any other loans to HBoS made in all or any of the Prospecti, announcements, circulars, press releases, statements to the press and the like in connection with the merger foresaid; and
(2) should state the date by which you (or the insurer/s) will provide a full written response and if it is a date later than 90 days from date hereof:
a. you should give reasons why a longer period is needed;
b. if the reason is that you are seeking advice you should state that fact; from whom the advice is sought; and when you expect to have received that advice or be in a position to provide a full response.
(3) may request further information to enable you to provide a full response.
12. Your full written response should:
(1) accept the claim in whole or in part; or
(2) state that the claim is not accepted; and unless you accept the whole of the claim, the response should:
(3) give reasons why the claim is not accepted, identifying which facts and which parts of the claim (if any) are accepted and which are disputed, and the basis of that dispute;
(4) state whether you intend to make a counterclaim against our client (and, if so, provide information equivalent to this letter before claim);
(5) state whether you allege that our client was wholly or partly to blame for the problem that led to the dispute and, if so, summarise the facts relied on;
(6) state whether you agree to our proposals below for Alternative Dispute Resolution ("ADR") and if not, state why not and suggest an alternative form of ADR (or state why none is considered appropriate);
(7) list the essential documents on which you intend to rely;
(8) enclose copies of documents requested by us below, or explain why they will not be provided; and
(9) identify and ask for copies of any further relevant documents, not in your possession and which the defendant wishes to see.
13. We shall respond to your reply within 14 days after receipt thereof.
14. The Practice Directions further require that starting proceedings should be a step of last resort, and proceedings should not normally be started when a settlement is still actively being explored. Although ADR is not compulsory, the parties should consider whether some form of ADR procedure might enable them to settle the matter without starting proceedings. The court may require evidence that the parties considered some form of ADR. We propose

that the parties should agree to submit the dispute to mediation. A mediator/s should be agreed between the parties, position papers and documents exchanged and a private and confidential mediation should be undertaken by the parties as soon as is practicable after we have provided our client's response as provided for in paragraph 6 above.
15. Documents provided by one party to another in the course of complying with this letter must not be used for any purpose other than resolving the matter, unless the disclosing party agrees in writing.
16. Our clients are required to say whether they have entered into a funding arrangement and we advise you in this regard that they have joined Lloyds Action Now Association, a voluntary non-incorporated association of erstwhile shareholders in LTSB. A copy of the Constitution of the Association, comprising of the Rules and Methodology of the Association is attached. Our client will, at the appropriate time, be able and prepared to put up reasonable security for costs in the event that it becomes necessary to issue proceedings. This is not an issue that we are prepared at this stage to deal with beyond what is stated in this paragraph. Should there be any development regarding funding arrangements before you provide your full response, we will let you know thereof.
17. We provide the following information to you:-
(1) the claimants' full name are as stated above;
(2) the basis on which the claim is made, a summary of the facts on which the claim is based, what our client demands from you and how our client's financial loss is calculated, is set out below.
18. We presume that you will be legally represented but you should note that:
(1) the court has powers to impose sanctions for failure to comply with this letter; and
(2) ignoring this letter before claim may lead to our clients starting proceedings and may increase your liability for costs.
19. We shall provide the documents and/or explanations reasonably requested by you within as short a period of time as is practicable or explain in writing why the documents will not be provided.
20. Documents specifically requested.
Without derogating from the general obligation that you have, in accordance with the Practice Directions, to answer this letter fully and substantively and to provide documentation, we request copies of the following specific documentation and information:-
(1) There are indications that LTSB loaned a sum of about £10 billion (or any other amount) to HBoS following the meeting in September 2008 and before the merger in February 2009:-
i. Please confirm or deny this;
ii. Please provide a copy of the agreements entered into between HBoS and LTSB in this regard – in the event that you admit this allegation.
(2) A copy of the accountants' reports in relation to the merger following the process of due diligence, as well as all drafts thereof in your possession, are required. To the extent that these documents are in your possession ex officio they are required in any event.
(3) A copy of the notes taken by you and/or on your behalf at and following and consequent upon the meetings at the Treasury in September/October 2008 are required.
(4) Copies of all and any documents evidencing you expectations and/or undertakings received and/or calculations made regarding and/or discussions that you had as to your remuneration, incentives, bonuses and/or rewards following the merger are required.
(5) Copies of all correspondence between HM Treasury and/or Sir Nicholas Macpherson on the one hand and LTSB and any of its directors or employees or any of its advisers named in the LTSB Circular dated 3 November 2008 between the period 16 September 2008 and 3 November 2008 regarding the statement in the LTSB Circular dated 3 November 2008 at page 246 paragraph 1 part XII (additional information) which read as follows:
"*Nicholas Macpherson (acting in his capacity as permanent secretary to HM Treasury) (the 'HM Treasury responsible person') accepts responsibility for the*

information contained in this document relating to HM Treasury, including any statements of expectation or intention on the part of HM Treasury. To the best of the knowledge and belief of the HM Treasury responsible person (who has taken all reasonable care to ensure that such is the case), the information contained in this document for which he is responsible is in accordance within effects and does not omit anything likely to affect the import of such information."

(6) Any drafts of the Statement, whether in hard copy or electronic form preceding the ones which were published in the respective HBoS and LTSB Circulars;

(7) A copy of the *a postiori* report drafted following the merger.

21. In following the above procedure, the parties will have a genuine opportunity to resolve the matter without needing to start proceedings. At the very least, it should be possible to establish what issues remain outstanding so as to narrow the scope of the proceedings and therefore limit potential costs and, if having completed the procedure, the matter has not been resolved, then we should undertake a further review of your and our client's respective positions to see if proceedings can still be avoided.

C. Relevant background facts and circumstances

General

22. In relation to the various causes of action the following background facts and circumstances are relevant. We appreciate that you are familiar with the bulk thereof yet we find it expedient to do so in order to put our clients' claims in perspective.

23. Patterns of lending, particularly interbank lending, were disturbed since summer 2007 when fear of counter-parties' liquidity resulted in instability and volatility in the international financial markets.

24. The UK Government stepped in to address the situation by taking certain steps in an endeavour to stabilise the situation. The Banking (Specific Provisions) Act 2008 ("the BSP Act") was introduced with effect from 21 February 2008, operative for one year only. The nationalisation of Northern Rock and the mortgage book business of Bradley & Bingley were effected in terms of the BSP Act. The BSP Act was substituted by the Banking Act 2009. Despite the existence of the BSP Act during the period September 2008 to January 2009 (during which the facts pertinent to the causes of action pursued herein arose) government did not purport to act in terms thereof when the salvation of HBOS was sought by means of the acquisition thereof by LTSB. Neither were the retrospective powers provided for in the Banking Act 2009 utilised for that purpose.

25. Despite this volatility LTSB retained its AAA credit rating during 2008. RBS and HBOS were ostensibly in serious financial trouble by the summer of 2008. The government had to deal with this state of affairs against the background of the huge commitments incurred in respect of the Northern Rock and Bradley & Bingley nationalisations.

26. By early September 2008 Fannie Mae and Freddie Mac were placed in conservatorship and Lehman Bros failed spectacularly. On 18 September 2008 LTSB and HBOS announced that HBOS had received an approach from LTSB with a view to it acquiring HBOS.

27. On 8 October 2008 HM Government, after consultation with BoE and the Financial Services Authority ("FSA") announced that it was bringing forward specific and comprehensive measures to ensure the stability of the financial system and to protect ordinary savers, depositors and borrowers. Conspicuously absent from the parties government wished to protect, were shareholders of affected banks (despite the fact that many shareholders had invested in LTSB as a form of saving for retirement or to provide for education etc). The following salient facts emerged from the announcement (press release annexed):

(1) In its provision of short-term liquidity the BoE would extend and widen its facilities in whatever way necessary to ensure the stability of the system. At least £200 billion would be made available to banks under the special liquidity scheme. In addition government would establish a facility, which would make available Tier 1 capital in appropriate form (expected to be preference shares or PIBS) to eligible institutions. Eligible institutions were UK incorporated banks (including UK subsidiaries of foreign institutions which have had a substantial business in the UK and building societies).

(2) Following discussions convened by HM Treasury several banks, amongst which

LTSB and HBOS, confirmed their participation in a government supported recapitalisation scheme.
(3) Participating institutions committed to the Government that they would increase their total Tier 1 capital by £25 billion. This was an aggregate increase and individual increases would vary from institution to institution. In order to facilitate this process the Government would be making available £25 billion to be drawn on by these institutions if desired to assist in this process as preference share capital or PIBS and was also willing to assist in the raising of ordinary equity if requested to do so.
(4) In addition to this the Government stood ready to provide an incremental minimum of £25 billion of further support for all eligible institutions, in the form of preference shares, PIBS or, at the request of an eligible institution, as assistance to an ordinary equity fund raising.
(5) The amount to be issued per institution would be finalised following detailed discussions. If the Government was to provide the capital, the issue would carry terms and conditions and reflect the financial commitment being made by the taxpayer.
(6) The government would take decisive action to reopen the market for medium term funding for eligible institutions that raise appropriate amounts of Tier 1 capital. Specifically the Government would make available to eligible institutions for an interim period as agreed and on appropriate commercial terms, a government guarantee of new short and medium term debt issuance to assist in refinancing maturing, wholesale funding obligations as they fell due.
(7) To qualify for this support the relevant institution had to raise Tier 1 capital by the amount and in the form the Government considered appropriate whether by government subscription or from other sources. It was being made available immediately to inter alia LTSB and HBOS.
28. On 13 October 2008 the boards of both LTSB and HBOS announced that they would participate in the proposed government funding. HBOS undertook to raise £11.5 billion and LTSB £5.5 billion of new capital.
29. Only in December 2009 was it publicly disclosed that BoE, with the knowledge of HM Treasury, had advanced an amount of £25.4 billion to HBOS during October 2008. This fact was not made public at any stage before:
a. the respective Circulars were published;
b. the LTSB shareholders had to consider approving the acquisition;
c. LTSB shareholders who considered partaking in the scheme of the acquisition had to make informed decisions regarding the purchase of new shares or the disposal of existing shareholdings.
30. The loan was known to you specifically and to the tripartite authorities and the boards of LTSB and HBOS.
31. In his evidence earlier this year to a parliamentary Select Committee LBG CEO Eric Daniels said the following in replies to questions posed:-
“Mr Fallon: But you did not disclose the £25 billion.
Mr Daniels: Correct.
Mr Fallon: Why was that?
Mr Daniels: It was not felt to be necessary because the fact that the amount of funding was substantial, the fact that HBOS was completely dependent on it and the fact that HBOS would not be able to operate without it was viewed as more than sufficient”.
32. No doubt you agree with this.
33. The loan of £62 billion of taxpayer backed emergency funding for RBS (£36bn) and HBOS (£25.4bn) was kept secret ostensibly in an effort to ensure the success of the proposed government funding announced on 8 October 2008.
34. This was done in apparent disregard of the interests of shareholders of LTSB, who collectively have lost in excess of £14bn. Knowledge of the £25.4bn loan would have had a considerable influence on the decisions which LTSB shareholders had to take, namely whether to consent to the acquisition, or purchase shares under circumstances where there

was such a material black hole in the financial position of HBOS which had to be filled by government funding and/or to take up the share offer explained in the LTSB Circular and the subsequent LTSB Prospectus and/or to decide whether or not to retain LTSB shares at all. In particular, it should have been clear not only that this substantial funding would become a liability of LBG upon completion of the acquisition, but that it was indicative of the desperate financial status in which HBOS had found itself. It should have been foreseeable that such weakness, once detected by the markets, would have had a vastly detrimental effect on the share price of LBG. In the event and very shortly after consummating the deal government "bail outs" totalling almost £20bn had to be doled out with the suspension of dividends.

35. Most importantly, it would have been apparent that disclosure of this fact before the acquisition would seriously jeopardise the acquisition thereby risking the failure of HBoS and resulting either in its bankruptcy or its nationalisation. Instead, by keeping the £25.4bn funding secret, the likelihood of the approval of the acquisition was vastly improved, but at the potential expense of the LTSB shareholders who would become shareholders in LBG with all the toxic baggage of HBoS attached to the new entity.

36. Circulars announcing the acquisition and the terms thereof were issued by LTSB on 3 November 2008 and by HBOS on or about 13 November 2008. By that time the making of the £25.4 billion advance was, seen in retrospect, a *fait accompli*. None of the Circulars disclosed this fact.

The HBoS Circular (copy attached)

37. At present we do not assert that relief can be obtained on behalf of our clients against HBOS or its directors at the time but it is nevertheless valuable to highlight a few matters evident from its circular. It sought to raise the sum of £11,5 billion by a placing an open offer of approximately 7,5 billion shares at 113.6p per open offer share and a HM Treasury preference share subscription of 3 million shares at £1,000 each. After completion of this process, the ordinary HBoS shares would be swapped at a ratio of 0.605 for one LTSB share.

38. Not surprisingly, the HBOS board expressed the view that the transaction would be beneficial to its own shareholders.

39. At paragraph 2, page 14, it is stated that on 18 September 2008 the boards of HBoS and LTSB (with the support of the UK government) announced that they had reached agreement on the terms of the recommended acquisition of HBoS by LTSB. This is unambiguous confirmation of the material intervention of government in the restructuring of the respective banks prior to 18 September 2008.

The LTSB Circular (copy attached)

40. The information in the Circular relating to HM Treasury and for which Sir Nicholas took responsibility appears *inter alia* in the following passages of the LTSB Circular:

(1) It is a recurrent theme that if the resolutions on which the placing and open offer or the acquisition are conditional were not approved or for some other reason the placing and open offer agreement was terminated or the acquisition did not complete, the proposed government funding would not be available to Lloyds TSB (See letter to shareholders p11 and the passage at p20 to the following effect:

"Accordingly, the placing and open offer and the acquisition are interconditional. If the resolutions on which the placing and open offer or the acquisition are conditional are not approved or for some other reason the placing and open offer agreement is terminated or the acquisition does not complete, HM Treasury has stated that, in that event, it would expect Lloyds TSB to take appropriate action to address its capital position in the light of the policy objectives set out in HM Treasury's announcement of 8 October 2008 on financial support to the banking industry"

(see also p41, paragraph 2.1; p47, paragraph 1*);*

(2) The depth of HM Treasury's extraordinary involvement in the acquisition process appears from the fact that HM Treasury was party to the placing and open offer agreement effective as of 13 October 2008 entered into between Lloyds TSB, HM Treasury, Citigroup Global Markets Limited, Citigroup Global Markets UK Equity Limited, Merrill Lynch and UBS (paragraph 9.1.3); and had the right, in its discretion, to waive certain conditions (p19, *p*54, paragraph 3)

(3) Although the information (p20) correctly deals with the fact that upon completion

of the acquisition and the HBOS preference shares scheme, HM Treasury would be owning £4 billion enlarged group HMT preference shares and that the enlarged group would need to repurchase or redeem an aggregate of £4 billion of new preference shares before payment of dividends on ordinary shares could resume, this passage appears to indicate the total exposure of LBG to HM Treasury upon completion of the acquisition. However, it misrepresented the total exposure which LBG would have had. It was an appropriate opportunity for you, your codirectors and Sir Nicholas to divulge the existence of the £25.4bn funding to HBoS which would become a liability of LBG.

(4) The same duty arose if regard is had to paragraph 12.2 (p266) where the massive funding which had occurred during October 2008 was simply ignored:

"HBOS GROUP" : Save for the £4 billion net cash proceeds raised by HBOS in its rights issue in July 2008 and as disclosed in the sections headed "Group Overview", "Divisional Review" and "Outlook" in part XII ("HBOS Interim Management Statement 3 November 2008") of this document, which sets out the current trading, trends and prospects of the HBOS group, ***there has been no significant change in the financial or trading position of the HBOS group since 30 June 2008****, the date to which HBOS' last published interim financial information (which is set out in part IX ("Historical Financial Information Relating to HBOD PLS") of this document) was prepared."*

This clearly called for correction. None was forthcoming.

(5) A further example of a misrepresentation which required necessary disclosure is found at:

a. p22: In calculating the core tier 1 ratio no account has been taken of the trading performance of Lloyds TSB or HBOS **or of other transactions** by Lloyds TSB or **HBOS** since 30 June 2008, including the sale by HBOS of Bank West and St Andrews, except for the equity placing completed by Lloyds TSB on 19 September 2008; and

b. p271, in relation to HBoS:

"The proposed placing of £8.5 billion additional equity and £3 billion 12% preference shares in January 2009, subject to shareholder approval, would be equivalent to an increase in the relevant capital ratios at that time of some 340 BPS for tier I and 250 BPS for core tier I. Most importantly, this injection of capital is linked to the provision of government guarantees for certain wholesale funding issuance. This materially strengthens the group's funding position following deposit outflows in September and in the first half of October, which have now slowed significantly."

(6) A shareholder would have been justified to infer that aid in the form of government guarantees had been provided and that it (and nothing else) strengthened the group's funding position. Nothing is said of the vast amount of BoE funding of £25.4bn without which HBoS would probably have been constructively insolvent. Sir John Gieve (Deputy Governor BoE) said that after the demise of Lehman Bros "we knew straight away that the British banks most in doubt Bradford and Bingley and HBOS would be in the firing line the next day". It is a clear omission for which you should be held liable. Patently misleading is the passage at p33 which deals with the future funding assistance by the Government and which spells out that "how and when such measures will be implemented are uncertain." It unambiguously creates the impression that such funding is only prospective whereas you knew at that stage that substantial funding had already been granted to HBOS and would be subsumed into LBG debt.

(7) Under circumstances where (at p38, paragraph 1.14) mention is made that *"The State aid rules aim to prevent companies from being given an artificial or unfair competitive advantage as a result of governmental assistance"* it would have been the ideal situation to disclose that HBoS was indeed enjoying a competitive advantage by burying its disastrous financial position under the £25.4bn BoE

funding.
The LTSB Prospectus and Supplementary Prospectus
41. Parts III and V of the LTSB Circular are incorporated in the text of the prospectus (page 18, paragraph 1.14 and page 62 paragraph B). Warnings of the consequences of noncompliance with the acquisition and taking up of shares were repeated. (paragraph2.1, page 21, pages 43 and 54). There is no mention of the £25.4 billion issue.
42. The supplementary prospectus issued in December 2008 also failed to disclose the existence of the £25.4bn advance.
Inferences to be drawn from the background circumstances
43. By the time the circulars were published in early November 2008, you not only had knowledge of the £25.4 billion advance made to HBOS during October 2008 but you went along with the Government's election to maintain secrecy which adversely affected LTSB shareholders' attitude to vote in favour of the acquisition (or to take up shares on offer or to dispose of shares in LTSB or not to dispose of current shareholdings).
44. You knew that HM's Government not only encouraged the acquisition but actively promoted and facilitated it, inter alia by sidestepping EU competition laws that stood in the way of the deal.
45. Our instructions are that you pursued this course of action regardless of the interests of LTSB shareholders. In particular, after BoE had made the £25.4bn advance, which was indicative of the serious liquidity crisis experienced by HBoS during October 2008 and failed to make public disclosure thereof, it allowed the transaction to proceed regardless of the foreseeable devastating effect the acquisition would have on LTSB shareholders.
46. Our clients are of the view that the shareholders in banks which were in serious financial trouble might not have been deserving of protection. However, in this instance the interests of shareholders of acquiring banks were not taken into account. As matters turned out the shareholders of LTSB footed the bill of HM Treasury's attempts to salvage one insolvent bank, HBOS. That cannot be justified.
D. The legal basis of the claims that our clients assert against you.
Summary of causes of action
47. As presently advised the causes of action are – based on intentional or alternatively negligent misrepresentation –
(1) That our client Mr Z purchased new shares in LTSB, the issuance of which was foreshadowed in the LTSB Circular. Had the truth been disclosed in the Circular or otherwise regarding the existence of the £25.4bn advance to HBOS it is likely that the acquisition would not have been approved and that our client would not have committed himself to purchasing new shares.
(2) Our client Mrs B was a shareholder in LTSB but was persuaded by the misleading Circular to retain her shares. She could not/would not purchase new shares. Had she known the truth, and had the acquisition been approved by the LTSB shareholders, she would have sold her shares. She lost the opportunity to do so because she was unaware of the truth.
(3) Each of our clients will claim alternatively in equity based on equitable estoppel.
48. With this background in mind we deal with the essence of the claims against you.
49. Misrepresentation
(1) A claim under the law relating to misrepresentation for losses suffered as a result of purchasing shares in reliance on information published of and concerning the proposed acquisition; and
(2) A claim under the law relating to misrepresentation for persons who held shares but were persuaded not to sell their shares in reliance on information published of and concerning the proposed acquisition
Since these claims have a lot in common we deal with them jointly.
50. In breach of that duty you did not avail yourself of the opportunity to disclose the crucially material fact of the advance of £25.4bn. On the available instructions it is difficult to avoid the inference that this non-disclosure was deliberately made, in fact it has been conceded that the information was kept secret.
51. We would prefer not to file Particulars of Claim in Court making out a case based on fraud but

as presently instructed we seem compelled to do so. There can be no doubt – the fact of the loans was deliberately and calculatedly kept secret so that LTSB shareholders were not put off the proposed acquisition of HBOS.
52. If you disagree with us in this regard you will provide a full and detailed reasoning as to why we should not so plead our clients' cases.
53. In the alternative you were negligent in not making the disclosure. The non-disclosure misled shareholders into believing that the capital support given by the Government was disclosed in the Circular and was limited to the Government providing capital by taking up preference shares in HBOS and underwriting the ordinary share issue and by giving certain prospective commitments regarding guarantees.
54. Had the truth been revealed, shareholders would have been able to draw their own conclusions regarding the real state of the finances of HBOS and would probably have concluded (as would our clients) that a loan of that magnitude was indicative of a financial position much worse than that demonstrated in the LTSB Circular and that, in fact, HBOS was insolvent and/or that the effect of the advance would have had a seriously detrimental effect on LTSB shareholder values in LBG after the acquisition. This is borne out by the fact that, to keep LBG afloat, the Government had to resort to "bail-outs" totalling almost £20bn which resulted in the suspension of dividends.
55. The misrepresentation had at least the following consequences:
(1) It materially misstated the financial position of HBoS;
(2) It resulted in the approval of the acquisition; and/or
(3) It resulted in our client Mr Z committing himself to take up shares on offer by LTSB;
(4) It resulted in our client Mrs B accepting that the risk of keeping her existing shares was low and persuading her not to dispose of her shares prior to or shortly after the acquisition.
56. In consequence of the misrepresentations our clients have suffered losses equating to £2.50 per new share acquired in the case of Mr Z and £1.50 per share in the case of Mrs B.
57. The loss suffered by Mr Z firstly equals the difference between the position he would have been in had the acquisition not proceeded on the one hand and the position he found himself in by keeping his own shares and by acquiring new shares. On the basis of a projection of the LTSB share price if no acquisition had occurred the shares would have been worth approximately £3.00 per share. The position he found himself in having acquired the shares was that, as the parlous state of HBoS financial position was realised by the market, the actual share price dropped to some 50p (and even lower to 22p). The per share loss is accordingly calculated as £2.50 per new share acquired.
58. The loss suffered by Mrs B is premised on the basis that, had the truth been known and the acquisition nevertheless approved, she forfeited the opportunity to dispose of the shares, which she would have done had she known the truth. Such sale would have occurred at a price of approximately 200p per share during November 2008. Having held on to the shares, she suffered a loss calculated as being the difference between the price they would have obtained and the market price shortly after the acquisition which price level continues at present.
59. The misrepresentation regarding the £25.4bn loan to HBOS by not disclosing same in the Circular, is causative regarding losses arising both from the vote in favour of acquisition and regarding losses arising from shareholders' decisions regarding their ownership of shares.
Averments to be made by Mr Z and Mrs B in the Particulars of Claim
60. The gist of the averments that will be made by Mr Z should it become necessary to commence with proceedings are the following:
(1) Prior to the acquisition Mr Z purchased 34,000 ordinary shares in LTSB on 13th November 2008;
(2) He paid a sum of £2.03 per share;
(3) These shares converted to an equal number of LBG shares after the acquisition;
(4) He is still the beneficial owner of these shares;
(5) He read or saw or heard various reports in the media of and concerning the proposed merger of LTSB with HBOS;

(6) He read the LTSB and HBOS circulars and understood them to recommend the acquisition whilst it had set out the prospect of acquiring further shares;
(7) He read the Circular of LTSB in relation to the share offer;
(8) He appreciated that HBOS was financially stressed;
(9) He understood and accepted that the proposed acquisition would be beneficial to the LTSB shareholders;
(10) He was unaware of the fact that HBOS was just prior to the proposed merger, bankrupt and in jeopardy of being nationalised;
(11) He was unaware of the fact that the state had loaned a sum of £25.4 bn to HBOS;
(12) He understood the Statement, read in the context of the LTSB Circular, as an assurance by HM Treasury that the whole truth of the funding by HM Treasury to HBoS had been revealed in the Circular;
(13) He believed and understood that as a LTSB shareholder he would acquire equity in LBG equating to 54% of LBG, his shareholding in LTSB being pro rated to the total LTSB shareholding in LBG;
(14) The misrepresentation was intended to induce shareholders to vote in favour of the acquisition and was further intended to encourage shareholders to take up shares in the new issue and it indeed had that effect;
(15) Had he known that HBOS was parlous to the extent that it was and that the Government had loaned £25.4bn to HBOS to keep it afloat, he would not have purchased new shares in LTSB;
(16) Had the acquisition not taken place, they would have been worth approximately £3.00 per share.
(17) In consequence of the foregoing he has suffered losses in the sum £2.50 in respect per share; a total thus of £85,000, which he hereby claims from you.
(18) It may emerge that your conduct was calculated to benefit you personally:-
a. financially, in terms of bonus and/or salary; and/or
b. in a non pecuniary manner such as honours or prestige;
and in that event our client shall claim exemplary damages in addition to the above.
61. The gist of the averments to be made by Mrs B are:
(1) She owned 837 ordinary shares in LTSB prior to its acquisition of HBoS;
(2) The shares were, prior to merger of LTSB and HBOS worth £3.00, on a projected basis whilst it traded during November 2008 at a price of approximately £2.00 per share;
(3) The shares, which were converted to LBG shares as a result of the acquisition, are now worth approximately £00.50p;
(4) She still owns these shares;
(5) Paragraphs 5-16 of Mr Z's averments are repeated in respect of Mrs B;
(6) The misrepresentation induced shareholders to vote in favour of the acquisition and was further intended to encourage shareholders to take up shares in the new issue; it further induced her to believe that had that been the situation, it would be prudent to keep her shares although she would not/could not take up the new share offer;
(7) Had she known that HBOS was parlous to the extent that it was and that the Government had loaned £25.4bn to HBOS to keep it afloat, she would have sold his existing shareholding instead;
(8) If she had sold his shares in November 2008 she was likely to have done so at a price of £2.00 per share.
62. In consequence of the foregoing she has suffered losses in the sum of £1.50 per share a total
thus of £1,255.50, which she hereby claims from you;
63. It may emerge that your conduct was calculated to benefit you personally:
(1) financially, in terms of bonus and/or salary; and/or
(2) in a non pecuniary manner such as honours or prestige;
and in that event our clients shall claim exemplary damages in addition to the above.

64. Alternatively, Mrs B lost the chance to sell her shares in LTSB by virtue of the foregoing.
65. As a consequence of which she has suffered losses in the sum of £1.50 per share a total thus
of £1,255.50, which sum, or such other sum as may be just and equitable, she hereby claims from you.

Claim in equity based on equitable estoppel

66. This claim will be pleaded in the alternative to the claims outlined above.
67. It is premised on the basis that shareholders confronted with the Circular and thereafter the prospectus could accept that on a fair value basis of both LTSB and HBOS it would result in a 54/46 split of interests once the acquisition was complete. In fact HBOS was in such a parlous state that it would not have able to keep afloat without government funding. This situation was carried forward to LBG upon completion of the acquisition. It resulted in governmental rescues of LBG in early 2009, severely diluting the value of shares in LBG. A AAA rated bank (LTSB) was converted into one making losses, with the Government as the major shareholder and financial saviour.
68. This created an iniquitous situation for the LTSB shareholders which cries out for compensation in equity. Although compensation in equity is in the court's discretion, we consider that a point of departure is the actual damages suffered as calculated in respect of the claim based on misrepresentation and we claim payment of a like amount under this alternative claim.

E. Concluding remarks

69. We await:
(1) Your acknowledgement by 18/06/2010; and
(2) Your detailed and full response by 03/08/2010.

Yours faithfully

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