TC01963

Appeal number TC/2009/10762

Income tax – limited liability partnership acquired licence to film rights and sub-licensed rights to distributor – complex financing arrangements involving loans to members of the partnership and defeasance deposit by the distributor – whether partnership carrying on a trade (a precondition for members to claim relief for a prepayment of interest on their borrowings) – s 362 Taxes Act 1988 – whether the arrangements as a whole were designed to give a series of pre-determined cash flows with object of giving members allowable interest payments – whether licensing of film rights was a trading activity – partnership not carrying on a trade, but a non-trade business – appeal dismissed.

FIRST-TIER TRIBUNAL
TAX

ECLIPSE FILM PARTNERS No 35 LLP **Appellant**

- and -

THE COMMISSIONERS FOR HER MAJESTY'S REVENUE AND CUSTOMS **Respondents**

TRIBUNAL: EDWARD SADLER
JOHN WALTERS, QC (Tribunal Judges)

Sitting in public at 45 Bedford Square, London WC1 on 13–29 July and 31 August 2011

Jonathan Peacock, QC and Jolyon Maugham, counsel, instructed by Freshfields Bruckhaus Deringer LLP for the Appellant

Malcolm Gammie, QC, Rajesh Pillai and Rebecca Murray, counsel, instructed by the General Counsel and Solicitor to HM Revenue and Customs, for the Respondents

DECISION

Introduction

The appeal

1. This is an appeal by Eclipse Film Partners No 35 LLP ("Eclipse 35"), a limited liability partnership, against a decision of The Commissioners for Her Majesty's Revenue and Customs ("the Commissioners") that, in the tax year ended 5 April 2007, Eclipse 35 was not carrying on a trade, or if it was carrying on a trade, it was not doing so with a view to profit.

2. Eclipse 35 made a partnership tax return for the year ended 5 April 2007 claiming that it was, in that year, carrying on a trade of acquiring and exploiting film rights, although no profits from that trade had accrued in that year. The Commissioners began an enquiry into that return under section 12AC Taxes Management Act 1970 ("TMA 1970"). On 15 May 2009, and following a direction of a Special Commissioner (*Eclipse Film Partners No 35 LLP* v *The Commissioners for Her Majesty's Revenue and Customs* (SPC00736)) requiring the Commissioners to issue a closure notice, Mr N Hagan, an Inspector of Taxes in the Specialist Investigations Section of the Commissioners, wrote to Eclipse 35 by way of a notice of completion of enquiry into a partnership return (that is, a closure notice) under section 28B TMA 1970. Mr Hagan's letter comprises the decision of the Commissioners against which Eclipse 35 now appeals. In its Notice of Appeal to this Tribunal, dated 9 June 2009, the grounds for appeal stated by Eclipse 35 are that the Commissioners' decision is wrong both in law and in fact.

The issue to be decided

3. As will become apparent, the transactions which Eclipse 35 (and its members) entered into, and which form the basis of its case that it was carrying on at the relevant time the trade of acquiring and exploiting film rights, are complex. Nevertheless, the issue we have to decide is (in concept, at least) simple: in the tax year ended 5 April 2007 was Eclipse 35 carrying on a trade?

4. Although the point was a matter of dispute between the parties, as we describe below, we consider, for the reasons we give below, that if we decide that Eclipse 35 was carrying on a trade in that year then we should also decide two further related questions: first, what was the trade it was carrying on (a question which is inherent in the decision that it was carrying on a trade); and secondly, whether it was carrying on its trade with a view to profit.

5. The Commissioners also pressed us to decide (should we find that Eclipse 35 was carrying on a trade) the further question of whether monies borrowed by Eclipse 35's members and used by them to contribute capital to Eclipse 35 were monies used for the purposes of such trade. For the reasons we give below we do not consider that that is an issue which is within the scope of the appeal we are required to determine.

6. At first sight it may seem strange that this issue should be the subject of substantial and protracted litigation when, in the tax year in question, Eclipse 35 had no profits or income chargeable to tax. We explained the wider significance of Eclipse 35's appeal in the following terms in our decision in *Eclipse Film Partners No 35 LLP v The Commissioners for Her Majesty's Revenue and Customs* (TC 01256) (a decision concerning Eclipse 35's application for a direction to exclude certain expert evidence which the Commissioners intended to adduce in the hearing of the appeal, a matter we deal with below):

> "The principal significance of [Eclipse 35's] appeal relates not to the tax position of [Eclipse 35] itself, but to that of its individual members. Each of the [289] members of [Eclipse 35] borrowed funds to make their respective investments in [Eclipse 35] and made a prepayment of the interest payable on those borrowings for which they have claimed tax relief. The aggregate amount of that tax relief is in the order of £117 million. It is a necessary precondition to a successful claim for such relief on the part of the members that [Eclipse 35] should be carrying on a trade with a view to profit in the tax year in which the members made the interest prepayment. The members wait in the wings, as it were, whilst [Eclipse 35] pursues its appeal against the Commissioners' decision on the trading issue."

A summary of the relevant transactions and the parties to those transactions

7. As mentioned, Eclipse 35 and its members entered into a complex set of transactions with members of the Disney group of companies in relation to the acquisition, distribution and marketing of film rights and with members of the Barclays group of companies in relation to the financing of the acquisition of such film rights. It is helpful at the outset to identify the principal parties involved and to give a summary of the principal transactions.

The principal parties

Eclipse Film Partners No. 35 LLP ("Eclipse 35")	A UK limited liability partnership and the Appellant in this appeal
The members of Eclipse 35 ("the Members")	The 289 persons (individuals and companies) who were the members (i.e. partners) of Eclipse 35 on 3 April 2007 and who had contributed capital to Eclipse 35, most of which capital they funded by monies borrowed from Eagle
Barclays Bank plc ("Barclays")	The issuer of a letter of credit securing the payment by the Distributor of certain sums due to Eclipse 35 under the film distribution arrangements. Also the funder of Eagle
Eagle Financial and Leasing Services (UK) Limited ("Eagle")	A wholly-owned subsidiary of Barclays, which made loans to the Members and received, as

	security for such loans, the benefit of the letter of credit issued by Barclays
Walt Disney Pictures ("Disney")	A US corporation and a member of The Walt Disney Company group of companies which on 3 April 2007 as grantor entered into a licensing agreement with Eclipse 35 (as licensee) in relation to two films produced by the Disney group
WDPT Distribution VIII LLC ("the Distributor")	A US corporation and a member of The Walt Disney Company group of companies which on 3 April 2007 as licensee entered into a distribution agreement with Eclipse 35 (as licensor) in relation to the distribution of the two films the subject of the licensing agreement between Disney and Eclipse 35, and which procured the issue by Barclays of the letter of credit to secure its payment obligations to Eclipse 35 under the distribution agreement
WDMSP Limited ("WDMSP Ltd")	A UK company which is a member of The Walt Disney Company group of companies and which entered into an agreement with Eclipse 35 for the provision of marketing and advisory services in relation to the two films for which Eclipse 35 held a licence
Future Films Limited ("Future")	A UK company with a business of arranging financing of films and also the production and distribution of films, which for a consultancy fee promoted Eclipse 35 and provided film advisory and other services to Eclipse 35

A summary of the transactions

8. The following will suffice as an introductory summary of the transactions involving Eclipse 35 and the Members which are relevant for the purposes of this appeal:

(1) Eclipse 35 is a limited liability partnership incorporated on 3 October 2006. Its partnership deed was entered into on 13 March 2007, and states that Eclipse 35 will carry on the business of the production, distribution, financing and exploitation of films, including the licensing and exploitation of film rights acquired from Disney.

(2) On 3 April 2007 Eclipse 35 had 289 Members (and two Designated Members). All or most of the Members are individuals liable to UK income tax, and for whom, if the relevant conditions are met, tax relief will be available for

interest paid on borrowed monies applied by them by way of contribution to the partnership capital of Eclipse 35.

(3) On 3April 2007 Eclipse 35 obtained a licence from Disney, for a period of twenty years, of specified rights to exploit and distribute two films produced by Disney and entitled respectively "Enchanted" and "Underdog" (together, "the Films") ("the Licensing Agreement"). As consideration for such licence Eclipse 35 paid a licence fee (in aggregate, for the Films, of approximately £503 million) and also a variable royalty. The licence fee was divided into twenty annual instalments, and on 3 April 2007 Eclipse 35 paid Disney the aggregate amount as an advance against its obligations to pay the annual instalments.

(4) Also on 3 April 2007 Eclipse 35 entered into an agreement with the Distributor by way of sub-licence of the exploitation and distribution rights in the Films for a term of twenty years ("the Distribution Agreement"). The Distributor is required to exploit the Films and ensure their distribution. As consideration the Distributor is obliged to pay Eclipse 35 specified sums annually over twenty years (referred to as Annual Ordinary Distributions, and totalling approximately £1,022 million), variable distributions (the variable royalty which Eclipse 35 is due to pay to Disney under the Licensing Agreement matches these variable distributions), and "contingent receipts", being amounts payable under a complex formulation if gross receipts from the exploitation of the Films exceed a certain threshold after payment of prior charges ("Contingent Receipts").

(5) As security for its obligations to pay the Annual Ordinary Distributions to Eclipse 35, the Distributor provided a letter of credit issued by Barclays, payments under the letter of credit directly corresponding to the Annual Ordinary Distribution payments ("the Letter of Credit"). Issuance of the Letter of Credit relieved the Distributor from its payment obligations to Eclipse 35 (so that, in effect, Eclipse 35 substituted Barclays risk for Distributor risk). The Distributor deposited the sum of approximately £497 million with Barclays and charged that sum to Barclays to secure the issue of the Letter of Credit and to fund Barclays in respect of its obligations under the Letter of Credit.

(6) Eclipse 35 was financed by its Members, who on 3 April 2007 contributed capital to the partnership in an aggregate amount of £840 million (thereby providing Eclipse 35 with the capital to pay the licence advance to Disney and to make the other payments which Eclipse 35 undertook on that day). Each Member chose to finance his capital contributions in part from his own resources but substantially (as to approximately 94 per cent) by undertaking borrowings for that purpose, borrowing under a twenty year facility made available to him by Eagle. In aggregate the Members borrowed approximately £790 million from Eagle and contributed the balance of capital (approximately £50 million) from their own resources.

(7) The terms of the Eagle facility provided for a fixed rate of interest, and required the borrowing Member to pre-pay the interest accruing over the first ten years of the borrowing (a payment in aggregate of approximately £293 million, which the Members paid on 3 April 2007). The borrowing by Members from Eagle was secured by a charge given by Eclipse 35 over the Letter of Credit.

(8) On 3 April 2007, following the contribution by Members of their capital, and pursuant to a provision to that effect in the partnership agreement, Eclipse 35 made a payment (expressed to be by way of loan on account of anticipated profits) to the Members of an aggregate amount of approximately £293 million (enabling Members to make the prepayment of interest to Eagle).

(9) The payments made between the parties on 3 April 2007, and the payments due over the twenty year term of the transactions, were in accordance with cash flow statements produced from financial models devised by Future and used in the promotion of the Eclipse 35 partnership to potential investors.

(10) On 9 February 2007 Eclipse 35 entered into an agreement with WDMSP Ltd ("the Marketing Services Agreement") whereby WDMSP Ltd agreed, for a fixed fee plus a share of any Contingent Receipts from the Films, to act as Eclipse 35's agent in developing marketing and release plans for the Films and to provide to Eclipse 35 services relating to the supervision of the Distributor in its implementation of such plans. Under the Distribution Agreement the Distributor agreed to implement the marketing and release plans prepared by WDMSP Ltd.

(11) On 3 October 2006 Eclipse 35 entered into a consultancy agreement with Future, whereby Future was appointed to provide to Eclipse 35 a number of services relating to the selection, acquisition and exploitation of films and film rights and the management of such matters on behalf of Eclipse 35. For these services Eclipse 35 agreed to pay Future a fee based on a percentage of the partnership capital raised by Eclipse 35 and of the net proceeds from the exploitation of any film rights licensed by Eclipse 35. Pursuant to this agreement Eclipse 35 paid Future a fee of approximately £44 million on 3 April 2007.

Eclipse 35's case in summary

9. Eclipse 35 contends that the only issue relevant to its appeal is whether or not it is carrying on a trade. It argues that all the relevant transactions are genuine transactions entered into for a commercial purpose, and following lengthy negotiation, with a leading entertainment and media corporation, and that Eclipse 35 entered into the transactions to which it is a party in the course of carrying on its trade of acquiring and exploiting film rights. It argues that it paid for and acquired highly valuable licences from Disney giving it the right to exploit two films which were characterised as having franchise potential, and that it exercised that right to exploit those films by entering into the distribution agreement with the Distributor, licensing those rights in consideration of specified periodic payments over twenty years (which in themselves ensured over that period profits for Eclipse 35) together with the possibility of receiving further earnings – the Contingent Receipts – if the films' gross income exceeded certain thresholds.

10. Eclipse 35 points to the arrangements it entered into with WDMSP Ltd for the creation of release and marketing plans for the films, and the supervision of the Distributor in the implementation of those plans, to show that it has an active role in the distribution and exploitation of the film rights.

11. If it is necessary to decide whether the trade carried on by Eclipse 35 was carried on with a view to profit, Eclipse 35 argues that this was so, since over the period of twenty years – and leaving aside the prospect of receiving any Contingent Receipts – an aggregate profit of approximately £474.4 million will accrue to Eclipse 35.

12. Eclipse 35 argues that the borrowings by the Members may be relevant to any claim which the Members may make for tax relief for the interest paid on such borrowings, but the manner in which and the extent to which the Members finance themselves to provide their capital to the partnership cannot be relevant to the issue as to whether or not Eclipse 35 is carrying on a trade.

13. Similarly, the banking and security arrangements entered into by Barclays and its associated company involving, variously, the Members, Disney and the Distributor are not matters to which Eclipse 35 is a party, or necessarily privy, and, again, are not relevant to the question which has to be decided.

The Commissioners' case in summary

14. The Commissioners argue a quite different case. They do not argue that the transactions entered into by Eclipse 35 were a sham, but they argue that in determining whether or not Eclipse 35 was carrying on a trade, the effect of those transactions must properly be understood by examining them in their entirety and context and with regard to the reality of what they effect, and not just their form.

15. Taking this approach, the Commissioners argue that the reality of the arrangements is that Eclipse 35 organised a sophisticated financial model involving all the parties, which was designed to give a series of pre-determined cash flows with the ultimate object of giving the Members interest payments (accelerated by prepayment) on borrowings for which they can claim tax relief to set against other income they have which is otherwise taxable. The movements of cash on financial close of the transactions entered into on 3 April 2007 set up the cash flows, and in their commercial result achieve only one thing: the payment by Eclipse 35 of approximately £6 million to Disney (referred to as "the Studio Benefit") in return for Disney making itself available to the transaction for little more than a day and the remote possibility of Disney paying the Contingent Receipts to Eclipse 35.

16. Therefore, the Commissioners argue, Eclipse 35 was not, by reason of entering into the transactions, carrying on a trade – at best it was making a speculative investment with regard to the possible earning of the Contingent Receipts, and all other amounts it received were determined by the cash flows set up on 3 April 2007, and without any reference to the earnings from the films.

17. The Commissioners also assert that Eclipse 35 cannot rightly claim to be carrying on the trade of acquiring and exploiting film rights in view of the terms of the documentation it entered into with Disney and the Distributor, the overall effect of which is that at no time were any film rights in the ownership or control of Eclipse 35 – whatever rights were purportedly granted by Disney were granted on terms which required them to be passed back immediately to the Distributor. Further, the grant of

those rights was expressed to be subject to prior arrangements within the Disney group ("the Prior Agreements"), the nature and scope of which were unknown to, and seemingly a matter of indifference to, Eclipse 35.

18. Further, even if it can be said that Eclipse 35 is licensing and sub-licensing film rights, in the circumstances of its particular transaction with a fixed return unrelated to the earnings of the films, there is no activity in the nature of trade, but rather an investment or the carrying on of a non-trade business.

19. The Commissioners also invited the Tribunal to determine that if Eclipse 35 were carrying on a trade, that trade was not conducted "with a view to profit", but with a view to the tax benefits which it was intended that the Members should secure by reason of the prepayment of interest on their borrowings used for their capital contributions to Eclipse 35 – Eclipse 35's actions had no objective other than to put the Members in a position to achieve those benefits.

Our decision in summary

20. We have concluded that Eclipse 35 was not carrying on a trade, but that its activities were a business involving the exploitation of films where the activities carried on do not amount to a trade (a 'non-trade business' within section 609, Income Tax (Trading and Other Income) Act 2005). Eclipse 35's appeal therefore fails and is dismissed.

21. If we had concluded that Eclipse 35 was carrying on a trade, we would also have concluded that it was carrying on a trade of the acquisition and exploitation of film rights and that such trade was being carried on with a view to profit.

The relevant statutory provisions

22. There was no dispute between the parties as to the legislation which is relevant to this appeal, nor was the interpretation of that legislation in dispute.

23. Section 1, Limited Liability Partnerships Act 2000 provides, so far as relevant:

> *(1) There shall be a new form of legal entity to be known as a limited liability partnership.*
>
> *(2) A limited liability partnership is a body corporate (with legal personality separate from that of its members) which is formed by being incorporated under this Act…*

24. Since a limited liability partnership is a body corporate, it would fall within the charge to corporation tax, were it not for the special provisions which confer "transparency" upon limited liability partnerships, to the effect that a limited liability partnership's activities are treated as carried on in partnership by its members (rather than by the limited liability partnership itself), and they are taxable accordingly. Thus where the members of a limited liability partnership are individuals, section 863, Income Tax (Trading and Other Income) Act 2005 ("ITTOIA 2005") provides (as relevant to this appeal):

(1) For income tax purposes, if a limited liability partnership carries on a trade, profession or business with a view to profit—

(a) all the activities of the limited liability partnership are treated as carried on in partnership by its members (and not by the limited liability partnership as such),

(b) anything done by, to or in relation to the limited liability partnership for the purposes of, or in connection with, any of its activities is treated as done by, to or in relation to the members as partners, and

(c) the property of the limited liability partnership is treated as held by the members as partnership property.

References in this subsection to the activities of the limited liability partnership are to anything that it does, whether or not in the course of carrying on a trade, profession or business with a view to profit.

(2) For all purposes, except as otherwise provided, in the Income Tax Acts—

(a) references to a firm include a limited liability partnership in relation to which subsection (1) applies,

(b) references to members of a firm include members of such a limited liability partnership,

(c) references to a company do not include such a limited liability partnership, and

(d) references to members of a company do not include members of such a limited liability partnership.

25. There is a corresponding provision in section 118ZA, Income and Corporation Taxes Act 1988 ("TA 1988") for those cases where the members of the limited liability partnership are themselves bodies corporate.

26. Where the members of a limited liability partnership are individuals, so that section 863 ITTOIA 2005 applies and they are treated as carrying on in partnership the activities of the limited liability partnership, the charge to income tax on their share of the limited liability partnership's income and profits is under Parts 2 to 5 of ITTOIA 2005. In particular, the provisions of Part 2 of ITTOIA 2005 apply to charge income taxed as trade profits, with section 5 of ITTOIA 2005 providing: "Income tax is charged on the profits of a trade, profession or vocation."

27. It is, however, the provisions relating to interest which is eligible for tax relief, and in particular interest paid on a borrowing by a member (who is an individual) for the purposes of contributing capital to a partnership, which underlie the issue to be decided in this appeal. In short, such interest is eligible for tax relief where the capital so contributed is used wholly for the purposes of the trade carried on by the partnership. It is in this context that Eclipse 35 has claimed that it is carrying on a trade, and has brought this appeal when the Commissioners determined otherwise.

28. For the tax year relevant to when the Members made their payment of interest on their borrowings from Eagle, the interest relief provisions pertinent to them are found in Part IX of TA 1988, and in particular sections 353 and 362.

29. Section 353(1) TA 1988 provides:

> *Where a person pays interest in any year of assessment, that person, if he makes a claim to the relief, shall for that year of assessment be entitled (subject to sections 359 to 368 of this Act and section 52 of ITTOIA 2005) to relief in accordance with this section in respect of so much (if any) of the amount of that interest as is eligible for relief under this section by virtue of sections 359 to 365.*

30. Section 362 TA 1988 is headed "Loan to buy into partnership" and provides:

> *(1) Subject to sections 363 to 365, interest is eligible for relief under section 353 if it is interest on a loan to an individual to defray money applied—*
>
> *(a) in purchasing a share in a partnership; or*
>
> *(b) in contributing money to a partnership by way of capital or premium, or in advancing money to a partnership, where the money contributed or advanced is used wholly for the purposes of the trade, profession or vocation carried on by the partnership; or*
>
> *(c) in paying off another loan interest on which would have been eligible for relief under that section had the loan not been paid off (on the assumption, if the loan was free of interest, that it carried interest);*
>
> *and the conditions stated in subsection (2) below are satisfied.*
>
> *(2) The conditions referred to in subsection (1) above are—*
>
> *(a) that, throughout the period from the application of the proceeds of the loan until the interest was paid, the individual has been a member of the partnership otherwise than*
>
> *(i) as a limited partner in a limited partnership registered under the Limited Partnerships Act 1907, or*
>
> *(ii) as a member of an investment LLP; and*
>
> *(b) that he shows that in that period he has not recovered any capital from the partnership, apart from any amount taken into account under section 363(1).*

31. Eclipse 35 is prepared to accept that a Member seeking tax relief for the interest paid on his borrowing from Eagle will have to establish, first, that Eclipse 35 was carrying on a trade (see section 362(1)(b) TA 1988); and secondly that the borrowed money he contributed to Eclipse 35 by way of capital is used wholly for the purposes of that trade carried on by Eclipse 35 (see again section 362(1)(b) TA 1988). Eclipse 35 also accepts that if a Member wishes that the activities of Eclipse 35 are attributed to him for tax purposes then he will also have to establish that Eclipse 35 is carrying on its trade with a view to profit (see section 863(1) ITTOIA 2005).

32. However, Eclipse 35 argues that the matter in dispute in the present appeal is its tax return for the year to 5 April 2007 in which Eclipse 35 stated only that it was in that year carrying on a trade: it is not germane to its tax position that it should in that tax return state that it was carrying on the trade with a view to profit; nor that the monies contributed by the Members were used wholly for the purposes of the trade it was then carrying on, since its tax return contained no item of expenditure. Thus, Eclipse 35 argues, the only matter which properly falls to be decided in its appeal against the decision of the Commissioners in relation to its tax return is the question of whether in that tax year it was carrying on a trade. Anything further risks presuming upon any appeal which a Member might subsequently wish to bring in relation to the conditions he has to satisfy if he claims relief for interest on his borrowings from Eagle and his eligibility for such relief is challenged by the Commissioners.

33. The only definition of "trade" in the tax legislation as it applied for the tax year in question, is to be found in section 832(1) TA 1988:

> *"trade" includes every trade, manufacture, adventure or concern in the nature of trade*

As we refer to below in our conclusions, in addition case law offers guidance as to the principles by which one may determine whether a particular activity comprises a trade or the carrying on of a trade.

34. Finally, we need to refer to Chapter 3 of Part 5 of ITTOIA 2005, which is headed "Films and Sound Recordings: Non-Trade Businesses", and provides for a charge to income tax where the activities of exploiting a film do not amount to a trade. Section 609(1) ITTOIA 2005 is in these terms:

> *Income tax is charged on income from a business involving the exploitation of films or sound recordings where the activities carried on do not amount to a trade.*
>
> *Such a business is referred to in this Chapter as a "non-trade business".*

The evidence before us

35. We had extensive evidence before us at the hearing of the appeal. The documentary evidence, including witness statements and the documents exhibited to those statements, amounted to about a hundred lever arch files, impressively organised and categorised by Freshfields Bruckhaus Deringer LLP, the solicitors acting for Eclipse 35 in this appeal. In addition, Eclipse 35 produced four witnesses, and the Commissioners produced two witnesses, all of whom gave extensive oral evidence at the hearing.

The documentary evidence

36. The scope of the documentary evidence included the following:

(1) The partnership documents relating to the formation of Eclipse 35; the terms of its partnership agreement; the deeds of adherence by which Members became members and contributed their capital; and partnership minutes and resolutions;

(2) The documents relating to the promotion of Eclipse 35 to potential members, including the information memoranda and correspondence with HSBC Private Bank and independent financial advisers;

(3) Correspondence, memoranda, promotional documents and similar documentation relating to earlier film financing transactions devised and promoted by Future which were precursors of the transactions involving Eclipse 35 and its Members;

(4) The documentation relating to the engagement of Future by Eclipse 35;

(5) Correspondence (including emails) between, variously, Future, Screen Capital International Corporation and Disney relating to the negotiation of the terms of the transaction for the licensing and sub-licensing of the rights to the Films and the associated financing;

(6) Correspondence (including emails) between Future and Barclays relating to the negotiation of the terms of the financing of the transaction, including the loan facility to the Members and the issue of the letter of credit, and including memoranda internal to the Barclays group relating to credit risk and risk-weighting of the financing for capital adequacy purposes;

(7) The documentation relating to the report and opinion produced by The Salter Group LLC in March 2007 setting out a range of possible gross receipts from each of the Films and the likelihood of Eclipse 35 earning Contingent Receipts from the Films;

(8) The transaction documents whereby Eclipse 35 acquired and sub-licensed the film rights and all the related transaction documents entered into by the associated parties in relation to Eclipse 35's transactions, including the loan facility extended by Eagle to the Members, the deposit arrangements between the relevant Disney companies and Barclays, the issue of the letter of credit by Barclays in favour of Eclipse 35; the funding arrangements between Barclays and Eagle; and related security documentation;

(9) The documentation relating to the engagement of WDMSP Ltd by Eclipse 35; the engagement by WDMSP Ltd of consultants and its arrangements with the Disney group Buena Vista distribution companies for the secondment of advisers; the release and marketing plans and promotional DVDs in relation to the Films; and the arrangements whereby release and marketing matters were monitored on behalf of Eclipse 35 and information on such matters was provided and reported upon to Eclipse 35;

(10) Bank account entries relating to the movement of funds on financial closing of the transactions on 3 April 2007; and cash flow statements showing such movement of funds and also income and payment streams consequent upon the transaction for the period of twenty years; and

(11) Annual statements for periods up to 30 June 2011 showing the financial performance of the Films and the shortfall as against the threshold at which the Contingent Receipts become payable; similar documentation relating to Disney films licensed in earlier Eclipse partnerships promoted by Future; similar documentation relating to Variable Distributions; and the financial statements of Eclipse 35 for each of the years up to 5 April 2010.

The witness evidence – Eclipse 35's witnesses

37. Four witnesses appeared for Eclipse 35: Mr Timothy Phillip Levy of Future; Mr David Molner of Screen Capital International Corporation ("SCI"); Mr Stuart Salter of Salter Film Consultants Limited ("SFC"); and Mr Eric C. Briggs of The Salter Group LLC ("Salter Group"). Each witness produced one or more witness statements as his evidence-in-chief, and all were cross-examined at length at the hearing by Mr Gammie, who appeared for the Commissioners. Mr Briggs gave his evidence by video link from Los Angeles, and Mr Molner gave the final part of his evidence by video link from New York.

38. Mr Levy was the principal witness for Eclipse 35. He had prepared two witness statements. Mr Levy is the Chief Executive Officer of Future Capital Partners Limited and holds directorships in various other companies in the Future group of companies. He is also a Member of Eclipse 35, in which he invested £1,032,000 by way of contribution to its capital. Mr Levy started working in the film industry in 1997, and co-founded in 2000 what is now the Future group of companies. He has extensive experience in devising and promoting structured fundraising and financing transactions to provide capital from private investors for investment in the production and acquisition of films and the exploitation of films.

39. Mr Levy dealt with two main areas in his first witness statement: an overview of the film distribution business and the general background to the transaction entered into by Eclipse 35 in relation to the Films.

40. In relation to the film distribution business Mr Levy explained the usual pattern for the distribution of films by reference to the territories in which films are likely to be released and the different markets through which a film may be exploited (theatrical exhibition (that is, cinema release); non-theatrical release (for example, films shown in hotels and by airlines); home entertainment (video and DVD); and television (pay TV and free-to-air)). He explained how a film can generate revenues for a distributor over a number of years as it is released sequentially into these different markets. He described film distribution arrangements made entirely within the studio group which produced the film and those involving independent third party distributors.

41. In relation to the background to Eclipse 35 and its licensing of the Films, Mr Levy explained the genesis of the structuring of the film licensing transactions entered into by the Eclipse partnerships and its origins in sale and leaseback transactions which provided tax shelter (by relief by way of deferral of tax paid). He explained how Future developed a proposal to exploit "franchise films" produced by major

studios, being films of particular value (such as sequel films or films based on existing media such as books, comics, a television series or video games) with a likely long revenue-producing life through exploitation in a wide number of territories and across the range of markets in which films can be exploited; he explained the benefits of such a proposal for the investors and the studio. Mr Levy described the discussions with Disney which resulted in Future signing a term sheet with Disney in December 2005, and the first tranche of Eclipse transactions which closed in April 2006, and subsequent tranches based largely on the initial documentation. He explained how the Eclipse structure was modified following changes in tax relief for losses in March 2007 and resulted in the Eclipse 35 transaction with the feature of the prepayment of interest by Members on their borrowings from Eagle. He outlined the terms of the Eclipse 35 transaction and those of the principal transaction documents. He described the financial performance of the Films since their release, and the financial performance of films licensed in the earlier Eclipse tranches.

42. Mr Levy's second witness statement was produced in response to the report submitted by Mr Marcus Stanton and the report submitted by Mr Steven D. Sills, (Mr Stanton and Mr Sills are witnesses who appeared for the Commissioners). Mr Levy challenged various conclusions which Mr Stanton had reached in his analysis of the cash flow statements which reflect the payments made between the parties over the twenty year life of the licence arrangements. Mr Levy also challenged certain statements made by Mr Sills in his report, as to what constitutes a "franchise film"; the expectation which Eclipse 35 might reasonably have had in April 2007 as to the earning of Contingent Receipts; and the ability of Disney to manipulate revenues from the Films to the possible detriment of Eclipse 35 (and the protection against such a risk which Eclipse 35 had put in place in order to secure the best opportunity to receive Contingent Receipts).

43. The Commissioners submitted that Mr Levy's evidence should be viewed with caution by the Tribunal, since he had a direct and significant interest in the outcome of the case, both as a Member who had made a substantial investment in Eclipse 35 and as a part-owner of Future which had benefited from fees in the transaction. Mr Levy's interest cannot be disputed, but the Commissioners did not, to any significant extent, demonstrate that Mr Levy's evidence was unreliable or misleading, and we saw no reason to question the truthfulness of his evidence.

44. Mr Molner had prepared three witness statements. Mr Molner is the Managing Director of SCI, a company based in Los Angeles which he founded in January 2001. SCI was engaged by Future and by Eclipse 35 to conduct the commercial negotiations (principally with Disney) relating to the earlier Eclipse transactions, the licence and sub-licence of the Films, the gathering of information for the preparation of the release and marketing plans through the agency and services of WDMSP Ltd, and the monitoring of the implementation of those plans by the Distributor. SCI also worked with Salter Group in the preparatory work undertaken to enable Salter Group to formulate the opinion it gave as to the likelihood of the Films earning Contingent Receipts for Eclipse 35 (including compiling the financial model used in that exercise).

45. Mr Molner's career in the film industry began in 1995 when he joined Paramount Pictures, where he was eventually promoted to the role of Senior Vice President of Worldwide Corporate Business Development. In that position he had responsibilities for obtaining film finance from syndicated public and private limited partnerships, and those responsibilities extended to negotiating a range of commercial transactions including the acquisition, financing and licensing of film rights. SCI specialises in structuring film and sports financing transactions, negotiating with the major US film studios on behalf of investors from the United States and Europe.

46. Mr Molner's first witness statement dealt with the relationship between SCI and Future; the background to the Eclipse transactions and SCI's role in those transactions; the commercial negotiations with various film studios in presenting the Eclipse structure and the eventual detailed negotiations with Disney resulting in the December 2005 term sheet between Future and Disney and the subsequent negotiation of the tranches of Eclipse transactions; the negotiations with Disney resulting in the Eclipse 35 transaction with particular reference to the key commercial requirements and motivating factors for Disney; the significance of pricing issues and the negotiation of the Contingent Receipts provisions in the sub-licence to the Distributor, including the "cross-collateralisation" of the rights to the Contingent Receipts as between each of the Films; the negotiation of the Studio Benefit (the net cash retention for Disney); the negotiation of the films chosen for the various Eclipse transactions and in particular the choice of the Films for Eclipse 35; the negotiation of the provisions in the documentation whereby Disney sought to protect itself from the insolvency of Eclipse 35; and the understanding which he had of the effect of the Prior Agreements (the undisclosed arrangements within the Disney group subject to which the Films were licensed to Eclipse 35).

47. Mr Molner also explained in his first witness statement the role of SCI in obtaining for Future a range of estimates (based on different assumptions) of likely gross revenues from the Films by engaging the services of Salter Group, as a basis for estimating possible values for the Films and for estimating the likelihood of Contingent Receipts becoming payable over the twenty-year lifetime of the transaction. Mr Molner also commented on the earnings performance of the Films to date and possible future earnings, in the context of the likelihood of Eclipse 35 receiving Contingent Receipts.

48. Finally, in his first witness statement, Mr Molner dealt with SCI's role in relation to the arrangements with WDMSP Ltd for the release and marketing plans for the films and the monitoring of the implementation of those plans on behalf of Eclipse 35.

49. Mr Molner's second witness statement was prepared in response to certain statements included in the report submitted by Mr Sills, with respect to the differences between using independent and studio distributors of films; the extent to which WDMSP Ltd influenced the marketing and distribution of the Films; the purport of the Prior Agreements and their likely effect on the value of the rights held by Eclipse 35; the definition of Contingent Receipts in the documentation, and the likelihood of Contingent Receipts becoming payable; the effect of "cross-collateralising" the Contingent Receipts from the two Films; and the risks to Eclipse 35 of Disney,

through its distribution network, entering into arrangements for the distribution of the Films which might benefit the Disney organisation as a whole, but to the possible detriment of Eclipse 35 as investor in the Films.

50. Mr Molner's third witness statement was prepared in the course of the hearing in response to challenges put to him by Mr Gammie in his cross-examination of Mr Molner. It corrects Mr Molner's first and second witness statements in relation to the discussions which Mr Molner had with Disney executives as to the Prior Agreements, and Disney's refusal to disclose them or their terms (and certain other matters, such as the terms of financial participation by the leading actors and production team in films the subject of the various Eclipse transactions) to SCI; and Mr Molner's surmise as to the likely purpose and effect of such agreements and his basis for such surmise.

51. The Commissioners, in their written closing submissions, mounted a strong challenge to the credibility of Mr Molner's evidence, describing it as to a large extent implausible and self-serving, so that it should not be accepted except to the extent that it is corroborated by documentary evidence or third party witness evidence. They argued that much of his evidence was based on speculation and supposition, and that his experience in the film industry before he formed SCI was limited in scope to financing, rather than the licensing of film rights. They also argued that, in his challenge to the evidence of Mr Sills, Mr Molner's evidence must be regarded with caution, as his position was that of a partisan party rather than that of an independent expert.

52. The Commissioners were particularly critical of the evidence which Mr Molner gave as to his understanding of the nature and effect of the Prior Agreements and the discussions he had had with Disney as to their possible disclosure and general purport, and the conclusions he had reached on the basis of those discussions and his knowledge of industry practice. Certain inconsistencies between the evidence which Mr Molner gave under cross-examination and his first two witness statements, and a certain amount of confusion which thereby resulted, led to the Tribunal to direct in the course of the hearing that Mr Molner produce a third witness statement setting out his considered evidence on this matter.

53. We do not accept such a general challenge to Mr Molner's credibility as a witness. He appeared to us as a person of high intelligence with extensive and relevant experience – the Commissioners argued that his expertise is restricted to film financing, but it is clear from his witness statement that Mr Molner had responsibility at Paramount for negotiation of commercial matters including film licensing arrangements, and in his oral evidence he showed a detailed working knowledge of such matters. Mr Molner gave evidence on a wide range of complex and detailed matters, including intricate and protracted negotiations with a large commercial team from Disney conducted some years previously, and his evidence was articulate and convincing. That said, he could, we consider, be fairly criticised for inaccuracies in his first witness statement, and, in particular, for a failure to disclose or produce at the hearing a valuation of the rights licensed by Disney to Eclipse 35, which he said SCI had made by working from the Salter Group projections of estimated revenues from the Films (as to which, see paragraph 317 below). Furthermore, on some matters,

under cross-examination, his recollection was correctly challenged on the basis of contemporary statements in email exchanges. Nevertheless, in our view the overall credibility of his evidence was not undermined.

54. As to the matter of the Prior Agreements, the inconsistency in Mr Molner's evidence related to the possible nature of such documents which Disney would not disclose. It seems that Mr Molner had revisited the transaction documentation when preparing for the hearing, and had realised that the Prior Agreements are more precisely defined (all as agreements between parties within the Disney group) than Mr Molner had suggested in his first two witness statements produced some time earlier (where the suggestion is that they may include agreements with "star" actors and producers, as well as intra-group agreements). It is also fair to Mr Molner to say that seemingly the Prior Agreements assumed a greater significance in the eyes of the Commissioners as matters progressed than perhaps Eclipse 35 and its advisers and witnesses had anticipated. In any event, we do not consider that this matter calls into question Mr Molner's general reliability as a witness.

55. Mr Salter had prepared two witness statements. Mr Salter, who is now semi-retired, has no connection with Salter Group (see the evidence of Mr Briggs, below). Mr Salter has since 2006 worked as a consultant to WDMSP Ltd in relation to the marketing and distribution of a number of films produced by Disney, including the Films. Mr Salter's working life has been spent in the business of internationally marketing and distributing films. From 1991 until 2006 he worked for Disney in Paris and London, where he was an Executive Vice-President of Buena Vista International, which was at that time the trading division within the Disney group responsible for the cinema marketing and distribution of Disney films in all territories other than North America. Mr Salter's particular responsibilities were for the marketing and distribution of films in Europe, the Middle East and Africa.

56. Mr Salter's first witness statement dealt with his role as a consultant to WDMSP Ltd in relation to films which have been licensed through the various Eclipse structures, including the Films. In that role he has monitored the distribution and marketing plans proposed by WDMSP Ltd (using Disney staff), and subsequently implemented by the Distributor and has reported to WDMSP Ltd on those plans and their implementation, advising on whether in his opinion they are reasonable and appropriate. He explained the different key stages in the marketing and distribution process for the cinema release of films: the marketing campaign to support the release; the scheduling of release dates in different territories appropriate to the nature and content of the films in question; and setting the budget for the release process.

57. Mr Salter's second witness statement was prepared in response to certain statements included in the report submitted by Mr Sills as to the extent of Mr Salter's work in his consultancy with WDMSP Ltd.

58. Mr Salter was cross-examined by Mr Gammie, with a view to determining the scope and extent of his consultancy activities for WDMSP Ltd and also the extent to which Mr Salter relied on the information-gathering and collation activities of SCI, but the Commissioners did not challenge Mr Salter's credibility as a witness.

59. Mr Briggs had prepared a witness statement. Mr Briggs is a principal of Salter Group, a position he has held since its formation in 2003. Prior to that Mr Briggs worked at an international investment bank primarily on forecast and valuation projects in the entertainment and media industry. Salter Group is based in Los Angeles. Its business is the provision of financial and strategic analysis and advice and valuations and forecasts in the film and entertainment industries, and Mr Briggs has worked for a range of international media and banking clients on forecasts and valuations of film libraries and music catalogues.

60. Mr Briggs's witness statement is concerned with Salter Group's opinion dated 22 February 2007 issued to Future and relating to certain films, including the Films. Salter Group was engaged to provide aggregate cash receipts forecasts for the Films during different exploitation cycles over a period of twenty years. Those forecasts were made on the basis of certain key assumptions and a range of possible cases ("best", "base", and "downside"), using a methodology based on the distribution strategies and plans which were then anticipated for the Films and on the earnings performance of a range of films judged (by reference to such matters as genre and plot, target audience, and key actors) to be comparable to the Films. The forecast cash receipts thereby estimated were applied to a financial model provided by SCI of likely expenses, prior allocation of financial participations by key actors and producers, and similar deductions from gross receipts to determine the possibility of Contingent Receipts arising for Eclipse 35 across the range of cases identified.

61. Mr Briggs was cross-examined by Mr Gammie as to the exact extent of his functions in preparing the Salter Group opinion, and the extent to which he relied on information and financial models supplied by SCI. The Commissioners did not challenge Mr Briggs's credibility as a witness.

The witness evidence – the Commissioners' expert witnesses

62. Two witnesses appeared for the Commissioners, both classified by the Commissioners as expert witnesses: Mr Marcus Stanton, a consultant to a number of banks and government agencies in the UK and overseas; and Mr Steven D. Sills of the firm Green Hasson Janks LLP. Each witness produced a report and was cross-examined at length by Mr Peacock, who appeared for Eclipse 35.

63. As we refer to below, the evidence provided by Mr Stanton in his report was the subject of an application by Eclipse 35 that all or some of it should not be admitted in these proceedings.

64. Mr Sills is a Certified Public Accountant and a member of the California Bar. He is a partner in the Motion Picture and Television Participation Services Department of the firm of Green Hasson Janks LLP and is based in Los Angeles. Since 1982 Mr Sills has specialised in the auditing of profit participation arrangements in relation to films, which requires a review of distribution agreements between the profit participant (an investor in the films, or a person such as an actor with a share in the earnings) and the distributor and a review of the accounts maintained by the distributor for the film in question in order to ascertain whether the profit participant

has received what is properly due to him under the distribution agreements. Mr Sills always acts for the profit participant in such cases, rather than the film studio or distributor. He has also appeared as an expert witness in entertainment litigation matters involving projections of film gross revenues and the application of financial models for determining participation shares.

65. Mr Sills's report dealt with the following matters: the "vertical integration" nature of the Disney group and the likely effect of the Prior Agreements upon the licence (and its value) granted by Disney to Eclipse 35; the likely significance to the Disney group of the marketing and release plans supplied by Eclipse 35 through the agency and services of WDMSP Ltd; the Contingent Receipts provisions in the distribution agreement between Eclipse 35 and the Distributor and the extent to which they conform to industry norms; the likelihood of Eclipse 35 receiving any Contingent Receipts; and the classification of the Films as "franchise films".

66. Eclipse 35 challenged Mr Sills's evidence in general and specific terms. Mr Peacock argued that Mr Sills's report was presented as expert evidence, but that the nature of his expertise is uncertain (it has neither a legal nor an accountancy basis), and that his working life has been spent analysing profit participation rights solely from the viewpoint of the profit participant. He also argued that Mr Sills reached certain conclusions (such as his view that the licensing and distribution arrangements could be viewed as a combined transaction which resulted in a net consequence which was the true nature of that transaction) which were not within the proper scope of an expert witness, as they are submissions of fact or of law.

67. We broadly accept Mr Peacock's challenges to Mr Sills's evidence and in consequence place limited reliance on that evidence. We accept that he has wide experience in the field of profit participation rights in film distribution arrangements, and for that reason we give weight to his evidence as it relates to the terms of the Contingent Receipts provisions in the agreement between Eclipse 35 and the Distributor. However, beyond that, although his evidence was put forward as that of an expert, much of his evidence (for example as to the likely purpose and effect of the Prior Agreements, or the value or benefit of the marketing arrangements put in place by WDMSP Ltd) was little more than surmise, and not, as was revealed in cross-examination, surmise which was based on first-hand knowledge or particular experience of the matters in question. Mr Sills's wider generalisations as to the true nature of the licensing and distribution arrangements which Eclipse 35 entered into with Disney strayed beyond his experience and in our view were not properly within his remit as an expert.

Mr Stanton's report and Eclipse 35's application to exclude it

68. A few weeks before the hearing of its appeal Eclipse 35 applied to us for a direction excluding the report (or the majority of it) prepared by Mr Stanton, and submitted as expert evidence by the Commissioners, on the grounds that it is inadmissible, since it relates to UK tax matters, which is the province of the Tribunal itself, and since, further, it puts forward a partial version of the facts, dressing as expert evidence matters which properly should be made by way of submission by the

Commissioners when they make their case at the hearing. The Commissioners resisted that application, and we heard the application, with detailed argument from each side, on 1 June 2011.

69. Our decision, reported in *Eclipse Film Partners No 35 LLP v The Commissioners for Her Majesty's Revenue and Customs* (TC 01256), was to dismiss Eclipse 35's application at that time, and to hear Mr Stanton's evidence with the benefit of any cross-examination of him at the hearing, and also to hear any evidence which Eclipse 35 wished to adduce by way of challenge to Mr Stanton's evidence, so that we would then be in a position to decide whether it should be excluded in whole or in part, and if not, the weight we should attribute to it.

70. As already indicated, Eclipse 35 did present evidence to challenge Mr Stanton's report, in the form of a second witness statement prepared by Mr Levy. Also, Mr Stanton was cross-examined at length by Mr Peacock.

71. In closing written submissions Mr Peacock and Mr Maugham renewed Eclipse 35's application to exclude Mr Stanton's report, adopting the arguments which Mr Maugham had advanced on Eclipse 35's behalf at the June 2011 hearing of the application. Mr Peacock and Mr Maugham argued, in the alternative, that if we did admit all or any part of Mr Stanton's evidence, we should attribute little weight to it in view of (as they saw it) Mr Stanton's limited expertise in the relevant fields, the report's partiality and selective nature, and the errors and omissions in the report as established by Mr Levy's evidence and in cross-examination.

72. Mr Gammie (with Mr Pillai and Miss Murray – who had appeared for the Commissioners at the June 2011 hearing of Eclipse 35's initial application) also made written submissions on this issue. They strongly rejected as unfounded the assertions of Mr Peacock and Mr Maugham that Mr Stanton had acted with partiality in preparing his report, or in any way had acted in a manner which implied a breach by him of his duty as expert to the Tribunal. They pointed out that Eclipse 35 had not particularised those parts of the report which it sought to exclude. Mr Gammie and his junior counsel argued that the transactions which Eclipse 35 and its Members entered into were structured finance transactions, consisting of seeking some tax advantage without taking on credit risk, and that Mr Stanton has manifest expertise in such transactions which enables him to give an expert view on such matters. They also pointed out that Mr Stanton provided the only evidence available to the Tribunal on the cash flow financial models underlying the transactions between the parties which, in their submission, are essential to a proper understanding of those transactions and their purpose: Eclipse 35 did not tender as a witness the employee at Future who was responsible for the financial modelling of the Eclipse film finance transactions.

73. We extract the following from our decision on the earlier application by Eclipse 35 as a summary of Mr Stanton's qualifications and experience and also the scope of his report:

"12 The evidence of Mr Stanton to which E35 takes exception is set out in a document entitled "Expert Report of Marcus Stanton" which is dated 8 April 2011 and is signed by Mr Stanton. The Report runs to some ninety pages, and we were told that there were lengthy exhibits to the Report (which we did not read). It is expressed to be Mr Stanton's professional opinion on the matter in dispute between E35 and the Commissioners, that opinion having been requested by the Commissioners. In preparing the Report Mr Stanton states that he has complied with Part 35 of the Civil Procedural Rules and the accompanying Practice Direction.

13 Mr Stanton begins by setting out his qualifications and experience. In brief, he qualified as a Chartered Accountant and practised at one of the leading firms of chartered accountants, specialising in international and corporate taxation. He then held a series of positions with leading UK merchant and investment banks, including that of Head of Structured Finance and Chief Operating Officer in the Global Capital Markets division of Robert Fleming & Co. Since 2001 he has acted as a banking consultant to banks and various government agencies in the UK and overseas and has also held a number of non-executive directorships in companies in the financial sector.

14 Mr Stanton divides his Report into ten sections, as follows (and adopting his section headings):

(1) The Role of Structured Finance in Tax Driven Transactions: this is a general explanation of the role of arrangers and banks in the context of tax-based products marketed to individuals followed by a description of the funding arrangements entered into by E35 and its members and the tax relief claimed by the members for the prepaid interest;

(2) The Transaction Arrangements: this is an overview of the transaction and a review of the main transaction documents and cash flows, with Mr Stanton expressing his view that the arrangements can be viewed as a combined transaction;

(3) The Profits/Losses of the Eclipse Partnership and the Eclipse Partners: this is an analysis of the likely profits and losses accruing from the transactions to E35 and to its members;

(4) The Derivation of the Transaction Amounts: this is an analysis of the payments made under the transaction documents, with the opinion expressed that such amounts were determined by financial calculations rather than by reference to any film activity;

(5) The Net Profit Calculations Prepared by Future Films: this is an analysis of the profit figures given in the promotional documentation sent to prospective members, relating those figures to the outcome (expressed by Mr Stanton to be a loss) where the members substantially borrow (as they all did) to invest in E35;

> (6) The Contingent Receipt Calculations: this is an analysis of the significance in the financial calculations underlying to transaction documents of the right of members to share in "Contingent Receipts" from the films in which the investment is made (that is, earnings from the films over and above the fixed royalties payable to E35);
>
> (7) The Banking Arrangements: this is an analysis of the loan and other facilities provided by members of the Barclays Bank group of companies, the credit risk undertaken by Barclays, and the risk-weighting of the arrangements for Barclays' capital adequacy purposes;
>
> (8) The Prepaid Interest: this comments on the prepayment of interest on their borrowings by the members and the resulting tax relief claimed by them;
>
> (9) The Risk being borne by the Eclipse Partners: this is an analysis of the nature of the risk to which the members are exposed in the event of default; and
>
> (10) The Role of the Tax Benefits in the Arrangements: this is an opinion that the amount of the investment made by each member was based on the tax shelter sought by that member and that a major factor in determining the size of the E35 partnership was the amount of tax shelter sought by its members collectively, rather than the requirement to finance particular films.
>
> 15 In the course of his Report Mr Stanton uses the cash flow and other numbers supplied by Future Films (the promoters of E35) and, by a process he refers to as "reverse engineering", uses that information to produce his own cash flows and calculations which he claims support his views on the financial and tax basis underlying the transaction as a whole and the individual transaction documents."

74. Having now had the benefit of hearing all the evidence and arguments in this case we are in a position to decide whether or not to allow Eclipse 35's application to exclude Mr Stanton's evidence. Our decision is not to exclude it, but to admit it and to attribute to it – or to its different parts – the weight which we consider appropriate in the light of all the extensive evidence and submissions which we heard.

75. There is a case for excluding part of Mr Stanton's evidence: we agree with Eclipse 35's argument that in parts Mr Stanton proffers his opinion on matters which are questions of law, most notably when he opines that "these arrangements can reasonably be viewed as a combined transaction, in the sense that the main transaction legs were all to happen together or not at all", and where he comments on the meaning and effect of transaction documents. We also accept that in part his opinion is based on surmise, for example with regard to possible further documents (further, that is, to those produced pursuant to the exercise by the Commissioners of their information-gathering powers) within the Barclays group as to the risk-weighting of the loan transactions. Eclipse 35 did not, however, make out a case for clear and specific surgical excision, and in the overall context we think such an approach would

not be particularly helpful – we are well able to identify those areas where Mr Stanton was trespassing into areas which are matters for our determination (and Mr Peacock's forthright and extensive submissions left us in little doubt as to what those matters are), and the reliance we place on Mr Stanton's evidence can be calibrated accordingly.

76. The real value of Mr Stanton's evidence, as Mr Gammie indicated, was to introduce into the case particular areas of evidence – most notably the cash flows underlying the transactions and the issue of the risk-weighting for the capital adequacy purposes of the Barclays group of the deposit and loan transactions – which in our view have some relevance and might otherwise have received less scrutiny than they did. If we take the cash flow statements which Mr Stanton produced (which show the cash movements on financial close of the transactions on 3 April 2007 and the subsequent income streams between the various parties over the following twenty years) they were in themselves unexceptional and not in their general approach or result disputed by Mr Levy, but they shed light on the financial basis of the transactions for the parties, the profitability of those transactions, and the financial effect of their tax consequences. In turn this led Eclipse 35, through the evidence of Mr Levy and Mr Peacock's cross-examination of Mr Stanton, to argue that the cash flows constructed by Mr Stanton had certain deficiencies and took no account of certain contingencies (in particular, the possibility of Eclipse 35 receiving Contingent Receipts) and to challenge certain of the inferences which Mr Stanton had drawn from the cash flow statements. We were therefore presented (helpfully) with a range of pertinent evidence as to the financial effects and significance of the transactions. In that way Mr Stanton's evidence was "helpful in assisting the court to reach a fully informed decision": *United Bank of Kuwait v Prudential Property Services Limited* (unreported decision of the Court of Appeal of 27 November 1995).

77. The significance of, and the weight we attribute to, the different parts of Mr Stanton's evidence will be apparent from our findings of fact and conclusions.

Findings of fact

78. In paragraphs 80 to 252 below we set out our findings of fact from the evidence before us. First we deal with the context of the Eclipse 35 transaction, setting out the development of the Eclipse structure and transactions and the formation of Eclipse 35, including the investment made by the Members. Then we deal with the terms of the transaction documents. This is followed by the financial terms of the transactions and the cash flows which underlie the transactions. We then deal with the marketing services arrangements.

79. In paragraphs 253 to 367 below we make further findings of fact in relation to disputed matters concerning the nature of Eclipse 35's activities and the arrangements it entered into.

The Eclipse structure and transactions and the formation of Eclipse 35

Eclipse partnership transactions prior to Eclipse 35

80. Eclipse 35 is, as the name suggests, one of a series of partnerships which entered into broadly similar transactions relating to the acquisition and distribution of film rights. The Eclipse 35 structure of transactions has certain features which are specific to it (as mentioned below), but the essential terms of the agreement made with Disney were negotiated at an earlier stage in relation to the transactions entered into by the predecessor partnerships. It is necessary, therefore, to give this context to the transactions of Eclipse 35 which are our concern in this appeal.

81. The origins of the transactions entered into by the Eclipse partnerships were sale (or lease) and leaseback film financing transactions promoted over a number of years by Future and other promoters engaged in procuring private finance from individuals for the production or acquisition of films and the exploitation of those films through distributorship arrangements. The immediate origin of the Eclipse structure was a different transaction developed by Future and referred to as the "Library" transaction.

82. Eclipse 35's transaction was the fourth in a series or tranches of transactions whereby film rights were licensed from Disney to a number of "Eclipse" partnerships. In each case Future promoted the partnerships and sought investors to contribute capital to the partnerships to finance them for the acquisition of the licence to the film rights, with the grant back to Disney (or, more accurately, another member of the Disney group) of distributorship rights, and Future and SCI negotiated with Disney on behalf of the Eclipse partnerships.

83. Prior to concluding agreements with Disney, Future and SCI had also negotiated similar transactions with other film studios, including Warner Brothers, Sony, Universal and Paramount, but for a number of reasons (including the reluctance of other studios to countenance the marketing and release arrangements which Future and SCI on behalf of the Eclipse partnerships eventually agreed with Disney) those negotiations came to nothing.

84. On 22 December 2005 Future (by Mr Levy) and SCI (by Mr Molner) entered into with Disney what was termed a "non-binding letter of terms indicating our intention to work with each other in good faith to close the Transactions" ("the Term Sheet"). The "Transactions" identified in the Term Sheet related to partnership structures which included the Eclipse partnerships. The Term Sheet (so far as it related to the Eclipse partnerships) included the following matters:

(1) Confirmation that preliminary internal approval within the Disney organisation had been obtained for the Transactions, but that final approval would be required from Disney's audit committee and from the President of Disney as to the definition of contingent proceeds (that is, Contingent Receipts);

(2) Successful execution of the Transactions was conditional on a number of matters, including documentation satisfactory to Disney, the successful raising of capital by the partnerships, the making of banking arrangements satisfactory to

Disney, and Disney being satisfied as to relevant tax, insolvency and security matters;

(3) The term of the deal for any Eclipse partnership would vary between 9 and 23 years, with certain early termination provisions;

(4) Disney agreed to make certain specified films available in an agreed order of priority (the list of films contained two films used in earlier tranches of Eclipse transactions, but not the Films used in the Eclipse 35 transaction). Disney agreed to offer further films (satisfactory to SCI and Future) if the value of the film rights for the specified films fell short of US$3.6 billion;

(5) Each Eclipse partnership was required at its cost to obtain a valuation (based on independent advice) for the rights in each film to be acquired from Disney; and

(6) Credit enhancement arrangements were envisaged in relation to the obligations of the Disney distributor party, to be facilitated by a deposit made by the distributor. Such deposit was to equal 97.22 per cent of the price paid by the respective Eclipse partnership for the licence of the film rights, and the aggregate amount of such differential between the price paid and the deposit for all films licensed to Eclipse partnerships was not to exceed US$35 million unless the aggregate value of the film rights exceeded US$3.6 billion. (This differential is subsequently referred to as the "Studio Benefit".)

85. On 5 April 2006 a number of Eclipse partnerships entered into transactions to take a licence of, and to grant a distribution licence of, certain rights in the Disney film "Pirates of the Caribbean: Dead Man's Chest". This was the first tranche of Eclipse transactions.

86. On 21 July 2006 a further number of Eclipse partnerships entered into transactions to take a licence of, and to grant a distribution licence of, certain rights in the Disney film "Pirates of the Caribbean: At World's End". This was the second tranche of Eclipse transactions.

87. On 19 March 2007 a further number of Eclipse partnerships entered into transactions to take a licence of, and to grant a distribution licence of, certain rights in the Disney film "National Treasure: Book of Secrets". This was the third tranche of Eclipse transactions.

88. In January 2007 Disney offered the Films as films to be licensed in an Eclipse transaction.

89. The Term Sheet and the individual Eclipse transactions comprising each tranche were the subject of extensive negotiation between Future, SCI and Disney, involving senior management, legal, accounting, commercial and marketing executives within the Disney organisation. The lead negotiator for Future and the Eclipse partnerships was Mr Molner, but Mr Levy and his colleagues at Future were also involved in negotiations on behalf of the Eclipse partnerships.

90. Matters which were the subject of particularly intensive negotiation included the following:

(1) The value to be attributed to the film rights licensed and the amount of the fixed royalties paid by the Distributor;

(2) The identity of the films, and the extent of the rights in such films, to be licensed;

(3) The protection of Disney's rights in the films in the eventuality of the insolvency of the Eclipse partnership;

(4) The marketing arrangements carried out through WDMSP Ltd, including the extent of WDMSP Ltd's role and its accountability to, respectively, the Eclipse partnership which engaged its services and Disney;

(5) The amount of the Studio Benefit in the case of each tranche (which was reduced from 2.5 per cent envisaged in the Term Sheet to 0.9722 per cent in the case of the first three tranches and to 1.15 per cent in the case of Eclipse 35);

(6) The terms on which the Contingent Receipts were to be ascertained, and the proportion of the Contingent Receipts to which the Eclipse partnerships were entitled; and

(7) The extent of the rights which the Eclipse partnership had to audit the gross income receipts earned by the films in order to monitor any entitlement of the Eclipse partnership to Contingent Receipts.

91. By the time that Eclipse 35 entered into its transaction most of the commercial terms and documents concerning the licensing of the Films and related matters had been agreed with Disney in negotiation of the earlier tranches. There were, however, further meetings, conference calls and email exchanges between Disney executives and (principally) Mr Molner in order to agree the particular features of the Eclipse 35 transaction.

92. The Eclipse 35 transaction is distinguished from the transactions in the other Eclipse tranches by the following features:

(1) Eclipse 35 acquired the entirety of the rights to the Films (and not, as had been the case with acquisitions of rights in the earlier Eclipse tranches, rights limited by territory or media);

(2) Eclipse 35 acquired the rights in two films, rather than a single film. As described below, for the purposes of calculating the entitlement of Eclipse 35 to Contingent Receipts, the two films were "cross-collateralised", that is, their financial performance was aggregated;

(3) In the first three tranches each Eclipse partnership was entitled to a 34 per cent share of Contingent Receipts, but in the case of Eclipse 35 the share was 40 per cent;

(4) In the first three tranches the rate of the Studio Benefit was fixed at 0.9722 per cent of the licence fee, but in the case of Eclipse 35 it was fixed at 1.15 per cent; and

(5) The Members of Eclipse 35 (unlike the members of the other Eclipse partnerships) prepaid interest for the first ten years of the borrowings they took to finance their capital contributions to Eclipse 35. This, as explained below, had a consequence for the amount of the fixed royalties payable by the Distributor (and in turn the amount which the Distributor deposited to secure payment of those royalties).

93. In deciding with which film studio to enter into licensing and distributorship arrangements, and in selecting the films to be licensed, Future and the Eclipse partnerships took account of the following matters:

(1) Major film studios have fully integrated media and distributorship businesses which enable them not only to maximise film revenues through their international distribution arrangements, but also to exploit film rights through the cycle of the film's earning capacity (by cinema release, home video release, pay-to-view TV, hotel and airline release, free TV, etc) and such associated exploitation as merchandising and video games. Future carried out negotiations with Warner Brothers and Disney (eventually concluding an agreement with Disney), both of which, of course, are major film studios of this type.

(2) Films are potentially "long-tail" assets, not only because they have different and successive cycles of exploitation over the years, but also because the introduction of new technology can, years after a film has been released, re-invigorate the capability of distributing a film in different formats. Particular films which by their subject matter are "franchise" films are likely to have an enduring attraction and longevity and are therefore best placed to exploit the "long tail" and earn maximised income over time with the best prospect for members of the Eclipse partnerships of receiving Contingent Receipts. A "franchise" film is one which is based on an existing media property, so that in some way (subject matter, established and specific genre, characters) a potential audience already has a connection which is expected to draw them to the film: it may be a film based on a book, a comic strip, or a television series, or as a sequel to an earlier film. In the first three Eclipse transactions the films selected were sequel films following upon very successful earlier films. The "franchise" nature of the films for which Eclipse 35 acquired rights is referred to below.

(3) It follows that films which, by reason of their "franchise" attributes, have the potential to earn high gross revenues over time, have premium value which reflects that potential, and the studio will wish to see that premium value in the licence fee it receives. It will also wish to see that distribution arrangements ensure that there is the best opportunity to realise that value. The significance to the studio of such value lies not just in the commercial terms of the licence agreement it enters into, but in the impact it has on values attributed to its portfolio of films which ultimately is reflected in its group balance sheet.

(4) Future was concerned that there should be a role for the Eclipse partnerships (acting through WDMSP Ltd) in formulating the marketing and release plans for the films to be licensed to the Eclipse partnerships. It was not interested in films which were, so to speak, too far down the marketing track. To that end it devised a scale by which, applying specified "threshold" criteria, it

could judge how far advanced were the marketing and release plans of individual films, so that films which were judged to be too high on the scale could be eliminated. In the case of all the films some element of marketing, release and distribution planning had been undertaken by the Disney group before the films were licensed to an Eclipse partnership.

94. The film licensed in the first tranche of the Eclipse transactions is the Disney film "Pirates of the Caribbean: Dead Man's Chest". The annual statement of gross receipts and contingent receipts as at 26 March 2011 shows that at that date (just under five years after the film was released) gross receipts from the film totalled US$908 million and that there was then a "deficit" in the contingent receipts calculation of US$82.5 million. In view of the likely "life" of the film and its positive performance to date against estimates, it is reasonable to expect that contingent receipts will eventually become payable to the relevant Eclipse partnerships. Corresponding figures for the film licensed in the second tranche of the Eclipse transactions, "Pirates of the Caribbean: At World's End", released a year later, show aggregate gross receipts as at 26 March 2011 of US$755 million and a contingent receipts "deficit" of US$258 million (reflecting the high production costs for the film).

The Films licensed by Eclipse 35

95. The Films which Disney proposed to Eclipse 35 and which Eclipse 35 chose to licence were "Enchanted" and "Underdog".

96. "Enchanted" is a story created by Disney with a princess as the main character and which draws on the Disney animations of classic fairy tales. It is described as "a unique twist on the classic Disney fairytale which showcases what happens when the magical, idyllic animated world and the modern, gritty, real-life world of New York City collide". Its leading actors include Amy Adams, Patrick Dempsey and Susan Sarandon. It was created by Disney to be an addition to its portfolio of "princess" films (comprising animation classic films as well as more recent films) which have been very successful in their own terms with family audiences and in the merchandising rights which they have generated for products aimed at young girls. Both Disney and Future regarded "Enchanted" as a "franchise" film in view of its connection to the Disney "princess" portfolio of films, of which it was intended to be a part.

97. "Enchanted" was released in the United States on 21 November 2007 and subsequently worldwide. In 2008 it was nominated for three Academy Awards and twenty-nine other awards.

98. "Underdog" is a film based on a United States cartoon and comic strip series dating from the 1970s. Its leading actors include Amy Adams, Jason Lee and James Belushi. Both Disney and Future regarded "Underdog" as a "franchise" film as it is derived from a comic strip. It was released in the United States on 3 August 2007, and was nominated for three awards. Whereas it was anticipated that "Enchanted" would, by reason of its subject, have an international audience, both Disney and Eclipse 35 considered that the appeal of "Underdog" was less certain: the comic strip

on which it was based was known only to one generation of the potential audience, and was not known outside the United States.

99. At Disney's insistence for all financial purposes in structuring the licence and distribution arrangements with Eclipse 35 the two Films are aggregated. The principal purpose and effect of this is to "cross-collateralise" the Films in ascertaining the entitlement of Eclipse 35 to Contingent Receipts – the calculations of that entitlement are made as if the Films were a single entity, with aggregation of all production, marketing and distribution costs and participations which are taken into account as debits in determining Contingent Receipts, as well as the aggregation of all gross revenues which are taken into account as credits for that purpose. Thus if one of the Films is successful and, taken alone, would deliver Contingent Receipts, but the other Film is not so successful and, taken alone, would result in a "deficit" Contingent Receipt calculation, that deficit, in the combined calculation, reduces or eliminates the Contingent Receipts otherwise payable in respect of the successful Film.

100. In agreeing to "cross-collateralise" the Films in this way Eclipse 35 was able to negotiate a 40 per cent share of any Contingent Receipts (as against a 35 per cent share in the case of the earlier Eclipse tranches).

101. As at 26 March 2011 aggregate gross receipts for the Films (taken together) were US$362 million, and, taking account of the "cross collateralisation" of the contingent receipt entitlement in respect of the two Films, there was a contingent receipts "deficit" of US$184 million.

102. As a general statement, "Enchanted" has been a success: its gross cinema release revenues have been above the "base case" range identified by Salter Group in the opinion they gave to Eclipse 35 as to likely performance of the film. "Underdog" has not been a success: its gross cinema release revenues are below the "downside case" range identified by Salter Group in that opinion. On current figures it is thought to be unlikely that any Contingent Receipts will be received by Eclipse 35.

The establishment of Eclipse 35 and its partnership deed

103. Eclipse 35 was incorporated on 3 October 2006 as a limited liability partnership with registered number OC3228434. The members on incorporation were Future Films (Management Services) Limited and Future Films (Partnership Services) Limited.

104. On 3 October 2006 Eclipse 35 entered into a Partnership Consultancy Agreement with Future. It recites that Eclipse 35 "was organised principally to carry on the trade of investment, acquisition and exploitation of films in the designated territories". Eclipse 35 engages Future to provide the "Partnership Consultancy Services", which are defined in Schedule 1 to the agreement to include identifying, evaluating and selecting films suitable for Eclipse 35 for its purposes of producing, acquiring, distributing, financing and exploiting films; procuring the purchase of films and any rights in films for the purpose of exploitation; procuring the exploitation of film rights by way of leasing, licence and distribution agreements and disposal; and entering into

agreements to acquire and exploit films to maximise the scope and profitability of Eclipse 35's business. All such services are undertaken by Future on behalf of Eclipse 35. Eclipse 35 agrees to pay Future for providing these services a fee comprising 5.5 per cent of the partnership capital raised by Eclipse 35 and 15 per cent of the net proceeds from the exploitation of the distribution of film rights licensed to Eclipse 35. Pursuant to this agreement Eclipse 35 paid Future a fee of approximately £44 million on 3 April 2007.

105. On 9 February 2007 Eclipse 35 entered into the Marketing and Services Agency Agreement with WDMSP Ltd. Its principal terms are set out below, but the broad purpose of the agreement is that WDMSP Ltd is, for a fee, appointed as Eclipse 35's agent and engaged to provide specified services, including the preparation of marketing and release plans in relation to the Films and overseeing the Distributor in its implementation of those plans.

106. On 13 March 2007 the two founding Members of Eclipse 35 entered into a partnership deed in relation to Eclipse 35 ("the Partnership Deed"). The Partnership Deed in these terms has since governed Eclipse 35 and its Members, and the investing Members became parties to the Partnership Deed (and thereby Members) by signing a Deed of Adherence and contributing their capital. Provisions of the Partnership Deed relevant to this appeal include the following:

(1) Eclipse 35 is required to carry on "the Business", defined to include film production, distribution, financing and exploitation, and in particular the licensing of the distribution rights in respect of such films owned or controlled by Disney as Future may agree with Disney should be licensed to Eclipse 35, and any business which is ancillary to such activities. Ancillary matters are expressed to include: receiving nominations from Disney of films suitable for Eclipse 35 to take a licence and grant distribution rights; obtaining a "likely range of the market value of those film nominations, as indicated by independent film valuation specialist"; using the services of WDMSP Ltd to prepare a marketing and releasing plan for films licensed to Eclipse 35; and thereafter to sub-licence the film rights to the Distributor for the implementation of the approved marketing and releasing plan.

(2) The Business is to be carried on to the extent expressly permitted by the "Transaction Documents" (essentially the documents under which Eclipse 35 subsequently licensed and distributed the Films), or by way of other commercial activities contemplated in conjunction with Disney, unless Disney consents to some other business activity.

(3) The liability of a member is limited to the amount of his capital contributed, that amount to be specified in the Deed of Adherence by which he becomes a Member.

(4) The two founding Members are appointed the Designated Members for the purposes of the limited liability partnership legislation, and they have the right and duty to manage the business and affairs of Eclipse 35, subject to the performance of those functions undertaken on behalf of Eclipse 35 by Future as promoter of Eclipse 35 and pursuant to the Partnership Consultancy Agreement.

To the extent that Members have conduct of the affairs of Eclipse 35, matters require the consent of Members who together hold 50 (or, for certain matters, 75) per cent of total capital contributed.

(5) Profits and losses are allocated to Members in proportion to capital contributed. Income of the partnership available for distribution to Members is to be distributed annually in proportion to capital contributed. The Designated Members have power to advance loans to Members against future income profits in advance of such profits being recognised in the accounts of the partnership, and any such advance is not to be treated as a reduction of Members' capital, and is repayable to the partnership on demand. (This power was exercised on "financial close" of the transactions on 3 April 2007, when an aggregate amount of approximately £293 million was advanced by Eclipse 35 to Members.)

(6) On the date which is six months after the expiry or early termination of the Licensing Agreement the Members will cause Eclipse 35 to be wound-up.

The promotion of the Eclipse partnerships to investors

107.The Eclipse partnerships (including Eclipse 35) were promoted to potential investors by an Information Memorandum dated 9 January 2006 which included what is described as a "Film Partnership Proposal". This set out the nature of the investment which would be made by investors if they became members of a partnership, summarising that investment as "an opportunity to participate in the exploitation of new Hollywood feature franchise films produced, owned or controlled by a US Major, through an exclusive joint venturing arrangement".

108.The Proposal included the following matters: the nature of the film licensing, marketing and related transactions which a partnership would enter into; examples of the "franchise" films which might be licensed within the proposed arrangements; the fixed royalties which a partnership would receive under the film distribution agreement; the credit enhancement of those fixed royalties by the issue of a letter of credit by a bank; the possibility of a partnership receiving "contingent receipts", dependent upon the success of the exploitation of the films licensed; the tax treatment of a partnership (namely, that the exploitation of the films should constitute a trade for such purposes); the attribution of trading profits or losses of a partnership to its members for their tax purposes; the expectation that a partnership (and hence investors) would make a profit for tax purposes in each year of assessment; the investment return (based on fixed royalties received and a range of assumptions as to "contingent receipts") which a member could anticipate (with financial illustrations); the projected pre-tax internal rate of return inherent in the licence and distribution arrangements; the terms of the partnership deed; and the financial, legal and film risks to which investors might be subject.

109.The Proposal explained that investors would make their investment by becoming members of an Eclipse limited liability partnership for which they would be required to contribute capital to the partnership. There was a minimum investment of £400,000. There is no reference in the Proposal to any loan facility for investors to enable them to borrow funds for their capital contributions.

110.On 13 March 2007 there was issued an "Addendum to Film Partnership Proposal" in respect of investment in Eclipse 35. This modified the Proposal, as it related to Eclipse 35, in a number of respects, including the following:

(1) The reference in the Proposal to the partnership entering into a joint venturing arrangement was said to be incorrect: instead the partnership is said to be entering into a licensing transaction as Disney's licensee;

(2) "Underdog" (but not "Enchanted") is identified as a film which Disney will licence to Eclipse 35;

(3) The minimum investment by way of capital contributed is £700,000 per Member;

(4) There is a statement as to the possibility of Eclipse 35 receiving Contingent Receipts, based on "advice from SCI, together with independent valuations from Salter Group LLC": in their opinion given on 22 February 2007 Salter Group expressed the view that if the Films performed in accordance with their "best case" performance range, "a payment of [Contingent Receipts] is possible". There is reference to the provision in the Distribution Agreement to the effect that the Distributor has no obligation to distribute any film licensed to it, and if it does so, has no obligation to maximise revenues from the films. This is described as protective language which is a standard requirement of major US film studios included to minimise the risk of litigation by contingent participants in their films;

(5) There is a statement that Eclipse 35's rights against Disney in the event that Disney is in breach of any of its obligations under the transaction documents are limited, but that on early termination the specified termination amount should be payable by Disney (that amount being restricted to the balance then secured under the Letter of Credit); and

(6) There is passing reference to the loans which may be provided to Members for the purpose of their subscribing capital to Eclipse 35.

111.Although the Proposal makes limited reference to borrowing by members, it was a feature of most, if not all, of the tranches of Eclipse transactions that facilities would be available for members to borrow the greater part of the amount they required to make capital contributions. In the promotional material the loan facilities were described as "full-recourse" loans. In relation to Eclipse 35, such facilities were made available by Eagle, on terms whereby the interest rate was fixed for the term of the borrowing, and Members would pre-pay on financial close of the transactions interest for the first ten years of borrowing. It was not a requirement that a Member should borrow any part of the capital he intended to contribute to Eclipse 35, nor that, if he decided to borrow, he should borrow a specified amount (but the terms of the facility limited his borrowing to 98 per cent of his capital contribution).

112.The investment was marketed to potential Members on the basis that the Eagle facility would be available to Members, and that if borrowings were made under that facility (or any other borrowing arrangement a Member might enter into) the interest paid would reduce the net profits received by a Member but, by reason of the

leveraging effect of the borrowing, increase the potential return on the cash investment made by the Member (that is, the part made from his own cash resources), especially if Contingent Receipts should become payable. Financial illustrations given to potential investors assumed a borrowing by the investor of 94 per cent of his capital contributed. The internal rate of return implicit in the financial basis of the transactions (disregarding the prospect of Contingent Receipts) was considered by Future to render the investment attractive to Members who did not wish to borrow part of the capital they intended to contribute.

113. Investors in search of tax relief comprised a particular "market" for the Eclipse 35 structure, including individuals who had invested in previous years in other film financings promoted by Future, and whose investments were by this time yielding taxable profits for which they were seeking tax shelter. Certain restrictions on tax relief introduced in the Budget in March 2007 caused Future to make changes to the Eclipse structure used in previous tranches, and in particular resulted in the arrangements whereby Members drawing on the borrowing facility were required to prepay interest for the first ten years. Members entered into such arrangements with the intention of claiming tax relief for the interest so prepaid in the tax year in which it was so paid. To the extent that such relief can be set against taxable interest in that tax year Members will enjoy a cash flow benefit which will be partially reversed over the twenty-year lifetime of the investment as they receive taxable income comprising the profits earned by Eclipse 35 (that is, the fixed royalties under the Distribution Agreement together with Contingent Receipts, if any) – (see paragraphs 197 to 199 below for the detail).

114. The promotion of Eclipse 35 was very successful. 289 investors became Members on 3 April 2007, subscribing in total £840 million. All investors availed themselves of the Eagle facility, each borrowing 94 per cent of his capital contributed to Eclipse 35 (so that approximately £50 million was contributed by Members from their cash resources and £790 million from borrowings under the Eagle facility). The success of the promotion is attributed to the following factors: the commercial success by then apparent of the "Pirates of the Caribbean" films licensed in previous Eclipse tranches; the attraction of Disney as the film studio counterparty; and the "market appetite" for an investment which offered tax relief at a time when other reliefs had been restricted by Budget changes.

The principal transaction documents

115. Eclipse 35 and the other parties to the transaction entered into the transaction documents on 3 April 2007, following the successful raising of capital by Eclipse 35. That was the date of what is described in the documents as "Financial Close", when, broadly, the immediate payment obligations in the transaction documents were discharged. Certain of the transaction documents (including the Marketing and Services Agency Agreement between Eclipse 35 and WDMSP Ltd and the Eagle facility documents) were entered into in advance of 3 April 2007.

116. All of the transaction documents are governed by English law.

117. The transaction documents can be categorised into the licensing and distribution documents (which deal with the grant of rights in the Films); the facility, deposit and security documents (which deal with the borrowings by members and the defeasance and security arrangements); and the marketing services documents. The following is a summary of the key provisions in the principal transaction documents.

The licensing and distribution documents

118. Eclipse 35 and Disney entered into the Licensing Agreement on 3 April 2007. It runs to 98 pages, including the detailed technical specifications relating to the Films. It recites that Eclipse 35 is concurrently entering into the Distribution Agreement, and that it has entered into the Marketing Services Agreement. It also recites that Disney and Eclipse 35 "are entering into this Agreement for the purposes of [Disney] licensing the Rights to [Eclipse 35] and providing for the terms on which [Eclipse 35] shall exploit the Rights".

119. Clause 2 comprises the grant of the licence of the Rights ("the Licence"):

(1) The Rights are the "distribution and/or exploitation rights in the media and in the Territory in respect of each of the [Films]" as set out in an Exhibit to the Licensing Agreement. In relation to each of the Films the specified media comprise "theatrical rights" (defined to include not just exhibition in cinemas, but also sound recording, merchandising and video game manufacture and distribution); "television rights"; and "video rights" (to include video cassettes and video discs and other electronic and digital formats including those transmitted on the Internet).

(2) The "Territories" comprise all the countries of the world.

(3) The grant of the Licence is in these terms: "[Disney] exclusively licenses subject to and only with effect from Financial Close the Rights free of all charges…to [Eclipse 35], its successors and assigns, throughout the Territory for the Term". The Term is the period of twenty years from Financial Close.

(4) The grant is expressed to operate "only as a terminable licence of the Rights pursuant to and in accordance with the express terms of this Agreement", and that no grant of any other interest in the Rights is made.

(5) The grant of the Licence is "expressly subject to the Prior Agreements". The "Prior Agreements" are specified licence agreements between Disney and its principal group distribution companies, dating from 1990 (and amended in the period up to August 2005), "and any and all other licences or other agreements between [Disney] and any one or more of its Affiliates relating in whole or in part to the [Films] and/or any of the Rights existing as at the date of Financial Close".

(6) Certain intellectual property and similar rights in or relating to the Films are excluded from the grant, except to the extent necessary to exploit the Rights.

(7) The grant confers on Eclipse 35 the right to exploit and sub-licence the Rights, but only by entering into the Distribution Agreement, and Eclipse 35 agrees to enter into the Distribution Agreement concurrently with the Licensing

Agreement. The rights licensed to Eclipse 35 by the Licence Agreement are personal to Eclipse 35 and cannot be assigned or sub-licensed except by entering into the Distribution Agreement

120. By Clause 3, the Licence takes effect upon the Letter of Credit becoming unconditional, whereupon Eclipse 35 is required to pay Disney "the Advance" on account of the "Licence Fees" payable during the Term of the Licence. If the Letter of Credit has not become unconditional on or before 5 April 2007, the Licence Agreement is then terminated.

121. The remuneration which Eclipse 35 is required to pay for the Licence is specified in Clause 4, and comprises the Licence Fees, being a fixed sum payable annually (on account of which the Advance is made on Financial Close) and a variable sum payable annually to the extent it accrues due in any year ("the Variable Royalty"):

(1) The Licence Fees are specified amounts payable on each anniversary of Financial Close (3 April 2007) up to and including April 2027. In April 2008 the Licence Fee is £266,283, but in subsequent years the Licence Fee increases year by year from £14,566,407 in April 2009 to £33,828,945 in April 2026. The final Licence Fee payable in April 2027 is a "balloon" payment of £89,809,802. The total of Licence Fees payable over the Term of the Licence is £502,929,537.

(2) The Advance paid on account of Licence Fees payable over the Term of the Licence was made by Eclipse 35 to Disney on Financial Close, and amounted to £502,929,537. As a broad statement (the termination provisions in the Licence Agreement are complex, and not directly material for the purposes of this appeal), upon the early termination of the Licence Disney is liable to pay back to Eclipse 35 the amount of the Advance less the aggregate of Licence Fees payable in the period up to the termination date, and less the amount of the Studio Benefit. However, that liability is discharged by the issue of the Letter of Credit, so that Eclipse 35's recourse is solely against Barclays under the Letter of Credit, and the amount to which Eclipse 35 is entitled on early termination cannot exceed the maximum amount which Eclipse 35 can claim as at the termination date under the Letter of Credit.

(3) The Variable Royalty in any year equals the amount of the "Variable Distributions" (if any) to which Eclipse 35 is entitled from the Distributor under the Distribution Agreement. (The mechanism for payment of the Variable Royalty is that, under the security arrangements between Eclipse 35 and Disney, Eclipse 35 irrevocably directs (i) the Distributor to pay the Variable Distributions to WDMSP Ltd and (ii) WDMSP Ltd to pay the corresponding Variable Royalties to Disney.)

122. By Clause 8 Disney provides physical delivery of the Films to Eclipse 35 by delivering the specified prints, negatives and other technical representations of the Films to a specified laboratory to be held for the account of the Distributor.

123. There is provision as to the running length and rating of the Films, and provision for Eclipse 35 to terminate the Licence Agreement, or accept a substituted film, if either of the Films is not completed and released by a specified date. There are

extensive provisions dealing with protection of copyright and other intellectual property rights, the preparation and use of foreign language versions of the Films, and the rights of Eclipse 35 to publicise and promote the Films.

124.The provisions relating to termination provide for either party to terminate the Licence Agreement on the occasion of specified default by the other (such as material breach of a term of the Licence Agreement, or an event which could result in insolvency). There is an automatic termination if the Distribution Agreement is terminated. Eclipse 35 has the right to terminate the Licence Agreement voluntarily at any time by notice.

125.Disney agrees to provide to Eclipse 35 the marketing information and materials which Eclipse 35 agrees with WDMSP Ltd to provide to WDMSP Ltd in the Marketing Services Agreement.

126.Clauses 17 to 22 comprise representations, warranties and indemnities given by each party to the other. In addition to the usual warranties as to legal and financial standing and proper compliance, the representations, warranties and indemnities include the following:

(1) Eclipse 35 warrants that it will have the financial resources required to perform its obligations under the Licensing Agreement;

(2) Eclipse 35 warrants that it is not a party to any agreement other than the documents for this particular transaction, and that it has not taken any action other than for the commercial purpose of acquiring and exploiting the Rights and raising capital from the Members. It also covenants that it will not, until the termination of the Licensing Agreement, conduct any business other than by way of implementation of the transaction documents, unless it has the prior written consent of Disney;

(3) Disney warrants that the performance of the Licensing Agreement will not violate any material agreement to which Disney is a party;

(4) Disney warrants that (subject to the Prior Agreements), it holds or controls all licences to the Rights and to the Films;

(5) Both parties acknowledge that the Distributor will, under the Distribution Agreement, exploit the Rights diligently in a manner consistent with the Disney group's prevailing and commercially reasonable practices;

(6) Eclipse 35 acknowledges that Disney, WDMSP Ltd and other Disney parties to the transaction documents are part of the Disney group, and may, in their discretion, enter into arrangements with affiliated companies in connection with the exploitation of the Rights and the Films;

(7) Eclipse 35 acknowledges that no representation has been given by Disney as to the likely financial or commercial performance of the Films, or as to the likelihood of Eclipse 35 earning any Contingent Receipts;

(8) Disney indemnifies Eclipse 35 and the Members against any third party claims arising from any defect in the chain of title to each of the Films or the Rights.

127. The parties agree in Clause 37 that for the purposes of applying United States tax law and financial reporting requirements, the transactions effected by the transaction documents will be considered as a whole rather than only according to their legal form, and "are to be treated solely as the purchase by [Eclipse 35] of its right to participate in proceeds for an amount equal to the net financial benefit of the transactions as of Financial Close to [the Disney group]".

128. Eclipse 35 and the Distributor entered into the Distribution Agreement on 3 April 2007. It runs to 128 pages, including the provisions for the calculation of any entitlement to Contingent Rights and the detailed technical specifications relating to the Films.

129. The Distribution Agreement recites that Eclipse 35 is concurrently entering into the Licensing Agreement and the Marketing Services Agreement, and that "[Eclipse 35] and Distributor are entering into this Agreement for the purposes of [Eclipse 35's] licensing the Rights to Distributor and providing for the terms on which Distributor shall exploit the Rights".

130. By Clause 2 Eclipse 35, with effect from Financial Close, and subject to the Prior Agreements, exclusively licenses the Rights to the Distributor throughout the Territory (all the countries in the world) for the Term (twenty years from Financial Close). The definition of "the Rights" accords with the definition given to the same term in the Licensing Agreement.

131. The Distributor agrees to perform all Eclipse 35's obligations under the Licensing Agreement to exploit the Rights, and Eclipse 35 agrees that:

> "…pursuant to this Agreement [Eclipse 35] exclusively and exhaustively licenses to Distributor … all of the rights in and to each of the [Films] licensed to [Eclipse 35] pursuant to the Licensing Agreement, and that [Eclipse 35] has reserved no such rights from the licence granted to Distributor hereunder, and that accordingly during the Term [Eclipse 35] shall not be entitled to and shall not take any action with respect to any of the rights or any of the [Films] except such actions as may be expressly provided for pursuant to this Agreement."

The Distributor is given the right to distribute, advertise, publicise and exploit the Rights upon such terms as it alone sees fit.

132. There are provisions to terminate the Distribution Agreement if the Licensing Agreement is terminated because the Letter of Credit does not go unconditional.

133. Clause 4 deals with the marketing and release plans provided for in the Marketing Services Agreement: the Distributor agrees to undertake the detailed implementation of such plans under the oversight of WDMSP Ltd. However, Eclipse 35 agrees that

the Distributor can modify such plans, or deviate from them in order to exploit the Rights and the Films in compliance with the terms of any relevant agreements between Disney group companies, or in circumstances where Eclipse 35 has recognised that the Distributor has no obligation to distribute the Films or to maximise the revenues from the Films.

134. By Clause 5, the consideration given by the Distributor to Eclipse 35 for the sub-licence of the Rights has, in each accounting period of a year, three elements: the Annual Ordinary Distributions ("AODs"); the Variable Distributions; and Eclipse 35's 40 per cent share of Contingent Receipts:

(1) The Distributor is liable following each accounting period to pay the AOD for that accounting period. As with the Licence Fees payable by Eclipse 35 under the Licensing Agreement, the AODs are specified amounts payable on each anniversary of Financial Close (3 April 2007) up to and including April 2027. In April 2008 the AOD is £2,520,316, but in subsequent years the AOD increases year by year from £16,802,108 in April 2009 to £53,542,148 in April 2026. The final AOD payable in April 2027 is a "balloon" payment of £349,842,695. The total of AODs payable over the Term of the Distribution Agreement is £1,021,873,047.

(2) The issue of the Letter of Credit by Barclays satisfies all the Distributor's obligations to pay AODs, so that Eclipse 35 has recourse only to the Letter of Credit.

(3) Variable Distributions are payable annually in respect of each annual accounting period during the Term. They are calculated, for each accounting period, in US dollars by a complex formula by reference to different types of revenues earned by the Films and royalty rates applied to certain of those types of revenues, and from the resulting calculation the amount of the AOD for the accounting period in question is deducted. For the years to the end of March 2008 and 2009 respectively Variable Distributions of US$36.236 million and US$47.4 million were paid, but no Variable Distributions have been paid in subsequent years (because the amount of AODs in each of those years has exceeded the amounts calculated by reference to the specified revenues from the Films).

(4) The amount of Variable Distributions received by Eclipse 35 is matched by the amount of Variable Royalties paid by Eclipse 35 to Disney under the Licensing Agreement. Eclipse 35 is required to appoint WDMSP Ltd as its collecting agent to receive the Variable Distributions and to pay them (as Variable Royalties) to Disney.

(5) Eclipse 35 is entitled to its 40 per cent share of Contingent Receipts, which is payable annually in respect of each annual accounting period during the term. Contingent Receipts are calculated, for each accounting period, in US dollars. The schedule to the Distribution Agreement setting out the formula for definition and computation of Contingent Receipts extends to fifteen closely-typed pages. In summary, there is deducted from the revenues earned from the exploitation of the Films a series of detailed costs relating to the production, marketing and

distribution of the Films and profit or revenue participations and similar contingent amounts paid to "talent". The AODs payable in each year are also deducted in the calculation of Contingent Receipts.

(6) The calculations relating to Variable Distributions and Contingent Receipts for each annual accounting period are set out by the Distributor in an annual statement produced for Eclipse 35. Eclipse 35 has the right to challenge such annual statement and to have it audited.

(7) The payment by the Distributor to Eclipse 35 of Variable Distributions and Contingent Receipts is guaranteed by Disney under a separate deed of guarantee entered into between Disney and Eclipse 35.

135. There are provisions in the Distribution Agreement which directly correspond to provisions in the Licensing Agreement, including provisions relating to physical delivery of the Films; the release of the Films and the right to substitute other films in the event of delay; foreign language versions of the Films; and copyright and other intellectual property rights in the Films.

136. The termination provisions in the Distribution Agreement largely correspond to those in the Licensing Agreement. As well as each party having a right to terminate on the occurrence of specified events of default, each party has a right to voluntarily terminate the agreement upon notice. On termination of the Distribution Agreement the Licensing Agreement is automatically terminated, and all Rights in the Films revert to Disney. All sums due and owing by the Distributor to Eclipse 35 at termination are payable (but not in respect of AODs, since Eclipse 35's recourse is to the Letter of Credit).

137. Each of Eclipse 35 and the Distributor give warranties, representations and indemnities which correspond to the commitments given by Eclipse 35 and Disney in the Licensing Agreement. Eclipse 35 warrants that, subject to the Prior Agreements, it holds licences to all such rights in the Films as it is licensing to the Distributor, and that it has not taken any action other than for the commercial purpose of acquiring and exploiting the Rights and related matters. Eclipse 35 acknowledges that the Distributor will exploit the Rights diligently in a manner consistent with the Distributor's and Disney's prevailing and commercially reasonable practices as applied to films owned by the Disney group. Eclipse 35 also accepts that the Distributor may enter into arrangements with other Disney group companies in relation to the distribution of the Films without the Distributor first offering comparable arrangements to third parties. Eclipse 35 also accepts that the Distributor may have certain fiduciary and other duties to other Disney group companies in relation to the Films and other Disney films which may compete or conflict with the Distributor's obligations to Eclipse 35, and that the Distributor may act in the best interests of the Disney group which may not be in the best interests of Eclipse 35 (and any such action by the Distributor will not be a breach of any of the obligations owed by the Distributor to Eclipse 35 under the Distribution Agreement).

138. There is a clause, directly corresponding to the like clause in the Licensing Agreement, dealing with the way in which the transactions are to be treated for the purposes of United States tax law and financial reporting requirements.

The facility, deposit and security documents

139.The principal facility, deposit and security documents comprise the Letter of Credit, the Reimbursement Agreement, the Deposit Agreement and Deposit Charge, the Funding Agreement, the Loan Facility Letter and the Financial Close Agreement.

140.The Letter of Credit was issued by Barclays to Eclipse 35 on 3 April 2007. It was issued at the request of Disney and the Distributor.

141.By the terms of the Letter of Credit Eclipse 35 is entitled, on each "Annual Date" to make an "Annual Drawing" of the "Annual Amount" for that Annual Date. The Annual Amount fixed for each Annual Date corresponds exactly with the amount of the AOD payable under the Distribution Agreement for the date in question. Eclipse 35 makes such an Annual Drawing by serving a "Demand Notice" on Barclays.

142.Eclipse 35 is also entitled, on the "Termination Date" to make a "Termination Drawing" of the "Termination Amount". The Termination Date is the date on which the Licensing Agreement terminates. The Termination Amount is calculated as the notional balance as at the Termination Date on a deposit account where it is assumed that £497 million has been deposited on 3 April 2007 at specified rates of interest (fixed for successive five year periods) and from which Annual Amounts have been withdrawn on each Annual Date (that is, a notional account which corresponds to the actual deposit account at Barclays held by the Distributor – see the Deposit Agreement and Deposit Charge below).

143.Eclipse 35 has the right to assign its entitlement under the Letter of Credit to any person. (Eclipse 35 assigned its rights to Eagle as security for the facility advances which Eagle made to the Members.)

144.The Reimbursement Agreement is dated 3 April 2007 and the parties are the Distributor and Barclays. It recites that the Distributor has entered into the Reimbursement Agreement (and made the deposit in the deposit account with Barclays which is the subject of the Deposit Agreement and Deposit Charge) to induce Barclays to issue the Letter of Credit.

145.It provides that if at any time Eclipse 35 demands payment of an Annual Amount or the Termination Amount under the Letter of Credit, then the Distributor will pay Barclays from the deposit account an amount equal to the amount demanded under the Letter of Credit (such payment is by way of settlement of its counter-indemnity obligations arising from Barclays issuing the Letter of Credit).

146.The Deposit Agreement and Deposit Charge is dated 3 April 2007 and is between the Distributor and Barclays. It recites that the deposit made by the Distributor with Barclays to which the agreement relates is made to induce Barclays to issue the Letter of Credit.

147.The Distributor agrees to open an account with Barclays and to deposit £497 million in that account on 3 April 2007. The account is to earn interest at specified rates (fixed for successive five year periods). On each occasion that Barclays receives

a demand from Eclipse 35 for payment of an Annual Amount or the Termination Amount pursuant to the Letter of Credit (whereupon the Distributor becomes liable to make payment to Barclays under the Reimbursement Agreement), Barclays will release to the Distributor from the account an amount equal to that Annual Amount on terms whereby the Distributor is required to instruct Barclays to pay that amount to Eclipse 35 in settlement of Eclipse 35's entitlement to the Annual Amount in question. Barclays agrees to pay such amounts without any set-off, deduction or counterclaim.

148.As security for performance of these arrangements and of the Distributor's obligations to Barclays under the Reimbursement Agreement, the Distributor charges in favour of Barclays its right, title and interest in and to the account and the deposit in that account and agrees to hold such right, title and interest on trust for application in accordance with the terms of the Deposit Agreement and Deposit Charge and the Reimbursement Agreement. The security thus created is released once the Distributor has no further obligations to Barclays and the Letter of Credit has been discharged or has expired. Barclays is appointed as the Distributor's attorney for the purposes of operating the account whilst the charge is in place.

149.Interest (at the specified rates) is to accrue during each interest period of a year, and accrued interest is to be credited to the account at the end of each interest period. However, Barclays agreed that on 3 April 2007 it would credit the account (so that it should form part of the deposit) with "interest equal to an amount previously notified by [Barclays] to [the Distributor]". Such amount is referred to as "the Prepaid Interest Amount", and is "credited on account of the interest accruing on the [deposit]" for the first ten years of the deposit. If the deposit arrangements are terminated prior to the expiry of that ten year period (for example, if a Termination Amount is paid under the Letter of Credit) an amount equal to the unearned portion of the Prepaid Interest Amount is debited from the account and is paid to Barclays.

150.(It may be noted here that the amount which Barclays credited to the account on 3 April 2007 as the Prepaid Interest Amount was £293 million, so that on that date the total credit balance on the account was £790 million – equal to the amount which Barclays advanced on that date to Eagle: see the Funding Agreement below. That amount of £293 million exceeds the amount of prepaid interest which Barclays would have been liable to pay on the deposit of £497 million had it made a prepayment of interest for the first ten years of the deposit at the interest rates fixed for that ten year period by the terms of the Deposit Agreement and Deposit Charge.)

151.The Funding Agreement is dated 3 April 2007 and the parties are Eagle (as borrower) and Barclays (as lender). It recites that Eagle has entered into facility agreements with the Members of Eclipse 35; that as security for the obligations of the Members to Eagle, Eagle has taken an assignment of the Letter of Credit; and that Barclays has agreed to make a loan facility to Eagle to enable Eagle to make loans to the Members.

152.Barclays agrees to make an advance to Eagle of an amount not exceeding the aggregate amount to be advanced by Eagle to the Members. (The amount advanced

was £790 million.) Interest is to accrue at the rate at which interest is payable on the loans Eagle makes to Members, and is to be paid annually. However, Eagle is, on the day the advance is made, to make a prepayment of interest for the first ten years of the term of the advance. (The amount of interest prepaid was £293 million, which is equal to the Prepaid Interest Amount which Barclays credited to the Distributor's deposit account with Barclays under the terms of the Deposit Agreement and Deposit Charge.) If the advance is repaid in full prior to the end of that ten year period, the unearned portion of the prepaid interest will be refunded to Eagle by Barclays. Eagle is required to repay Barclays the advance on terms which correspond to the repayments made by Members of their advances from Eagle.

153. Both parties have a reciprocal right of set-off in respect of amounts due and payable or rights arising under the Funding Agreement or the Letter of Credit.

154. The Loan Facility Letter is dated 30 March 2007 and is issued by Eagle to each Member who decides to use the facility (all Members took that decision). It sets out the terms on which Eagle is prepared to make an advance by way of loan to the Member.

155. Eagle is prepared to lend the Member not more than 98 per cent of his capital subscription to Eclipse 35 as a member in that partnership. Certain conditions precedent have to be satisfied before the advance can be drawn down, including the provision of security for the advance (Eagle receiving a first fixed charge from the Member of the Member's share and interest in Eclipse 35; and a charge over partnership assets of Eclipse 35 and an assignment by way of security from Eclipse 35 to Eagle of the Letter of Credit and the entitlement of Eclipse 35 to AODs payable under the Distribution Agreement). It is also a condition precedent that Eagle is satisfied that for its capital adequacy compliance requirements "Eagle is entitled to accord to the exposure to the [Member] for the [advance] a zero per cent risk weighting".

156. Interest is paid at a rate which is fixed for the first five years and for successive five year periods. The fixed interest rates for each five year period are those which apply to the deposit made by the Distributor to Barclays under the Deposit Agreement and Deposit Charge. Interest is payable annually in arrears. On the drawdown date the Member is required to pay Eagle prepaid interest, being an amount on account of interest accruing on the advance for the first ten years of the borrowing. If the advance is repaid in full prior to the end of that ten year period, the unearned portion of the prepaid interest will be refunded to the Member by Eagle.

157. The advance is repayable in annual instalments as specified in a repayment schedule. The Member undertakes that all AODs receivable by Eclipse 35 (or amounts due under the Letter of Credit in place of AODs) are paid to a dedicated account from which amounts will be applied in reduction of the advance. Upon certain events (including the early termination of any of the transaction documents) there is an acceleration of the repayment of the advance. Upon notice the Member can prepay the advance in full, meeting any break costs incurred by Eagle.

158. There is a declaration that Eagle has full recourse to the Member for repayment in full of the advance, and nothing in the terms of the facility is to imply that Eagle has recourse only to the AODs or the amounts due under the Letter of Credit, so that the Member remains liable to Eagle for any amount of the advance which is not discharged out of AODs or from amounts due under the Letter of Credit.

159. On 3 April 2007 the Members drew down under the facility in aggregate £790 million, and made prepayments of interest totalling £293 million.

160. The Financial Close Agreement is dated 3 April 2007 and is between Disney and Future. Disney agrees to procure the issue of the Letter of Credit and to enter into those transaction documents to which it is a party, provided that all "Letter of Credit Conditions" are satisfied. The date on which the Letter of Credit Conditions are satisfied is "Financial Close".

161. The Letter of Credit Conditions include: the receipt by Disney of the Studio Benefit from Eclipse 35 (the Studio Benefit is an amount equal to 1.15 per cent of the Advance payable by Eclipse 35 to Disney under the Licensing Agreement); the offer of the Letter of Credit on terms which are acceptable to Disney; and the due execution of all relevant transaction documents and documents relating to the formation and capitalisation of Eclipse 35 and those documents being or becoming unconditional.

162. Financial Close occurred on 3 April 2007.

The marketing services documents

163. The principal marketing services documents comprise the Marketing Services Agreement, the Buena Vista Services Agreement, the SCI Services Agreement and the SFC Consultancy Agreement.

164. The Marketing Services Agreement is dated 9 February 2007 and the parties are Eclipse 35 and WDMSP Ltd. It recites that Eclipse 35 is engaging in the trade of acquiring and exploiting rights in films and that Future has recommended that Eclipse 35 should appoint WDMSP Ltd as its exclusive agent to provide the defined services in order to assist Eclipse 35 in engaging in its trade.

165. By Clause 1 Eclipse 35 irrevocably appoints WDMSP Ltd to be its exclusive agent to provide "the Services". The appointment is to continue until the Licensing Agreement is terminated, and Eclipse 35 agrees not to terminate the appointment of WDMSP Ltd or direct how WDMSP Ltd is to perform the Services other than as provided in the Marketing Services Agreement. There are provisions for early termination by one party in the event of material breach or insolvency on the part of the other.

166. The Services are set out in Schedule 1 to the Marketing Services Agreement to include "providing marketing and licensing personnel, equipment, perquisites, locations, facilities and any other related marketing and licensing services or elements which [Eclipse 35] may request from time to time" in relation to theatrical release,

home video and television, and to include providing specified information and documentation on a regular basis. Specified matters include "media planning", "release planning", "scheduling of key dates", "creation of key artwork", "competitive analysis". For each type of distribution (theatrical release, home video and television) there is an extensive and detailed list of matters on which information is to be provided to Eclipse 35.

167. WDMSP Ltd's duties are set out in Clause 2. Those duties include the following matters:

(1) To perform the Services "with due care and diligence in a manner consistent with [the Distributor's] and [Disney's] then prevailing and commercially reasonable practices" relating to the exploitation of films in the territories in which the Films may be exploited, and it agrees that the marketing and release plans prepared by WDMSP Ltd will be consistent with the Distributor's and Disney's overall strategy for the exploitation of the Films and other films which they may distribute.

(2) To procure the provision of services by "the Designees" in accordance with the terms of the Buena Vista Services Agreement and to secure the services of Mr Salter/SFC by the SFC Consultancy Agreement.

(3) To prepare "Marketing and Release Plans" in relation to the Films (being "specific marketing plans prepared by or on behalf of [WDMSP Ltd] setting out in summary terms the main aspects of a proposed marketing and exploitation campaign for the Rights in the Territory") for Eclipse 35's approval; to disclose such Plans to the Distributor; to oversee the conduct of the Distributor in implementing the Plans; to prepare and provide to Eclipse 35 a monthly report on the activities of the Distributor in implementing the Plans and any deviation on the part of the Distributor from the Plans; and to hold review meetings periodically with Eclipse 35's management.

168. Eclipse 35 and WDMSP Ltd acknowledge that the Distributor has agreed in the Distribution Agreement to exploit the Rights substantially in accordance with the parameters set out in the Marketing and Release Plans, and WDMSP Ltd agrees to notify Eclipse 35 if the Distributor materially deviates from the Plans to enable Eclipse 35 to exercise its right to terminate the Distribution Agreement if it wishes to do so.

169. Eclipse 35 and WDMSP Ltd acknowledge that WDMSP Ltd is a member of the Disney group and as such may have obligations and duties to group companies in relation to the Films which may compete or conflict with its obligations to Eclipse 35, in which case WDMSP Ltd is entitled to act in the best interests of the Disney group even if that is not in the best interests of Eclipse 35.

170. Eclipse 35 appoints WDMSP Ltd as its collection agent in respect of any Variable Distributions due to Eclipse 35 under the Distribution Agreement, and directs WDMSP Ltd to pay from such amounts the Variable Royalties due from Eclipse 35 to Disney under the Licensing Agreement.

171.Eclipse 35 agrees to pay WDMSP Ltd at Financial Close a fixed fee of £28,000 (to include £3,000 as a contribution towards the cost of WDMSP Ltd engaging SCI under the SCI Services Agreement and Mr Salter as a consultant under the SFC Consultancy Agreement). In addition, if for any year Eclipse 35 is entitled to Contingent Receipts, an additional fee equal to 2 per cent of Eclipse 35's share of Contingent Receipts will become payable. (It may be noted here that WDMSP Ltd entered into similar agreements, with identical fee arrangements, with each of the other Eclipse partnerships, so that the total fixed fees it earned by this means exceeded £850,000.)

172.The Buena Vista Services Agreement is dated 1 March 2007, and the parties are WDMSP Ltd, Buena Vista Pictures Distribution, Buena Vista International, Inc, Buena Vista Home Entertainment, Inc, and Buena Vista Television. The four Buena Vista companies (all of which are members of the Disney group involved with film distribution and exploitation) are together referred to as the "Designee Provider". The agreement recites that WDMSP Ltd has been appointed the agent of certain Eclipse partnerships (including Eclipse 35) under a marketing services agency agreement to perform on their behalf certain promotion and marketing activities in relation to the distribution of films; that the companies comprising the Designee Provider are companies which promote, market, sell and distribute films; and that the Designee Provider companies are willing to make available certain of their employees to provide certain services to WDMSP Ltd to enable it to perform the services it has agreed to provide to those partnerships.

173.By Clause 2 the Designee Provider companies agree to make available to WDMSP Ltd "the Designees" to perform "the Services" for WDMSP Ltd to enable WDMSP Ltd to carry out its obligations under the respective marketing services agency agreements with the Eclipse partnerships. The Designees are to be made available on a non-exclusive basis, and are to devote such time as is reasonably necessary to the provision of the Services.

174.The Designees are listed by name and job title. There are 23 of them, and they hold senior marketing, publicity and distribution positions in the relevant Buena Vista companies. There is provision to substitute other persons of sufficient experience and status should any change be necessary to the Designees. The Designee Provider companies undertake that the Designees have sufficient skill and expertise to be able to perform the Services efficiently and competently.

175.The Services which the Designees are to provide are set out in a schedule to the agreement, and are identical to the services which WDMSP Ltd agrees to provide to Eclipse 35 under the Marketing Services Agreement.

176.The agreement is for a term beginning on 1 March 2007 and ending eighteen months after the first theatrical release of the last of the films to be released in any territory.

177.WDMSP Ltd pays a fee to the Designee Provider of £45,000 less an amount equal to a quarter of certain of WDMSP Ltd's costs.

178. The SCI Services Agreement is also dated 1 March 2007. It is between WDMSP Ltd, the Buena Vista companies which are the Designee Provider, and SCI. It recites that the Designee Provider has agreed to make available the services of the Designees to WDMSP Ltd, and that SCI is willing to assist the Designees in their performance of those services.

179. SCI agrees to assist the Designees by acting as a liaison between them and "the Consultant" (Mr Salter) and by assisting the Designees in preparing and providing to Eclipse 35 and the other partnerships the reports which WDMSP Ltd is to provide under the Marketing Services Agreement. For these services WDMSP Ltd pays SCI a fee of £3,000 for each Eclipse partnership which is a party to the marketing services arrangements.

180. The SFC Consultancy Agreement originates from a consultancy agreement between WDMSP Ltd and Mr Salter dated 23 March 2006 which was novated to Salter Film Consultants Limited on 12 March 2007 and further amended on that date. It relates to all the Eclipse partnerships, including Eclipse 35. It recites that WDMSP Ltd has been engaged by the partnerships to provide marketing services; that WDMSP Ltd has entered into the Buena Vista Services Agreement (or a previous form of it) so that WDMSP Ltd has the services of the Designees to assist it in performing those marketing services; and that WDMSP Ltd wishes to engage Salter Film Consultants Limited (as "Consultant") to oversee and facilitate the performance of the Designees.

181. The agreement is for a term expiring on 12 March 2009. The Consultant agrees to provide to WDMSP Ltd "the Services", which are itemised in 12 numbered paragraphs in a schedule to the agreement. The Services include liaising with the Designees and SCI in relation to the preparation of Marketing and Release Plans and the other services which WDMSP Ltd has agreed to perform for Eclipse 35; assembling the work product of the Designees and SCI in connection with the preparation of the Marketing and Release Plans and ensuring that such Plans are in a form to be presented to WDMSP Ltd for consideration; if WDMSP Ltd approves the Marketing and Release Plans, presenting the approved Plans to Eclipse 35, Disney and the Distributor; from the information supplied by WDMSP Ltd, the Designees and SCI, tracking the performance of the Distributor in following the Marketing and Release Plans, including identifying whether the Distributor deviates materially from such Plans; reporting to WDMSP Ltd on the performance of the Films (as informed by the Distributor); and generally providing written reports to WDMSP Ltd on matters relevant to the services WDMSP Ltd is to perform for the Eclipse partnerships.

182. The Consultant agrees to work not less than three days per week for the first six months of the term of the agreement and thereafter such hours as may be agreed according to the reasonable requirements of WDMSP Ltd. The Consultant agrees to provide the Services in an expert and diligent manner and to the best of his ability and his commercial, technical and creative skills and in the best interests of WDMSP Ltd. The Consultant is to be remunerated at the rate of £700 per eight-hour day.

The financial terms of the transactions and the underlying cash flows

183. It is necessary to examine in more detail the financial terms of the transactions which Eclipse 35 and the other parties in the structure entered into and the underlying cash flows which result from those financial terms in the period during which Eclipse 35 has a licence of the Rights in the Films. Much of the evidence of Mr Stanton related to such matters, and the essence of the case presented by the Commissioners is that the transactions were no more than a means to create a flow of funds with the ultimate purpose and result of giving the Members an interest charge for which they could claim tax relief.

The movements of cash on Financial Close

184. As mentioned, the principal transaction documents took effect on what is referred to in those documents as Financial Close, as provided in the Financial Close Agreement – it is the moment at which a number of conditions precedent (mostly relating to the issue of the Letter of Credit) are satisfied, in effect when all the documents and the transactions they comprise become unconditional. Financial Close occurred on 3 April 2007. That date is, significantly, shortly before the end of a tax year, and that factor was clearly recognised since some or all of the arrangements put in place were to fall away if Financial Close were delayed beyond 5 April 2007. The significance would appear to be that there is an "efficiency" in the Members paying the prepaid interest just prior to the end of the tax year for which they will claim tax relief for such interest so paid.

185. On Financial Close all the licensing, banking and security transactions and arrangements took effect, and funds moved accordingly. The flow of funds on that date was as follows (all amounts are rounded to the nearest £1 million):

(1) Barclays paid Eagle £790 million by way of loan under the Funding Agreement;

(2) Eagle paid the Members in aggregate £790 million by way of loan under the Loan Facility Letters;

(3) The Members paid Eclipse 35 in aggregate £840 million by way of capital contributed to Eclipse 35 (using the borrowings from Eagle of £790 million and £50 million from their own cash resources);

(4) Eclipse 35 paid:

(a) £503 million to Disney by way of the Advance (the sum paid on account of the Licence Fees) due under the Licensing Agreement;

(b) £44 million to Future by way of its fee due under the Partnership Consultancy Agreement;

(c) £293 million in aggregate to the Members as loans against future income profits, pursuant to the Partnership Agreement;

(5) The Members paid Eagle in aggregate £293 million by way of a prepayment of interest under their respective Loan Facility Letters;

(6) Eagle paid Barclays £293 million by way of a prepayment of interest under the Funding Agreement;

(7) The Distributor paid Barclays £497 million by way of deposit under the Deposit Agreement and Deposit Charge to induce Barclays to issue the Letter of Credit, and out of which Barclays is reimbursed for the payments it makes to Eclipse 35 under the Letter of Credit in place of the AODs; and

(8) Barclays paid the Distributor £293 million (being the Prepaid Interest Amount, expressed to be on account of the interest accruing on the deposit made in the deposit account which the Distributor holds with Barclays under the Deposit Agreement and Deposit Charge, and credited to that account).

186. Disregarding for the moment the different contractual and legal bases under which these cash payments were made, and having regard only to the movement of cash, it will be seen that, in net terms, on 3 April 2007 the sum of £497 million was circulated around the parties (assuming that within the Disney group there was some accommodation between Disney and the Distributor), and that £50 million was introduced by the Members, and £44 million paid out to Future and £6 million paid out to Disney (the difference between the £503 million Advance and the deposit of £497 million made by the Distributor with Barclays). The £6 million is the Studio Benefit.

The accounting profits of Eclipse 35

187. The accounts of Eclipse 35, and the treatment in those accounts of the transactions to which it is a party, are relatively straightforward.

188. Eclipse 35 brings into account each year as turnover the amounts to which it is entitled under the Distribution Agreement for that year, being the AOD for that year (that amount is fixed – see paragraph 134(1) above); any Variable Distributions for that year; and any Contingent Receipts earned for that year. It shows as a cost of sales for that year the amounts due under the Licensing Agreement for that year, being the amount of the Licence Fee for that year (that amount also is fixed – see paragraph 121(1) above); and any Variable Royalties for that year. This results in the gross profit, from which is deducted administrative expenses in order to arrive at a profit (or loss).

189. For any year the amount of any Variable Distributions received is exactly matched by the amount of any Variable Royalties payable.

190. The Advance paid in respect of the Licence Fees is disregarded in accounting terms, since it is refundable to Eclipse 35 on early termination of the Licensing Agreement to the extent of any Licence Fees due after termination.

191. The administrative expenses very largely comprise the amortised fee of £44.6 million paid by Eclipse 35 to Future on Financial Close under the Partnership Consultancy Agreement. This fee is amortised on a straight line basis so as to accrue evenly over the twenty year term of the licensing and distribution arrangement.

192. No accrual is made for any amount of Contingent Receipts until (presumably) such time as any such amount is shown to have become payable.

193. The audited financial statements of Eclipse 35 for the period ended 5 April 2008 show a turnover of £20,638,455 (comprising the AOD for that year of £2,520,316 and the Variable Distributions for that year of £18,118,129); cost of sales of £18,385,822 (comprising the Licence Fee for that year of £266,283 and the Variable Royalties of £18,118,129); a resulting gross profit of £2,252,623; administrative expenses of £2,247,179; and a resulting profit of £5,444.

194. The audited financial statements of Eclipse 35 for the period ended 5 April 2009 show a turnover of £48,802,919; cost of sales of £46,568,566; a resulting gross profit of £2,234,353; administrative expenses of £2,228,861; and a resulting profit of £5,492.

195. The audited financial statements of Eclipse 35 for the period ended 5 April 2010 show a turnover of £17,558,203; cost of sales of £15,302,536; a resulting gross profit of £2,255,667; administrative expenses of £2,228,857; and a resulting profit of £26,810. (No Variable Distributions – and hence no Variable Royalties – were paid in the year ended 5 April 2010, hence the reduced turnover and cost of sales.)

196. Since for each year of the twenty year term of the licensing and distribution arrangement the Licence Fee, the AOD and the (amortised) consultancy fee paid to Future are fixed amounts, and since the Variable Distributions (if any) which are received are exactly matched by the Variable Royalties which will then be paid, it is possible to predict the minimum profits which will accrue to Eclipse 35 in each year – that is, the profits without regard to any Contingent Receipts which might become payable. Such an exercise gives the following results:

(1) In each of years 1 to 10 Eclipse 35 will make a minimal profit (of the order appearing in its audited financial statements for the years ended 5 April 2008, 5 April 2009 and 5 April 2010);

(2) In each of years 11 to 19 Eclipse 35 makes a substantial profit (of approximately £30 million in year 11 declining to approximately £17.5 million in year 19);

(3) In year 20 Eclipse 35 makes a profit of approximately £257.8 million (as a result of the "balloon" AOD and Licence Fee in that final year);

(4) Over the twenty year term Eclipse 35 makes an aggregate profit of approximately £474.4 million.

Any Contingent Receipts received would, *pro tanto*, increase such profit.

Interest payments and capital repayments made by Members and the relationship to Eclipse 35's profits

197. The amount of interest paid by Members (in aggregate) on the advance from Eagle over the twenty year term is fixed, and, in relation to the profits of Eclipse 35 (which for tax purposes are attributed to the Members), shows the following:

(1) £293 million of interest is paid on Financial Close, and Eclipse 35 has no profit at that point (so that Members can claim relief for the full amount of £293 million);

(2) In each of years 1 to 10 no interest is paid, and in those years no significant profit is made by Eclipse 35 (so that Members are taxable only on the minimal profit made by Eclipse 35 in each of those years);

(3) In each of years 11 to 19 the amount of interest paid equals, or nearly equals, the amount of profit made by Eclipse 35 in the corresponding year (that is, interest of £30 million in year 11 declining to interest of £17.5 million in year 19) (so that Members can claim relief for the interest paid against the equal amount of profits of Eclipse 35 attributed to them for tax purposes);

(4) In year 20 the amount of interest paid is £16 million and in that year Eclipse 35 makes a profit of £257.8 million (so that, after relief for such interest, Members are taxable on £241.8 million of the profits of Eclipse 35 attributed to them in that year); and

(5) Over the twenty year term a total amount of £524.7 million is paid by Members by way of interest. When netted against the profits (disregarding the possibility of Contingent Receipts) over that period made by Eclipse 35 (£474.4 million), there is an excess of interest of £50.3 million.

198. The following points may be noted by way of comment on these figures:

(1) The excess amount of interest of £50.3 million equates to the aggregate of the amounts paid to Disney by way of Studio Benefit and to Future by way of consultancy fee (so that if those amounts were not taken into account in reducing the profits of Eclipse 35, those profits in aggregate would equal the amount in aggregate of interest paid). The excess amount of interest can be regarded as funded by the capital contributed by Members from their own resources;

(2) In determining the net of tax position of the Members it is too simplistic to look only at interest paid and Eclipse 35 profits received: a full cash flow statement, akin to that commonly prepared for a finance leasing transaction, would take account of a notional (and taxable) return earned from the re-invested benefit of the tax relief claimed by Members (particularly with respect to the tax relief arising from the prepaid interest); and

(3) Any amounts which might be received by way of Contingent Receipts would, as mentioned, directly increase the profits of Eclipse 35 and in consequence reduce or eliminate the excess amount of interest over profits in the hands of Members.

199. Under the terms of the Loan Facility Letter each Member is required to repay the sum advanced to him by Eagle in accordance with a schedule of annual repayment amounts. Disregarding the prepayment of interest at Financial Close, the amount paid by the Members (in aggregate) in each year (capital repayment and – from year 11 – interest together) matches the AOD receivable by Eclipse 35 for that year. Eclipse 35 assigned, by way of security for the advances made by Eagle, the right to the AODs. In this manner the Members were assured that, in cash terms, and assuming no default, all payments of interest and repayments of capital would be made to Eagle, and the profile of AOD payments over the twenty year term was fixed to give this result.

The significance and consequences of the prepayment of interest by Members

200. The earlier Eclipse tranches do not feature a ten year prepayment of interest by the members of the respective partnerships who borrowed to make their respective capital contributions. Interest is paid as it accrues annually over the lifetime of the transaction.

201. The cash flow statements produced for those earlier Eclipse tranches show that in each year (until matters are reversed by "balloon" payments in the final year) the net profit of the relevant partnership (AOD less accrued licensing fee and administrative costs) which then falls to be attributed to the individual members is, for each such member's share, less than the interest paid by that member. In this way, until matters are reversed in the final year, a member has each year excess interest which he can use to shelter other income arising in that year, such as lease rental income from other film investments which, in tax terms, have become "positive" as earlier reliefs are reversed over the lifetime of those investments.

202. In the case of Eclipse 35, as already described, each Member prepaid interest (which was at a fixed rate) for the first ten years of his borrowing. This was introduced as a feature of the arrangements following a change in the rules for loss relief – so-called "sideways loss relief", available in the case of earlier Eclipse tranches, was no longer available as from early March 2007. The intention was that by making a prepayment of interest in this way each Member should be able to claim tax relief for the amount of interest so prepaid.

203. The prepayment of ten years' interest had a consequence for the cash flow implicit in the Eclipse 35 transaction. As mentioned above, the profile (that is, the amount and timing) of AODs payable matches the interest and principal payable by members in respect of their bank borrowings. This is the case in respect of the earlier Eclipse tranches. The prepayment of ten years' interest at Financial Close on 3 April 2007 means that, as compared with the earlier transactions where interest was paid annually, a reduced amount of AODs is required – the AODs are not required to fund the payment of interest annually over the first ten years of the lifetime of the transaction. In turn that requires a reduced deposit from the Distributor to secure the Letter of Credit which is, in effect, substituted for the AODs.

204.It is reasonable to assume that the bank lending to the members (in each of the Eclipse transactions) required, as a matter of security, that the amount of AODs should correlate with the interest and principal payments to be made by those members. In the case of Eclipse 35 and the loan to Members by Eagle it is reasonable to assume that Eagle required either a prepayment of interest if the amount of AODs were reduced or a greater amount of AODs should there be no prepayment of interest.

205.The restructuring of the interest payment arrangements in the Eclipse structure so as to accommodate a prepayment of interest as embodied in the Eclipse 35 transaction had the benefit for the Disney group that reduced AODs were payable (requiring a reduced deposit), although since the corresponding adjustment in the cash flow was reduced Licence Fees (see below) there is no discernible net benefit to the Disney group. The amount of the Studio Benefit is a percentage of the Licence Fees. In the earlier Eclipse tranches that percentage was 0.9722 but it was increased to 1.15 in the case of the Eclipse 35 transaction.

The quantification of the Licence Fees

206.The Licence Fees payable by Eclipse 35 under the Licensing Agreement (being the consideration paid for the Rights) comprise the third fixed element in the calculation of the profits of Eclipse 35 (the other two being the AODs and the amortised consultancy fee).

207.The Licence Fees total £503 million payable over twenty years, but settled by the Advance of that amount paid on Financial Close. Thus there was no discount for early payment by way of the Advance.

208.The contention of the Commissioners is that the amount of the Licence Fees (and the payment – or, rather, the accrual – profile of the Licence Fees) was determined solely by an arithmetic exercise in order to give the pattern of profit in Eclipse 35 which in turn correlated to the payment of interest by the Members as described above.

209.Eclipse 35 argues that although the Licence Fees are a factor which have to be accommodated within the financial basis underlying the transaction, the Licence Fees also are justified commercially, comprising a proper reflection of the value of the Rights licensed to Eclipse 35 by Disney. Eclipse 35 points to the work undertaken by Mr Briggs and his colleagues at Salter Group, and the evidence of Mr Molner (which we see no reason to question since it makes commercial sense) is that Disney had an expressed and legitimate concern that there should not be an implicit undervalue (as Disney would see it) of the Rights since that could have an adverse consequence for the values which third parties might attribute to the Disney portfolio of films (and in this connection it has to be borne in mind that Disney had a concern about this issue not just with the Rights in the Films in Eclipse 35's transaction, but with the films in the range of Eclipse transactions). The Eclipse Term Sheet with Disney provides that each Eclipse partnership will seek a valuation of the licensed rights based on independent advice.

210.The opinion which Eclipse 35 sought from Salter Group related to the forecast of the likely pattern of revenues (both as to amount and timing) earned by the Films. That information could be applied, in the context of Eclipse 35's transaction, for at least three purposes: to enable a view to be formed as to the likelihood of any Contingent Receipts being earned by Eclipse 35 (we deal with this in paragraphs 223 to 228 below); to measure whether the amount of AODs broadly corresponded to projected earnings from the Films; and to enable a valuation, or range of valuations, to be attributed to the Rights.

211.Salter Group is recognised as a leading practitioner in forecasting film and other media revenues and in valuing film and other media rights. It was engaged by Eclipse 35 to develop aggregate cash receipt forecasts for the Films (from all forms of exploitation) over the twenty year period of the Licensing Agreement on the basis of a ten-year first cycle of exploitation and two five-year subsequent cycles.

212.The approach adopted by Salter Group in carrying out this task was, in concept at least, fairly simple (and was individually applied for each of the Films). A set of key assumptions was used as to the following matters: the content, genre, target audience and casting of each Film; the production costs of each Film; the likely cost of releasing each Film in the USA and in the rest of the Territories in which it was to be distributed; and the likely domestic (that is, USA) and international distribution strategies. From its extensive database Salter Group identified what it considered to be a range of films comparable to each Film, and then the financial performance (that is, gross receipts – referred to in the business as "Ultimates") of each Film was forecast by reference to the key assumptions and the actual performance of the comparable films.

213.Much of the information comprising the key assumptions was provided by SCI which in turn used information provided by Disney or assumptions made from negotiations with Disney. Some information was publicly available.

214.The identification of a list of comparable films was a joint exercise by Salter Group and SCI. The list originally compiled in relation to "Enchanted" was adjusted to include a wider range of films in the family/children genre of films when initial calculations showed a range of Ultimates which Disney indicated fell short of Disney's internal forecasts. From the list of comparable films, three groups were identified: those which had under-performed as against expectation; those which had performed to expectation; and those which had out-performed against expectation.

215.In their opinion addressed to Future and dated 22 February 2007 (for Eclipse 35 it was re-issued on or before 3 April 2007) Salter Group gave a range of Ultimates for each Film – what it described as the Downside Case Scenario (based on the under-performing comparable films); the Base Case Scenario (based on the comparable films which had performed to expectation); and the Best Case Scenario (based on the out-performing comparable films). In each Case the Ultimates were itemised by reference to the distribution cycles Salter Group had predicated, domestic and international distribution, and the different types of release (cinema, home

entertainment, etc). The forecasts were phased by reference to the anticipated timing of receipts over those cycles (referred to as "timed Ultimates").

216.For "Underdog" the forecast Ultimates provided by Salter Group were: US$293,375,000 Downside; US$391,806,000 Base Case; and US$540,390,000 Best Case.

217.For "Enchanted" the forecast Ultimates provided by Salter Group were: US$498,171,000 Downside; US$600,287,000 Base Case; and US$927,822,000 Best Case.

218.To date "Enchanted" has performed a little better than the phased Base Case forecast of Ultimates provided by Salter Group. "Underdog" has performed significantly below the phased Downside forecast.

219.The Ultimates do not in themselves give a valuation of the Films (or, more strictly, the Rights). They form the basis of a valuation, but to reach a net present-day valuation in pounds sterling two further factors must be applied: a discounting factor to take account of the time delay in the receipt over twenty years of the revenues; and an exchange rate factor. As mentioned, Salter Group provided, from their workings on the Ultimates, assumptions as to the forecast timing of revenues to give the timed Ultimates to which a discount could be applied.

220.Eclipse 35 was unable to produce in evidence a valuation of the Rights produced contemporaneously with it entering into the transaction. Mr Molner's evidence was that SCI had carried out a valuation exercise (on the Base Case Ultimates) using an exchange rate of US$1.62 to £1.00 (that being a ten-year average rate in early 2007) and a range of discount rates from 2.5 per cent upwards. The resulting sterling figures ranged from about £500 million to in excess of £600 million.

221.Mr Molner's further evidence, which we accept, was that the aggregate amount of the Licence Fees to be paid under the Licensing Agreement was one of a range of matters for commercial negotiation with Disney – in that process each party would have had in its mind a sense of the range of likely valuations of the Rights to provide some kind of benchmark for the negotiation, but agreement as to a precise valuation was not an essential issue for either party in the context of agreeing the overall commercial deal. Disney would, however, for the reasons given, be cautious about agreeing to what it might see as an undervalue of the Rights.

222.Therefore, whilst we accept that the amount of the Licence Fees is, to a degree, fashioned by the cash flow which underlies the transaction, it also represents the likely value of the Rights licensed by Disney to Eclipse 35 or, at least, the value which the parties agreed to place on those Rights in the context of the overall deal which they struck after having regard to expert advice on the estimated financial performance of the Films.

The Contingent Receipts

223.As described (see paragraph 134 above), the Distribution Agreement gives Eclipse 35 a right to 40 per cent of any Contingent Receipts earned by the Films (taken together) – in essence a share in any "super profits" should the Films be very successful. As indicated, the terms upon which Contingent Receipts are calculated are a matter of great complexity in the Distribution Agreement. Eclipse 35 has audit rights to ensure that those terms are complied with.

224.There were detailed and lengthy negotiations between SCI (for Eclipse 35) and Disney as to the exact terms of the Contingent Receipts. Contingent receipt definitions and calculations are, for each film studio, a matter of standard form from which the studio is most reluctant to depart (not least because they have been shaped over the years in response to many disputes). The negotiations in the present case covered matters of detail in relation to the types and percentages of revenue to be included in the calculation, as well as the share to which Eclipse 35 would be entitled (increased from the 34 per cent share agreed in the earlier Eclipse transactions). It was a requirement of Disney that for the purposes of calculating Contingent Receipts the two Films should be regarded as one, that is, their financial performance "cross-collateralised".

225.Eclipse 35 sought from Salter Group its opinion as to the likelihood of the Films earning Contingent Receipts. This was principally required for the Addendum to Film Partnership Proposal (effectively the prospectus prepared for potential investors in Eclipse 35).

226.The scheme of the calculation of the Contingent Receipts and the financial model which produces that calculation is referred to in the film industry as a "waterfall" (no doubt with imagery in mind of gross revenues gushing forth, cascading into different channels, one of which is Contingent Receipts which it is hoped will be more than a dry stream – it is in any event an engagingly picturesque term for some 15 or so closely-typed pages of dense legal drafting). Salter Group used the waterfall financial model (an Excel spreadsheet) produced by SCI from the Contingent Receipts provisions negotiated for Eclipse 35 (the accuracy of the waterfall was not assessed by Salter Group) and applied to it the Ultimates as calculated by Salter Group for each of the three Cases it posited. Salter Group expressed their opinion in these terms: "Based upon The Salter Group's understanding of the deal structure reflected in the Waterfall and upon the projected performance of the Films as reflected in the Best Case Ultimates, The Salter Group determined that a payment of [Contingent Receipts] is possible."

227.If both Films, over the twenty year licence period, respectively were to perform to the Best Case envisaged by Salter Group, Eclipse 35 would receive over that period Contingent Receipts of at least US$95 million. If "Enchanted" were to perform to the Best Case and "Underdog" to the Base Case envisaged by Salter Group, then Eclipse 35 would receive Contingent Receipts of between US$49 million and US$59 million. "Underdog" alone would generate Contingent Receipts only if it performed to Salter Group's Best Case, and then the Contingent Receipts would be between US$4 million and US$5 million (disregarding the performance of "Enchanted").

228.The consequence of having the Films "cross-collateralised" is to reduce the likelihood that Contingent Receipts would be payable – both Films have to succeed. Unless both Films are equally successful, even if the Contingent Receipts threshold is achieved, one Film will, by its relative underperformance, reduce the Contingent Receipts which would otherwise be paid in respect of the other Film on a "stand alone" basis.

The effect of the security arrangements and the nature of the Members' borrowings

229.There was a dispute between the parties as to the effect of the security arrangements and two related questions: first whether the advance made by Eagle to the Members was on a full-recourse or a non-recourse (or limited recourse) basis; and secondly, whether for the capital adequacy purposes of Barclays and its group the advances made by Eagle were zero-risk weighted (that is, in short, fully secured by cash collateral), and if so, whether that necessitated that the cash simply moved in a circle. The Commissioners pursued these issues as part of their case that no commercial risk was undertaken by Eclipse 35 or its Members (or, indeed, for that matter, by Barclays/Eagle) with regard to the transactions or the flow of cash pursuant to the transactions, which in their view is a matter germane to the question of whether or not Eclipse 35 is trading.

230.As we have mentioned, the Loan Facility Letter in its terms states that Eagle has full recourse to the borrowing Member in the event that it could not recover repayment out of the AODs or the Letter of Credit (both of which were assigned by Eclipse 35 to Eagle as security for the borrowing by Members). The Commissioners, however, point to the Funding Agreement (by which Barclays funds Eagle for its advances to Members) and the mutual right of set-off included in its terms. This permits (but does not require) Eagle to set-off its debt due to Barclays under the Funding Agreement against Barclays' debt due to Eagle under the (assigned) Letter of Credit. Thus if Barclays defaulted under the Letter of Credit then Eagle could set-off its debt due to Barclays under the Funding Agreement – Barclays would thereby be treated as having paid out under the Letter of Credit (exercising its own right of set-off) and Eagle would then have no recourse against the Members (and, indeed, no reason to recover from them since its debt due to Barclays would have been discharged by operation of the set-off). The Commissioners argue that the non-recourse nature of the borrowing is a feature of the arrangements by which the Barclays group makes finance in the transaction available without cost to its capital base, that is, on a zero-risk weighted basis.

231.In reply Eclipse 35 argues that the nature of the borrowing by the Members is irrelevant to the question of whether Eclipse 35 is trading; that Eagle has a security interest only in the Letter of Credit rather than a full beneficial interest, so that its right of set-off in relation to its borrowing from Barclays is thereby constrained; and that, under the Deposit Agreement and Deposit Charge Barclays is prevented, by its agreement with the Distributor, from exercising any set-off with regard to its obligations to pay sums due under the Letter of Credit. Eclipse 35 also points to the testimony of Mr Levy to the effect that legal advice was received by Future from Clifford Chance (the lawyers who had acted for the Barclays group in relation to the

documentation) that the loans were full-recourse, and to the members in another Eclipse partnership re-negotiating their loans (taken on similar terms), following the Lehman Brothers bank failure, to provide that they were non-recourse to those members.

232.For the reasons we give below, the exact nature of the borrowing by the Members is not a matter which we consider is relevant to the issue we have to decide, nor, in any event, is it a matter essential to the decision we have reached. We have, however, concluded that Eagle could have recourse to the Members. That is the express and unequivocal provision of the Loan Facility Letter. Any attempt by the Members to argue that there is no personal recourse to them would be confronted by their agreement to the contrary. The Commissioners offer an ingenious argument, but it is by no means certain that in the event of the insolvency of Barclays (at which point the nature of the liability of the Members to Eagle would be tested) matters must unfold in the way they specify. Eagle has a right to set-off amounts due under the Letter of Credit against amounts it owes to Barclays under the Funding Agreement, but that right is not automatic – Eagle could choose instead to recover any balance due from a shortfall in payments under the Letter of Credit by proceeding against the Members personally and it is not clear that the Members could in that case compel Eagle to exercise any set-off entitlement it might have. In any event, as Eclipse 35 points out, that right cannot be exercised whilst Eagle has merely a security interest in the Letter of Credit, and (it would appear) it would acquire a beneficial interest in the Letter of Credit only after it had enforced the security, that is, after it had failed to recover from the Members the payments due from them under the Repayment Schedule.

233.As to the zero-risk weighting issue, the Commissioners point to the terms of the banking and security documents and the resulting cash flows and also to the evidence of Mr Stanton.

234.The starting point, they argue, is that it is a condition precedent to the Loan Facility Letter that Eagle is satisfied that for its capital adequacy compliance requirements "Eagle is entitled to accord to the exposure to the [Member] for the [advance] a zero per cent risk weighting", so that it is to be presumed that the arrangements entered into at Financial Close achieved that result.

235.In support of this they rely on Mr Stanton's view that it is necessary to judge whether such risk weighting is achieved at the Barclays consolidated group level, and that the inference from the documentation and cash flows is that it is, with the deposit of £790 million (increased to that amount by the Prepaid Interest Amount of £293 million paid by Barclays in respect of the deposit) held by Barclays under the Deposit Agreement and Deposit Charge and charged as security for the Letter of Credit ultimately providing what amounts to "ring-fenced" cash collateral for the advances made by Eagle to the Members. The Commissioners point out that, in addition to such charge, the Distributor, as part of the security arrangements, agrees to hold its interest in the charged deposit account on trust for the application of the security arrangements in relation to the Letter of Credit, and that thereby Barclays has put in place arrangements by which the sums held in that deposit account would be unavailable to the creditors of Barclays should Barclays become insolvent. This

shows, the Commissioners argue, first that the Members are not even at risk of Barclays default, and secondly that the monies deposited by the Distributor will always be available to repay Eagle in full so that there is zero-risk weighting for the Barclays group in relation to the loans to the Members. The Commissioners argue that even though Eclipse 35 was not a party to the funding and security arrangements, it was assured that they achieved zero-risk weighting (and had an interest in that fact) by reason of the condition precedent in the Loan Facility Agreement and the cost of the funds advanced to Members (a higher risk weighting would have increased that cost).

236.Eclipse 35 accepts that the Members have an interest in the advances being zero-risk weighted, but argues that the manner in which Barclays achieved that (internally and in its dealings with the Disney group) is a matter of commercial indifference to the Members and to Eclipse 35. It points to an internal Barclays document relating to the funding (produced to the Commissioners as a result of an information disclosure notice) which states that zero-risk weighting will be achieved by Eagle taking a charge over a Member's interest as a member of Eclipse 35; by Eagle taking a charge over the Letter of Credit and the AODs and the account into which amounts due under the Letter of Credit (or the AODs) are paid; and by Eclipse 35's irrevocable instructions to Eagle to transfer sums received into that account in repayment of the advance to the Member. It points out that no mention is made in that document of the deposit account and security arrangements created by the Deposit Agreement and Deposit Charge. It argues that the Commissioners have misunderstood those deposit and security arrangements: first the deposit is charged in favour of Barclays as security for the Letter of Credit, and secondly since a deposit account is no more than a debt by the bank to repay cash to the account holder, any trust over such an account cannot be a trust over an amount of cash: if Barclays were to fail the cash deposited by the Distributor would in no way be specially protected for the benefit of the account holder or anyone having an interest in that account.

237.Eclipse 35 therefore rejects the Commissioners' contention that the cash simply passes round in a circle without consequence. The movement of cash should not be regarded in isolation: the real issue is what rights and liabilities are created by the transactions which result in cash moving between parties. The Members are indebted to Eagle and have a personal liability if Barclays is unable to make payments in full under the Letter of Credit. Despite the security arrangements, should Barclays fail there is no "ring-fenced" cash asset which is available to Eclipse 35 or the Members or which discharges their debt to Eagle.

238.The Commissioners ask us to find that the advances by Eagle to the Members were zero-risk weighted for the capital adequacy purposes of the Barclays group. It is a reasonable inference that this was so. It was a condition precedent to the Loan Facility Letter that the advances should be so treated, and there is no evidence that such condition was waived. That is persuasive. The internal Barclays paper sets out the steps which the authors of that paper consider are necessary to achieve zero-risk weighting (all of which steps were implemented). (The Commissioners point out that this paper was prepared by the tax group within the bank, and that there must be other internal documents which demonstrate how cash was collateralised to achieve such

weighting, but that is speculation on the part of the Commissioners since Barclays has been subject to a number of information disclosure notices served by the Commissioners and there is no suggestion that Barclays has failed to comply with those notices.) Mr Stanton, with his experience of structured finance transactions, surmises that the lending was zero-risk weighted.

239. Whilst we can make a reasonable inference that the advances were zero-risk weighted (at least to the satisfaction of Eagle), what remains uncertain is how this was achieved. The Commissioners say, with Mr Stanton's support, that the steps outlined in the Barclays paper would not achieve that end. But the Commissioners did not persuade us, from the only other evidence available, namely the banking and security documents, that it was achieved in any other way. We have already concluded that Eagle has, ultimately, recourse against the Members, and we do not accept that cash representing the deposit is in some way "ring-fenced" so that it remains available to meet the Letter of Credit liabilities of Barclays notwithstanding the insolvency of Barclays. On this matter we prefer the construction of the security documents proposed by Eclipse 35 to that proposed by the Commissioners.

240. The discussion between the parties as to the recourse nature of the advances to the Members and the risk weighting attributed to those advances is something of a diversion (Eclipse 35 would say an irrelevance), or perhaps a means to an end. The Commissioners wish to establish that the advances have these characteristics (and, moreover, that zero-risk weighting was achieved in a particular manner) in order to argue that cash moved around between the parties without in reality creating any commercial risk. We do not agree with that view. Eclipse 35 is right to point out that it is necessary to look to the rights and liabilities created by the individual transactions under which the cash payments were made.

241. Eclipse 35 was dependent upon Barclays meeting its liabilities under the Letter of Credit, and the Members in consequence were so dependent. There was a cash deposit with Barclays by way of a defeasance account enabling Barclays to meet those liabilities, but neither Eclipse 35 nor the Members had any prior claim to that account or to the balance on that account should Barclays be unable to meet its Letter of Credit liabilities. In April 2007 the risk of Barclays defaulting may have seemed remote almost beyond imagination, but subsequent events showed it to be at least within contemplation. That, in our view, was the commercial risk which Eclipse 35 and the Members undertook when they embarked upon the transaction.

The marketing services arrangements

242. Eclipse 35 places reliance on the marketing services arrangements in its case that it is carrying on a trade of exploiting film rights. Its case is not that it carried on the marketing and distribution of the Films, but that, through the agency and services of WDMSP Ltd, it supervised the Distributor's marketing and distribution of the Films, in that it prepared a marketing plan and monitored the Distributor's adherence to that plan.

243.The Commissioners argue that Eclipse 35 had divested itself of the Rights in the Films to the Distributor, and therefore had no standing to have any realistic part in the exploitation of the Films, and that in any event the Films were exploited by the "Disney distribution machine", to which Eclipse 35 could contribute nothing of value.

244.The contractual arrangements through which Eclipse 35 supervised the marketing of the Films are set out in paragraphs 163 to 182 above. In summary, Eclipse 35 engaged WDMSP Ltd to act as its agent and to provide specified services relating to the marketing and release of the Films, such services to be provided in accord with the Disney group's practices in relation to film distribution and exploitation. WDMSP Ltd agreed with the Buena Vista companies (the Disney distribution companies) that they would provide to WDMSP Ltd the services of certain personnel, and WDMSP Ltd also agreed to engage the services of Mr Salter, who in turn would be supported by SCI.

245.The marketing services arrangements were the subject of detailed negotiation between Mr Molner of SCI (on behalf of the Eclipse partnerships) and the Disney group. Disney were concerned that their distribution plans, and the execution of those plans, would be subject to external scrutiny and review. There was also concern about the duties which WDMSP Ltd owed to Eclipse 35 and possible conflict with its position as a subsidiary of the Disney group, and a possible conflict between Disney's standard practices in relation to the marketing and release of films and possible requirements of Eclipse 35.

246.WDMSP Ltd prepared on Eclipse 35's behalf an initial Marketing and Release Plan for each of the Films. These were "master plans" setting out the marketing and distribution strategies for the Films, covering all the territories, and the range of media, in which the Films were to be exploited. They were primarily prepared by SCI on WDMSP Ltd's behalf using information supplied by the Designees (the Buena Vista executives) and with input from Mr Salter. They are extensive and detailed, running to approximately 50 pages for each Film. They take account of the different attributes of, and expectations for, the respective Films: for example, whereas it was expected that the "princess" theme of "Enchanted" would have equal recognition in the United States market and the international market (and hence would require a similar marketing strategy in both markets), it was anticipated that "Underdog" would have little recognition outside the United States, and so the plan provided initially for strong marketing in the United States in the hope that success there would provide a platform for marketing internationally.

247.The Disney group had not previously prepared, prior to the release of a film, a comprehensive marketing plan similar to the initial Marketing and Release Plans created for the Films covering marketing in all media and across all territories.

248.Once the initial Marketing and Release Plans were agreed, the role of WDMSP Ltd was to monitor the Distributor's exploitation of the Films to check whether it was proceeding in line with the Plans, and to question any variations proposed by the Distributor to the strategy laid out in the Plans, or to suggest any variations which it thought appropriate as matters unfolded following the release of the Films.

249. Under the arrangements put in place SCI obtained information on marketing plans and matters from the Designees and used that information to assist Mr Salter in preparing regular reports to Eclipse 35. On the basis of those reports Eclipse 35 then instructed WDMSP Ltd to carry out the marketing plan, with WDMSP Ltd in turn instructing the Distributor (the Distributor having agreed in the distribution Agreement to implement the plan, subject to certain limitations) and subsequently monitoring implementation of the plan. Within these arrangements Mr Salter was in regular contact with his former colleagues at Buena Vista International (who acted for the Distributor in relation to the exploitation of the Films in the international markets), enabling him to keep abreast of the information available as to the performance of the Films and to discuss the implications of such performance for the future release and marketing of the Films. Mr Salter was most active in the weeks preceding the cinema release of each Film (producing fortnightly reports in this period for Eclipse 35), and then again in the period leading up to the DVD release of each Film (producing reports every four weeks). Thereafter his role was largely receiving (through SCI) information on the financial performance of the Films and their release across the territories and reporting on that to Eclipse 35.

250. In view of the expertise within the Disney group as to the marketing and distribution of film rights there was little by way of intervention by WDMSP Ltd in the marketing activities of the Distributor following the release of the Films. Mr Salter made specific recommendations to Eclipse 35 (which in turn WDMSP Ltd made to the Distributor) on one occasion and, less formally, expressed his views to the Distributor on another occasion.

251. The first of those occasions concerned "Underdog". In August 2007 it became apparent that the film was not achieving box office expectations, and the plan for an international release had been predicated on success in the US domestic market. Mr Salter, in consultation with Buena Vista International executives, considered whether a cinema release of the film internationally (a high cost operation) should be abandoned or modified, and whether to do so risked damaging the revenues from other media in those territories where there the cinema release was abandoned or severely curtailed. WDMSP Ltd's eventual recommendation on Eclipse 35's behalf to the Distributor was to revise the release strategy by abandoning the cinema release in some European territories, which is what the Distributor did.

252. The second of those occasions was less significant, and concerned the cinema release of "Enchanted" in France, where there was concern that the agreed Christmas date for cinema release would coincide with a transport strike (such a strike could have an adverse effect upon the impact of billboard advertising, the major form of marketing the release of films in France). Mr Salter discussed the matter with Buena Vista International, recommending that the release should go ahead since otherwise major cinema chains in France, having been denied at short notice the film for their Christmas season, might be reluctant to take it at all at any other time. That recommendation accorded with the views of Buena Vista International, and that is how the Distributor proceeded.

Further findings as to the transactions and the nature of Eclipse 35's activities

253. We turn now to the further findings we make as to the nature of Eclipse 35's activities and the arrangements it entered into. Following the hearing we received very extensive written submissions from both parties as to the findings we should make and the conclusions we should reach in the light of the evidence before us. As will appear, not all these issues are relevant to the conclusion we have reached on the question of whether Eclipse 35 was carrying on a trade, but in view of the submissions made and the cases put to us we set out our findings on all these matters.

254. We look first at the question of whether Eclipse 35 acquired any rights from Disney having regard to the effect of the Licensing Agreement and the Distribution Agreement, and if so, whether those rights had value and whether Eclipse 35 was engaged in the distribution of those rights. We then look at the marketing services arrangements to determine whether Eclipse 35 was engaged in the directing and supervision of the marketing and release of the Films. Finally, and more briefly, we look at the borrowing facility, deposit and security arrangements.

The acquisition of rights: the Licensing Agreement and the Distribution Agreement

255. Eclipse 35's case is that, in entering into the Licensing Agreement, it acquired from Disney the rights, for a term of twenty years, to distribute and exploit the Films worldwide in a range of entertainment media. It argues that it paid approximately £503 million for those rights, which accorded with their market value, together with Variable Royalties (which provided Disney with a share of the revenues from the Films based on their performance). It argues that it then proceeded to distribute and exploit those rights by entering into the Distribution Agreement with the Distributor, granting it a twenty year licence requiring it to market and distribute the Films world wide. As consideration it was entitled to receive AODs payable over the twenty year term and totalling approximately £1,022 million, Variable Distributions (that is, an amount each year calculated by reference to gross revenues, but only to the extent such amount exceeded the AOD for that year) and the right to 40 per cent of any Contingent Receipts. Amounts equal to the Variable Distributions received were paid out as Variable Royalties.

256. The Commissioners argue that a proper construction of the Licensing Agreement and the Distribution Agreement shows that Eclipse 35 was not entitled to receive any rights (or any meaningful rights), and that such rights as it acquired from Disney were immediately returned to the Disney group. They argue, further, that the nature and value of such rights were significantly depreciated by the Prior Agreements, subject to which they were granted. Their case is that Disney, for the receipt of the Studio Benefit, was prepared to enter into these arrangements (and to surrender to Eclipse 35 a share of any Contingent Receipts) in order to create the cash flows on 3 April 2007 which gave the financial basis for the Members' investment, but Disney did so on terms which ensured it kept full control of the rights in the Films, which it proceeded to exploit just as it would have done absent any involvement of Eclipse 35. They argue that the amount paid by Eclipse 35 by way of Licence Fees was not related to the value of any rights granted by Disney, but was calculated to deliver to Disney the Studio Benefit of £6 million together with an amount placed in a defeasance account

to secure payment of specified amounts (equating to the amount of AODs) under the Letter of Credit.

257.The arguments before us on this issue were principally focused on four issues: the terms of the Licensing Agreement and of the Distribution Agreement; the effect of the Prior Agreements; the value and the valuation of the Rights; and the significance of the Contingent Rights.

(a) The terms of the Licensing Agreement and the Distribution Agreement

258.Eclipse 35's case is that the documentary and other evidence shows that the Rights it acquired under licence were valuable rights which it then proceeded to exploit. It points to the fact that the terms of the Licensing Agreement and of the Distribution Agreement were the subject of extensive and detailed negotiation between Disney and Future, and the resulting documents comprise a commercial and detailed licence and sub-licence. A particular concern of Disney was to secure their ability to recover the Rights in the event of the insolvency of Eclipse 35, as reflected in the warranties required of Eclipse 35 and the termination provisions in the documents – Disney would not have been so concerned had Eclipse 35 not had a real and valuable interest in the Films. Furthermore, the very fact that the Disney group entered into the Distribution Agreement, and agreed to pay Eclipse 35 the AODs, the Variable Distributions and a share of the Contingent Rights, evidences the existence of the Rights granted by the Licensing Agreement and their intrinsic value.

259.The Commissioners point to the combined effect of the Licensing Agreement and the Distribution Agreement, which are co-terminous. In their submission that combined effect shows that Eclipse 35 has no rights as against Disney in relation to the Films other than the speculative right to a share of Contingent Receipts: Eclipse 35 acquired nothing of value and in consequence had nothing capable of being exploited.

260.In support of this submission the Commissioners note that in the Licensing Agreement Eclipse 35 undertakes to enter into the Distribution Agreement "concurrently with" entering into the Licensing Agreement, and to grant an exclusive licence of the Rights to the Distributor in the terms of the Distribution Agreement – to the extent that Eclipse 35 acquired any rights under the Licensing Agreement it simultaneously divested itself of them by entering into the Distribution Agreement. Further, in the Distribution Agreement Eclipse 35 warrants that it has reserved no rights from the licence granted to the Distributor, and that it has no entitlement to take any action with respect to the Rights (including by way of their exploitation) except to the extent provided for in the Distribution Agreement. Although in the Licensing Agreement Eclipse 35 agrees to perform all of Disney's obligations arising in connection with the exploitation of the Rights, those obligations are immediately assumed by the Distributor in the Distribution Agreement, where the Distributor agrees to perform all of Eclipse 35's obligations pursuant to the Licensing Agreement arising in connection with the exploitation of the Rights (other than the payment by Eclipse 35 of the Licence Fees and the Variable Royalties).

261.Other terms in the detail of the Distribution Agreement support the view, according to the Commissioners, that there was no substance to the Rights. They point out that Eclipse 35 conferred on the Distributor the possession and custody of the "Delivery Materials" representing the physical manifestation of the Films, and that Eclipse 35 is not permitted to appear in the credits for the Films or to use its name in any publicity for the Films. Further, although certain duties are imposed on the Distributor to exploit the Rights with due care and diligence in a manner consistent with the practices of the Disney group, those duties are subject to the performance by the Distributor of any competing obligations and duties it may have to other Disney group companies.

262.The Commissioners also point to Clause 37 of the Licensing Agreement (and the corresponding provision in the Distribution Agreement) which relates to the treatment of the transactions for the purposes of United States tax and financial reporting requirements: for such purposes the Disney group declares that the transactions are "intended to be treated solely as the purchase by [Eclipse 35] of its right to participate in proceeds for an amount equal to the net financial benefit of the Transactions as of Financial Close to [the Disney Group]", notwithstanding the legal form of the transactions.

263.The Commissioners also argue that no commercial significance can be attributed to the payment by the Distributor of the Variable Distributions – because of the corresponding obligation on Eclipse 35 to pay the Variable Royalties under the Licensing Agreement, the result is no more than one Disney entity agreeing to pay a performance-related sum to another Disney entity, that payment to be made through the collection agency of another Disney entity, WDMSP Ltd.

(b) The Prior Agreements

264.As we have already noted, the Licensing Agreement provides that the grant of the Licence is "expressly subject to the Prior Agreements", and there is a corresponding provision with regard to the grant of the sub-licence in the Distribution Agreement. The "Prior Agreements" are specified licence agreements between Disney and its principal group distribution companies (the Buena Vista companies), dating from 1990 (and amended in the period up to August 2005), "and any and all other licences or other agreements between [Disney] and any one or more of its Affiliates relating in whole or in part to the [Films] and/or any of the Rights existing as at the date of Financial Close".

265.We have also referred above (paragraphs 50 to 54) to Mr Molner's evidence with regard to his enquiries of Disney as to the significance of the Prior Agreements (and whether he could have sight of them) and his own understanding of their purpose and effect. Certain inconsistencies in his evidence on these matters revealed in cross-examination resulted in his producing a third witness statement in the course of the hearing to clarify his evidence.

266.The significance in this case of the Prior Agreements is this: the Commissioners argue that they possibly grant valuable distribution rights within the Disney group,

and if so the Rights granted by the Licensing Agreement, being expressly subject to the Prior Agreements, are thereby very significantly depreciated in their value. At the very least by entering into the Licensing Agreement without knowing what was the effect of the Prior Agreements, Eclipse 35 clearly had little regard for the integrity of the arrangements as a genuine commercial transaction.

267. Eclipse 35 argues that it did, through Mr Molner (during negotiation of the first tranche of Eclipse transactions), raise the question of the effect of the Prior Agreements and asked to see them, but this was refused. This was not (based on his own experience at Paramount and in negotiating with other film studios) a surprise to Mr Molner since he understood them to deal with confidential matters. Mr Molner's evidence is that Disney's legal team gave oral confirmation that the Prior Agreements did not convey any rights – they were not prepared to disclose them (having regard to their confidential nature) because they were commercially irrelevant, rather than because they reserved out of the Rights a significant benefit for Disney which Disney wished to hide from Eclipse 35. In these circumstances Mr Molner concluded that in all likelihood the Prior Agreements comprised "master agreements" providing for royalty rates between Disney group companies in the event that distribution rights to individual films were transferred within the group – this provided a means of establishing transfer-pricing values for financial reporting and cross-border tax purposes and for the internal allocation of profit between different parts of the Disney group.

268. Further, if the Prior Agreements comprise a network of distribution arrangements within the Disney group, that, Eclipse 35 says, is to Eclipse 35's benefit and enhances the value of the Rights: Eclipse 35 exploited the Rights by sub-licensing them to the Distributor because it knew that the Disney group had unrivalled distribution expertise and an unrivalled distribution network of which Eclipse 35 wanted to take advantage. Even if the Prior Agreements provided for a system of intra-group licences which would apply to the Films, that does not necessarily preclude Disney from granting the Rights, as valuable rights, to Eclipse 35, and such licences then become the means by which the Distributor carries out its obligations under the Distribution Agreement to exploit the Films: at worst such licences provide some sort of limit or control on how the Distributor exploits the Films, but that does not render the Rights valueless.

269. In response to a point made by the Commissioners (who relied on the evidence of Mr Sills) that the Prior Agreements could provide the Disney group with an opportunity to "self-deal" (that is, to grant a particular distribution right to a group company on terms more favourable to that group company than arms-length terms), Eclipse 35 argues that such an opportunity does not in itself remove all value from the Rights. It argues that Eclipse 35 was entitled to assume that Disney, as a reputable and major commercial entity, acted in good faith in granting the Rights and in agreeing, in the Distribution Agreement, to market and distribute the Films. From the reports of the Distributor's activities prepared in carrying out the marketing services arrangements it is clear that the Distributor entered into a range of licensing deals in relation to the Films with third parties in order to obtain the best revenues.

270.Finally, Eclipse 35 points to the Variable Distributions actually received by Eclipse 35 under the Distribution Agreement and the calculation of those amounts: they demonstrate that Eclipse 35 was in receipt of substantial amounts by reason of the exploitation of the Rights and that those amounts were derived from the totality of the revenues from the exploitation of the Films in the territories and through the media specified in the Licensing Agreement and the Distribution Agreement. If there were pre-existing exploitation rights conferred by the Prior Agreements in relation to the Films some part of the revenues derived from the exploitation of the Films would flow to satisfy such rights, and that was not the case. The Rights granted by the Licensing Agreement and sub-granted by the Distribution Agreement comprised all the rights to the Films in relation to the specified territories and the specified media.

271.The Commissioners argue that it is reasonable to infer that the Prior Agreements confer distribution and exploitation rights on the Buena Vista distribution companies, and that since the Rights granted to Eclipse 35 are subject to the Prior Agreements the Rights are of little, if any, significance or value. They point to Mr Molner's first witness statement and also to his second witness statement (prepared in response to the witness statement of Mr Sills), in both of which it is clear that his assumption was that the Prior Agreements related to the distribution of films. It is only in his third witness statement that he states his assumption that they are "master agreements" which related to royalties or values for intra-group transfer purposes.

272.The Prior Agreements are expressed to be licence agreements between Disney and the various Buena Vista companies in the Disney group who variously have the function within the group of distributing films in different territories and through different media. The evidence of Mr Sills is that the Disney group is structured in this integrated way, separating film production from film distribution, and with different distribution companies organised by territory and medium, together providing a comprehensive distribution of all film rights. This structure is entirely consistent with the Prior Agreements conferring substantive distribution rights to the distribution companies within the Disney group, calling into question whether the Rights granted by the Licensing Agreement have any meaningful value.

273.In any event, the Commissioners argue, Eclipse 35 was prepared to take a licence of the Rights without knowing what was the effect of the Prior Agreements and hence without knowing whether or not the Prior Agreements affected the value of the Rights, and that is not a credible commercial stance – Eclipse 35's indifference on this matter shows that it had no concern for the nature or value of the key asset for its purported trade.

(c) The value and the valuation of the Rights

274.The issue of the Prior Agreements, in the case put forward by the Commissioners, goes to the question of the value of the Rights granted by the Licensing Agreement. The Commissioners argue, as a separate issue, that Eclipse 35 did not have available to it a valuation of the Rights to form the basis of its decision to pay £503 million by way of Licence Fees for the Rights under the Licensing Agreement. They argue that

that figure is simply derived from an arithmetic calculation to achieve the cash flows which underlie, and form the basis of, the transactions.

275.We describe above (see paragraphs 210 to 217) the exercise carried out by SCI and Salter Group to determine the estimated range of Ultimates for the Films, and Disney's interest in that exercise.

276.Eclipse 35's case on this issue of valuation is that throughout Future worked on the basis that film rights acquired were assets which carried a premium value because of the "franchise" nature of the films, and that the price paid for those rights had to reflect that value. For this reason the matching of films to be licensed with the capital raised for each tranche of the Eclipse transactions was a complex issue, with the further complication that the financial terms have to result in the investors receiving a minimum specified return which is the incentive for the contribution of their capital. It was a provision of the Term Sheet with Disney that each Eclipse partnership should obtain a valuation of the film rights licensed based on independent advice.

277.Eclipse 35 argues that it used, in Salter Group, recognised experts in forecasting the amount and timing of gross revenues, which is the principal component in a valuation exercise. They provided their expertise and applied it to the financial model (the waterfall) prepared by SCI from the terms of the documents. When Disney indicated that the likely gross revenues produced initially by Salter Group for "Enchanted" fell below Disney's own calculations, further adjustments were made to reflect the marketing drive which Disney had indicated they would make for that film and to broaden the scope of comparable films. This process of determining the Ultimates, across a range of possible cases, was commercial and carried out by experts. The actual performances of the films licensed in the various Eclipse tranches show that the Salter Group figures are accurate.

278.Two relatively simple exercises were then required to convert those performance forecast figures into a pounds sterling valuation: discounting for timing in accordance with the timed Ultimates forecast by Salter Group, and applying a reasonable exchange rate.

279.The resulting figure, as the aggregate Licence Fees, had to be commercially acceptable to Disney in the context of the overall commercial deal negotiated with Disney, and having regard to the capital raised. Eclipse 35 argued that this was, overall, a careful and legitimate exercise to arrive at Licence Fees which reflected a fair value for the Rights licensed.

280.The Commissioners argue that no actual valuation has been produced by Eclipse 35, but only the Salter Group Ultimates and an assertion as to how a valuation could be derived from those numbers. Even the production of the Ultimates was subject to manipulation by changing the films in the "comparable films" exercise undertaken by Salter Group, and Salter Group was dependent on the waterfall supplied by SCI for such matters as distribution costs and the effect of third party participation rights.

281.In any event, the true purpose of the Salter Group report was to provide an opinion as to the possibility of Eclipse 35 receiving Contingent Receipts, and to ensure that the amount to be paid as AODs (that amount being a consequence of the capital raised and the investors' return on that capital) broadly accorded with the forecast gross revenues from the Films.

(d) Contingent Receipts

282.The issue between the parties in relation to Contingent Receipts is whether the entitlement of Eclipse 35 to Contingent Receipts under the Distribution Agreement demonstrates both that Eclipse 35 acquired the Rights (on the basis that the Contingent Receipts are an incident of the Rights) and that the Rights have value. The matters in dispute relate to the nature of the entitlement to Contingent Receipts (that is, whether they are derived from the Rights or are an independent contractual entitlement) and also to their speculative nature.

283.We have already referred to the provisions in the Distribution Agreement which provide for the calculation and payment of Contingent Receipts (see paragraph 134) and to the Salter Group forecast and opinion in relation to their likely payment (see paragraphs 225 to 228).

284.Eclipse 35 argues that the terms of the Contingent Receipts provisions, and Eclipse 35's share, were the subject of real and extensive negotiations between Future and Disney, and that that indicates their real commercial significance to both parties. As to the nature of the entitlement to Contingent Receipts, they are payable under the Distribution Agreement as consideration for the Rights sub-licensed by Eclipse 35 to the Distributor.

285.Eclipse 35 argues that the Salter Group opinion demonstrates that, at the time the transactions were entered into, there was a possibility that, over the twenty year cycle of the Films, Contingent Receipts would become payable. That opinion was perfectly sustainable, since it required the Films to perform only 27 per cent better than Salter Group's Base Case in order to generate Contingent Receipts.

286.Eclipse 35 points to the actual performance of the film "Pirates of the Caribbean: Dead Man's Chest", the subject of the Eclipse first tranche, where the revenues to date indicate a probability that Contingent Receipts will become payable to the relevant Eclipse partnerships. It argues that the success of that film generated interest in film investment in the UK and was a factor in the minds of those investing in Eclipse 35, who saw the possibility of a share in super profits: it was a significant part of the marketing of Eclipse 35 to investors in the Addendum to the Film Partnership Proposal, for which purpose the Salter Group opinion was obtained. It acknowledges that current performance of the Films now makes it unlikely – but not impossible – that they will generate Contingent Receipts.

287.The Commissioners argue that Eclipse 35's entitlement to Contingent Receipts is a mere contractual right which does not flow from, or is not dependent upon, any holding by Eclipse 35 of the Rights, being a right to contingent future income from

the Distributor's exploitation of the Films. In its nature it is akin to the participation rights in the financial performance of a film which may be negotiated by investors in a film or by the leading actors and production team who have worked on a film. In the overall financial analysis of the transaction Disney was prepared to offer this right to contingent income in exchange for the immediate and certain right to the Studio Benefit.

288.The Commissioners challenge the reliability of the Salter Group opinion on the likelihood of the Films generating Contingent Receipts on the grounds that the waterfall on which the calculation of Contingent Receipts is modelled for the purposes of that opinion was provided by SCI and was not independently verified by Salter Group. They argue that Eclipse 35 had shown an indifference to the likelihood of the Films earning Contingent Receipts in that it agreed to Disney's demands for the cross collateralisation of the Films, knowing from the Salter Group workings that even if "Underdog" performed to the Best Case standard it would barely earn Contingent Receipts, so its pairing with "Enchanted" would almost certainly depreciate the likelihood of any Contingent Receipts being received by Eclipse 35. The financial performance of the Films to date shows that the accrual of Contingent Receipts, which as a forecast was always a remote contingency, has in reality turned out to be even more unlikely.

Discussion

289.Our conclusion with regard to the issues between the parties relating to the licensing of the Rights is that Eclipse 35 acquired the Rights under the Licensing Agreement which it then proceeded to sub-licence by entering into the Distribution Agreement. The Rights were valuable, and the Licence Fees, whilst not necessarily exactly equating to the value of the Rights, broadly represented that value when seen in the overall context of a commercially negotiated transaction. In substance, therefore, on these issues we accept the case made by Eclipse 35.

290.Mr Gammie, for the Commissioners, stressed that the Commissioners were not putting forward a case that the Licensing Agreement and the Distribution Agreement were sham documents, that is with an apparent legal effect which does not accord with the actual transaction agreed between the parties. He said his purpose was to identify the real effect of those agreements in their entirety by reference to their terms and the context in which they were entered into. However, his line of argument that no rights in the Films were acquired by Eclipse 35 is scarcely a step away from asserting that the agreements were a sham when the whole tenor of the agreements is that the Rights are licensed by Disney to Eclipse 35 and sub-licensed by Eclipse 35 to the Distributor.

291.The Licensing Agreement is a clear and unequivocal licence of the Rights for the term of twenty years. The licence is exclusive to Eclipse 35. It is made clear that the grant of such licence is terminable, and that it is not a sale or transfer of the title to the Rights, which remains with Disney, subject to the licence granted to Eclipse 35. The Rights so licensed are the distribution and other exploitation rights in respect of the Films in the media and throughout the Territory as specified in detail in the relevant

Exhibit to the Licensing Agreement. As consideration for the grant of the licence and its continuation during the term Eclipse 35 is liable to Studio to pay the (very substantial) Licence Fees and the Variable Royalties. Extensive further provisions relate to matters ancillary to, or to give full effect to, the licence of the Rights (such as dealing with the materials which provide the physical representation of the Films; protection of copyright; advertising and promotion rights; and making foreign language versions). There are also extensive provisions dealing with termination of the licence by expiry of the term or before the end of the term, with different consequences (in the case of early termination) depending upon the cause of termination, but in all cases, broadly, ensuring that the Rights revert to Disney.

292. Viewing the Licensing Agreement we see no basis for any conclusion other than that, by and upon its terms, Disney confers on Eclipse 35 the Rights it purports to confer, which, since they are exclusive exploitation rights in respect of the Films across the range of entertainment media, and in virtually every country in the world, are rights potentially of significant value.

293. Two questions then arise: first, whether the fact that the grant of the licence of the Rights is "expressly subject to the Prior Agreements" means that no Rights are licensed to Eclipse 35, or that such Rights as are licensed are of reduced value; and secondly, whether the terms of the Distribution Agreement, entered into and having effect contemporaneously with the Licensing Agreement, mean that no Rights are licensed to Eclipse 35.

294. The Prior Agreements are defined in the Licensing Agreement as a series of licence agreements between Disney and various Buena Vista distribution companies (which we understand are all within the Disney group of companies). In origin they date back to the early 1990s and earlier and have been amended most recently in 2005.

295. At the time Eclipse 35 entered into the Licensing Agreement it did not know the purpose and effect of the Prior Agreements, nor their effect upon, or consequences, if any, for, the licence it was taking of the Rights in the Films. We have referred to the confusion in the evidence of Mr Molner on the subject. There is evidence that Disney told him in the course of negotiating the first tranche of Eclipse transactions that their content was confidential and would not be disclosed. There is no evidence that assurances were sought by Future from Disney that the Prior Agreements did not and would not have a material and adverse impact upon the licence of the Rights which Disney was proposing to grant to each Eclipse partnership.

296. Mr Molner's assumption that the Prior Agreements are "master agreements" regulating on a standard form basis the transfer of rights within the Disney group is no more than surmise. Equally, Mr Sills's views that they pass valuable exploitation and distribution rights in respect of every Disney-produced film within what he described as the vertically integrated group, and that they permit what he referred to as "self-dealing" by Disney, is no more than surmise.

297.What is clear is that the Prior Agreements do not expressly relate to the Films, since they long pre-date them. If they are relevant at all to the Films it must be on some sort of long-standing "master agreement" basis, either because as a matter of their terms they engage with all, or certain classes, of Disney film at, for example, the point when production is complete and distribution is imminent, or because Disney has taken some prescribed action to bring the Films within their terms.

298.Eclipse 35 argues that the Prior Agreements are matters of routine "housekeeping" within the Disney group, and as such without significant consequence for the licence of the Rights to Eclipse 35. It points to what has actually happened since the Films have been distributed: for the years in which Variable Distributions were paid to Eclipse 35 under the Distribution Agreement it is possible to see from the statements which relate to those Variable Distributions that there has been no "leakage" of gross revenues. In the calculation of Variable Distributions all gross revenues earned by the Films can be accounted for. There is no payment out to a Buena Vista company or any other party such as one would find if there were some over-riding licence for value which had priority to the licence of the Rights.

299.That seems to us a convincing point, and we would only add that we would consider it unlikely that, in the context of a commercially negotiated transaction, a major organisation mindful of its reputation and acting in good faith would grant seemingly highly valuable rights which it knew to be rendered significantly less valuable by the existence of arrangements whose terms it was not prepared to disclose.

300.We conclude on balance, therefore, that the Prior Agreements, and the grant of the licence of the Rights in the Licensing Agreement subject to the Prior Agreements, did not render the licensed Rights valueless, or materially depreciate their value.

301.A more valid point made by the Commissioners with regard to the Prior Agreements in our view is the fact that Eclipse 35 was prepared to take a licence of the Rights subject to the Prior Agreements without obtaining some level of satisfaction or comfort from Disney beyond, at best, an un-minuted oral remark, as to their purpose and effect and possible significance for the Rights granted. That does speak to a degree of indifference about the value of what was being acquired, but that does not go to the question of what was acquired, but, rather, to the significance which Eclipse 35 attributed to this aspect of the transaction and the question of whether it was really engaged upon a speculative commercial venture.

302.As to the Distribution Agreement, this in its terms is an exclusive licence of the Rights made by Eclipse 35 to the Distributor which is made subject to the licence which Eclipse 35 has acquired pursuant to the Licensing Agreement. The Rights licensed are the distribution and exploitation rights exactly corresponding with the Rights licensed by Disney to Eclipse 35. The period of the licence is co-terminous with that of the licence held by Eclipse 35. The consideration given by the Distributor for the Rights licensed comprises the AODs, the Variable Distributions, and a 40 per cent share in Contingent Receipts. There are ancillary provisions and termination provisions which correspond to those in the Licensing Agreement.

303. In its terms there is nothing in the Distribution Agreement which detracts from or nullifies the Rights acquired by Eclipse 35 under the Licensing Agreement. If anything it confirms that they both exist and have high value. Therefore the beginning and end of the Commissioners' case is that since the Distribution Agreement was entered into concurrently with the Licensing Agreement, with both agreements coming into effect at Financial Close, and since the entirety of the Rights licensed to Eclipse 35 is licensed to the Distributor for what in all circumstances (including on early termination) is the exact same term, in the overall result no rights were acquired by Eclipse 35 and instead Disney licensed the Rights to the Distributor, its fellow group member.

304. We do not agree with that proposition. The Licensing Agreement and the Distribution Agreement must be given effect to in their own terms. The Licensing Agreement, whilst acknowledging that the Distribution Agreement will be entered into concurrently with it, grants a licence of valuable Rights to Eclipse 35. Correspondingly, the Distribution Agreement, whilst acknowledging that it is entered into concurrently with the Licensing Agreement, is the grant of a licence which Eclipse 35 is able to grant only if effect has been given to the Licensing Agreement. Both documents are meaningless if there is no licence of the Rights to Eclipse 35, and the rights and obligations they create or give rise to are illusory.

305. In our judgment the Licensing Agreement and the Distribution Agreement should be construed and applied so as to give them meaning, and for this objective no more is required than that they are treated as having effect in the logical sequence which their respective terms implicitly assume. Thus the Licensing Agreement should be regarded as having effect momentarily before the Distribution Agreement, so that Eclipse 35 has a licence of the Rights immediately before it sub-licences them to the Distributor.

306. The Commissioners found support in their view in the terms of Clause 37 of the Licensing Agreement and the corresponding provision in the Distribution Agreement. This states that for the purposes of applying US GAAP in the financial reporting of the Disney group and of applying US tax law, the transactions and arrangements contemplated by the Licensing Agreement and the Distribution Agreement and related documents "are intended to be treated solely as the purchase by [Eclipse 35] of its right to participate in proceeds for an amount equal to the net financial benefit of [those transactions and arrangements] as of Financial Close to [Disney], the Distributor and their affiliates". The parties, including Eclipse 35, are asked to acknowledge that this is the case, and to agree that for the same US purposes they take a consistent position.

307. We cannot see that this provision necessarily assists the Commissioners – indeed, it might tell against them. First, accounting treatment in accordance with GAAP may well require that, for those specific purposes, a transaction is reported in a way which differs from it proper legal form and effect – an obvious example in the UK, and one not far removed from the transactions entered into by Eclipse 35, is the treatment of UK finance leases. Secondly, Clause 37 specifies that this particular treatment of the transactions for the specified US tax and financial reporting purposes is to be afforded

by considering the transactions and arrangements "as a whole rather than only according to their legal form": thus the "legal form", which is our present concern, may, when analysed, result in a different outcome to that which is to be assumed for US accounting and tax purposes. Thirdly, if the proper construction of the Licensing Agreement and the Distribution Agreement were as the Commissioners contend, there would be no need to have Clause 37 – it is required only because, for those particular purposes, the treatment of the transactions effected by those documents differs from their actual legal effect.

308. Eclipse 35 argues that its entitlement to a share of Contingent Receipts payable under the terms of the Distribution Agreement is further evidence of the reality and value of the Rights it has acquired by the Licensing Agreement. The Commissioners argue that the entitlement to Contingent Receipts is not necessarily dependent upon the Rights, and in any event is an expectation so speculative and remote as to be of little, if any, value.

309. The right to Contingent Receipts is a right to a share in the gross revenues earned by the Films after allowing for a series of deductions, expenses and participations according to a pre-determined formula or financial model. It would seem that an entitlement to such a share or participation can be created as a matter of contract without the beneficiary holding an interest of an intellectual property nature in the films generating the revenues. Contingent Receipts are not inherently an attribute or incident of the rights to exploit a film. But they can be one of the benefits which flow to the holder of such rights because he is such a holder. That is so in Eclipse 35's case. Contingent Receipts, if they accrue, are paid "in consideration of the Rights licensed by [Eclipse 35] to the Distributor hereunder", as provided in the Distribution Agreement. That is so because it is the Rights, and nothing more, which Eclipse 35 has to contribute. In cases where similar participation rights are agreed with, say, film investors or actors, that is by way of consideration for the funds or performance which they contribute. The Commissioners argue that the right to Contingent Receipts is consideration for Eclipse 35 making available the Studio Benefit to Disney, but that requires a broader view than we are prepared to contemplate, at least in the present context of assessing whether Eclipse 35 acquired and sub-licensed valuable rights.

310. As to the question of the speculative value of Eclipse 35's entitlement to a share of Contingent Receipts, we need look no further than the Salter Group opinion on the matter. The Commissioners attacked this on a number of grounds, but we accept the evidence of Mr Briggs, its principal author. Salter Group is experienced in these matters and has a high reputation in the film and entertainment media industries. They prepared the opinion for the purpose of informing potential investors in Eclipse 35, with the responsibilities that that entailed. It is true that they relied on the "waterfall" prepared by SCI, but that was, as we understand it, no more than a spreadsheet replicating in the form of a financial model the terms in the Distribution Agreement setting out how Contingent Receipts are to be calculated.

311. The opinion was "that a payment of Contingent Proceeds [that is, Contingent Receipts] is possible". That opinion was based on the range of forecast Ultimates for

both Films for the three different Cases identified by Salter Group, and taking account of the cross-collateralisation of the Films.

312.As Mr Molner expressed it, no-one would be advised to invest in film rights by reference only to the prospect of what might be delivered by a participation such as the Contingent Receipts in this case. It is a speculation on the likelihood of a film proving to be an outstanding success in the earnings it generates (relative to its costs of production and distribution) over the length of its life, as it passes through the different cycles of release. One of the films licensed in an earlier Eclipse tranche looks likely to generate earnings which will deliver Contingent Receipts for that particular partnership. Although (due in large measure to the poor performance of "Underdog") it now looks most unlikely that Eclipse 35 will receive Contingent Receipts, it was reasonably expressed as a possibility when Eclipse 35 took a licence of the Rights. This was so notwithstanding that, as we have already mentioned, the chances of Eclipse 35 earning Contingent Receipts were reduced (and, even if they became payable, the amount would likely be reduced) by reason of it agreeing that for theses purposes the Films should be "cross-collateralised".

313.In our judgment that prospect, notwithstanding that it was far from certain, supports Eclipse 35's case that its entitlement to Contingent Receipts demonstrates that it was licensed Rights which were of substance and value.

314.As we mention below, however, we cannot agree with the further proposition which Eclipse 35 would have us accept with regard to its argument that it is carrying on a trade, namely that its entitlement to Contingent Receipts demonstrates that the fortunes of Eclipse 35's business are related to the performance of the Films. The prospect of earning Contingent Receipts, although a possibility, is too remote to qualify as a basis or justification for entering upon a trading venture on any commercial level, which Mr Molner readily acknowledged.

315.Finally there is the issue of the value attributed to those Rights. The Commissioners argue that no valuation was produced and there is nothing to substantiate the Licence Fees of £503 million paid by Eclipse 35 as consideration for the licence of the Rights under the Licensing Agreement.

316.Mr Molner described the process of matching (or perhaps juggling) the various components in the transaction: a film or films satisfying the "franchise" and other criteria; the amount of capital likely to be raised; and the return required for investors in the partnership which would be based on the amounts received from the Distributor. In that process the consideration given under the Licensing Agreement (Licence Fees plus the right to Variable Royalties) would broadly accord with the value of the film or films whose rights were licensed.

317.In the case of the Films there was no evidence of a valuation produced at the time the transaction was being negotiated. Mr Molner explained how a valuation was calculated, applying to the timed Ultimates forecast by Salter Group an appropriate discount factor to give a present-day value, and an exchange rate to convert the US dollar figure into pounds sterling. In that process the crucial element is the forecast of

the timed Ultimates – the other two components of the calculation are purely arithmetical and routine. That forecast was available to Eclipse 35 in March 2007. The other two components were, of course, known or capable of being ascertained at that time.

318.Mr Molner's evidence was that Disney ran a parallel exercise to the Salter Group Ultimates forecast, and that their exercise indicated forecast higher gross revenues with regard to "Enchanted", causing Salter Group to re-examine the group of films it was using as comparables in its forecasting exercise. It is reasonable to assume that Disney were assessing likely gross revenues in order to establish, for their own purposes, some kind of valuation of the two Films. It is reasonable to infer that Disney had an interest in the value implicitly placed on the Films by the Licence Fees (and the prospect of Variable Royalities) in the context of evidence or justification for the values it placed on them for its own accounting purposes.

319.Whilst Eclipse 35 could not produce in evidence an actual valuation of the Rights it acquired by licence under the Licensing Agreement we are satisfied that it had the information which enabled it to form a view as to the range of values in which the value of the Rights was likely to fall. It seems likely – on the evidence we can put it no higher – that, on their side of the transaction, Disney were mindful of the need to attribute a justifiable value to the Rights it licensed. In determining the actual amount of Licence Fees we accept that, in the negotiation of the transaction, the other factors mentioned by Mr Molner (accommodating the capital raised to the films to be licensed; ensuring an acceptable rate of return for Members' investment) had to be taken into account in addition to the figure produced by a valuation exercise, but looking at matters in the round we are able to conclude that Eclipse 35 entered into the transaction knowing the likely value of the Rights it acquired, and such value was taken into account in determining the consideration which it gave for the Rights.

320.Drawing all these matters together, therefore, we conclude that Eclipse 35 acquired the Rights by licence pursuant to the Licensing Agreement which it then subsequently proceeded to sub-licence to the Distributor pursuant to the Distribution Agreement. Neither the substance of the Rights nor their value was materially affected or depreciated by reason of the licence being granted subject to the Prior Agreements. The consideration which Eclipse 35 gave for the Rights reflected the likely value of the Rights. The Rights gave Eclipse 35, by reason of the Distribution Agreement, the entitlement to Contingent Receipts, and at the time the transaction was entered into a payment of Contingent Receipts, although speculative, was reasonably anticipated to be possible in the course of the twenty year term of the licence.

The marketing services arrangements and the nature of Eclipse 35's role

321.The next area of dispute between the parties concerned the marketing services arrangements: was Eclipse 35, by means of those arrangements, engaged in directing and supervising the marketing and release of the Films?

322.Eclipse 35's case is that it exploited the Rights it acquired by licence by sub-licensing those Rights to the Distributor and supervising the Distributor's marketing of the Films through the marketing services arrangements. It argues that the purpose of the marketing services arrangements was not that Eclipse 35 should carry out the marketing and distribution of the Films (that was the task of the Distributor), but that it should have a part in directing how those activities were to be carried out by the Distributor and in monitoring and supervising the Distributor's compliance with the agreed marketing and distribution strategies. In this way Eclipse 35 ensured that its interests were protected in a situation where there was a broad community of interests between Eclipse 35 and the Disney group in ensuring the success of the Films, but not necessarily an exact alignment of interests.

323.The Commissioners argue, first, that by reason of the Distribution Agreement Eclipse 35 had divested itself of the Rights, so that it could not, in any sense which is meaningful in the context of Eclipse 35 purportedly carrying on a trade, play any part in the release or marketing of the Films; secondly, that WDMSP Ltd was not an agent of Eclipse 35, so that its activities are not to be attributed to Eclipse 35; and thirdly, that in any event the marketing services arrangements are no more than administrative or information-providing activities with little real substance, and that the highly proficient and experienced Disney marketing and distribution operation had no need for any input from Eclipse 35 and in any event went about marketing and distributing the Films without any real regard to the arrangements provided for in the marketing services documents. They say that these arrangements are aimed at creating the appearance of a trade and have no real commercial significance.

324.We have set out in paragraphs 163 to 182 above the terms of the transaction documents relating to the marketing services arrangements, and in paragraphs 242 to 252 above the further findings as to those arrangements.

325.In support of its case Eclipse 35 points first to the threshold criteria which it used to identify films which in its view could benefit from the contribution it could make to their marketing – essentially, films which were not yet on what Mr Molner described as the marketing "launch pad" (in his imagery the marketing of a film is to be compared to the journey of a rocket: all the effort and thrust is required in preparing the rocket for launch and at the launch itself to set the film on its course, and thereafter it is only a question of fine tuning the pre-determined path). There was thus a serious and active process to ensure that the chosen films had, at the time they were licensed, a potential in terms of marketing strategy in respect of which Eclipse 35 could apply its influence.

326.Eclipse 35 then points to the master plan – the initial Marketing and Release Plan relating to all the media in which the Films were to be marketed – which it devised in advance of the release of each of the Films. A plan of this kind had not previously been prepared by the Disney group, and it was the strategy benchmark by reference to which WDMSP Ltd (through SCI and Mr Salter) monitored the Distributor's performance (it having agreed in the Distribution Agreement to undertake the detailed implementation of such plan under WDMSP Ltd's oversight).

327.In this exercise, Eclipse 35 argues, WDMSP Ltd acted as Eclipse 35's agent in agreeing to provide to Eclipse 35 the marketing services detailed in the Marketing Services Agreement, drawing upon the services of senior employees of the Buena Vista distribution companies through the "Designee" arrangements.

328.In pointing to the commercial reality of these arrangements Eclipse 35 refers to the evidence of Mr Levy and Mr Molner to the effect that discussions with other film studios had foundered, at least in part, because of their unwillingness to accept this level of intrusion into their marketing arrangements, and that the negotiations with Disney in this area had been difficult, especially in relation to the question of the duties which WDMSP Ltd owed to Eclipse 35 as its principal alongside its position and responsibilities as a member of the Disney group.

329.Eclipse 35 points to the substance of the Marketing and Release Plans, which were tailored to the respective Films. It points to the arrangements set up between WDMSP Ltd, SCI and Mr Salter for gathering information and reporting to Eclipse 35 on the performance of the marketing and release of the Films. In particular it points to Mr Salter's experience and close working relationship with his former Buena Vista colleagues which enabled him to monitor performance knowledgeably and effectively, and to intervene when circumstances required, as with the proposal to curtail the cinema release of "Underdog" in Europe after its disappointing opening box office performance in the United States.

330.In response to the Commissioners' charge, based on the evidence of Mr Sills, that the Disney group did not need any input from WDMSP Ltd in order to market and release the Films, Eclipse 35 argues that the purpose of the marketing services arrangements was not to supply some deficiency in the marketing activities of the Disney group, but to ensure that marketing was a collaborative exercise, to protect the interests of Eclipse 35.

331.The Commissioners' arguments are based on the nature of the relationship which Eclipse 35 has with WDMSP Ltd and on the reality of what it did. They argue that, on a proper analysis of the documents, WDMSP Ltd was not an agent of Eclipse 35 for marketing services or any other purposes (but instead agreed to provide services to Eclipse 35), and that in any event it played no part in the distribution or exploitation of the Films: at best it facilitated a reporting operation.

332.The Commissioners' first submission is that, since in their view Eclipse 35 has no rights which it is capable of exploiting, it is in no position to appoint an agent to do what it could not possibly do itself. We have already found that Eclipse 35 did acquire the Rights by licence, and if we are right in that then this argument falls away.

333.Next the Commissioners look to the detail of WDMSP Ltd's responsibilities under the Marketing Services Agreement. They point to provisions in Clause 2.1 of that agreement, which require that WDMSP Ltd must provide its services to Eclipse 35 "with due care and diligence in a manner consistent with Distributor's and [Disney's] then prevailing and commercially reasonable practices". They also point to provisions in Clause 5.1, which, first, assert WDMSP Ltd's "fiduciary duties" to

the Disney group (in its capacity as a member of that group) and its responsibility to act in the best interests of the group in priority to the interests of Eclipse 35 should there be competing interests; and, secondly, exclude the standards of care or obligations owed by law by an agent to the extent that they conflict with WDMSP Ltd's duty of care to perform its services consistently with the Disney group practices as required by Clause 2.1. Such provisions are contrary to the essence of agency and the duties which an agent owes to its principal.

334. Therefore, the Commissioners argue, in performing the services defined in the Marketing Services Agreement WDMSP Ltd is not acting as an agent, and its activities are not therefore the activities of Eclipse 35. At best it performed the services for the benefit of (but not on behalf of) Eclipse 35.

335. Next the Commissioners looked at the extent of WDMSP Ltd's activities. They point out that although Clause 4 of the Distribution Agreement speaks of the Distributor undertaking the detailed implementation of the Marketing and Release Plans under WDMSP Ltd's oversight, that is subject to the entitlement of the Distributor to deviate from or amend such Plans to allow it to exploit the Rights in a manner consistent with the Disney group's prevailing and commercially reasonable practices.

336. As to the reality of the position the Commissioners submit that Disney group companies and their employees carried out the marketing and distribution of the Films, and then notified WDMSP Ltd of what they had done, enabling WDMSP Ltd to pass that information on to Eclipse 35. WDMSP Ltd's activities were administrative only and had no consequence for the way in which the Films were actually marketed and released. That was only to be expected, given the unrivalled distribution expertise of the Disney group itself.

337. As to the use of threshold criteria, the Commissioners point out that implicit in that scheme was the recognition that significant decisions and activities with regard to the marketing of the chosen films had been made or undertaken before the films were brought into the Eclipse structure (and made or undertaken by the persons who it was contended would thereafter make or undertake subsequent decisions and activities in their capacity as "Designees"), so that the use of such criteria was no more than an artificial device designed to give credibility to the claim that Eclipse 35 had something of value to contribute in these areas.

338. As to the detail of the arrangements established, Mr Salter's activities under his Consultancy Agreement did not require him to take an executive part in the marketing and distribution of the Films – his role was to receive information from, or the work product of, others (such as the "Designees") and to pass that on to WDMSP Ltd and generally to act as a liaison between WDMSP Ltd, Eclipse 35 and the Buena Vista companies.

339. WDMSP Ltd itself had no capacity or ability to prepare or monitor marketing plans, and hence the arrangements with the Designee Providers to procure the Designees to perform services for WDMSP Ltd. There is no evidence that the

individuals (all employees of the respective Buena Vista companies) agreed to such arrangements, or were aware that the tasks they would otherwise carry out for those companies were carried out instead for the benefit of WDMSP Ltd under these arrangements. It is also questionable whether the Films (which were identified only after these arrangements were documented) were specifically brought within the scope of the arrangements.

340.Taking these points together, the Commissioners argue that the marketing services arrangements amounted to no more than a structure under which information was supplied to Eclipse 35 about the performance of its investment in the Films, and that the entirety of the marketing and distribution activities was carried out by the Distributor (using the Buena Vista distribution companies in accordance with normal Disney group practice). Nothing in those arrangements as they were actually carried out endowed the activities of Eclipse 35 with the character of trading.

Discussion

341.Mr Peacock made the point that, in part at least, the Commissioners' case is not directed at the case which Eclipse 35 has put forward: Eclipse 35's case is not that it was engaged in marketing and distributing the Films – it exploited the Rights it had acquired by sub-licensing them to the Distributor, and it was for the Distributor to market and distribute the Films. Eclipse 35 wished to ensure that its interests in the success of that process were taken into account, and to that end put itself in the position where it could not only monitor, but exercise supervisory control over the marketing and distribution activities carried out by the Distributor. It described its role as that of a collaborator with the Distributor in the marketing and release of the Films, and asked us to make a finding to that effect.

342.The issue therefore is whether Eclipse 35 can establish from the evidence that, collaboratively with the Distributor, it was engaged in directing and supervising the marketing and release of the Films.

343.First, we agree with the Commissioners that WDMSP Ltd cannot be regarded as an agent of Eclipse 35 despite its apparent appointment as such in Clause 1 of the Marketing Services Agreement. Mr Molner was candid enough to point out that a particular point of contention and negotiation between Future and the Disney group was the question of the responsibilities which WDMSP Ltd should owe to Eclipse 35 and those which the Disney group considered it should, as a member of that group, owe to the group, and which should prevail in the event of conflict. The drafting of the Marketing Services Agreement valiantly attempts to reconcile that point of strain, but in making that attempt undermines the fact of the agency it purports to establish.

344.It is, as Mr Gammie pointed out, the essence of the relationship of agency that the agent, when engaged on its principal's business, should, so long as it is acting within the law, act exclusively and in a fiduciary manner in the interests of its principal. This is not the case with WDMSP Ltd with respect to Eclipse 35, since there is express provision in the Marketing Services Agreement that any duties or obligations which WDMSP Ltd may have in its capacity as a Disney group member must prevail over

the duties it would otherwise owe as agent to Eclipse 35. The ambivalence of WDMSP Ltd's position is fatal to the claim that it is Eclipse 35's agent, even in respect of matters where there is apparently no conflict between its actions on behalf of Eclipse 35 and its duties as a Disney group member (the more so since there is no attempt to specify the nature and scope of such duties).

345. This in itself is not fatal to Eclipse 35's overall case, since WDMSP Ltd can provide the defined Services for Eclipse 35's benefit without doing so as agent, and that is a reasonable construction of the Marketing Services Agreement. There is certainly a valid legal distinction between the case where WDMSP Ltd acts as agent (so that, through such agency, Eclipse 35 performs the Services) and the case where WDMSP Ltd agrees to perform the Services so that their benefit enures for Eclipse 35, but in the latter case Eclipse 35 may still reasonably argue that it is engaged in the activities in question in that it has arranged for them to be undertaken for its own benefit.

346. Our difficulty lies more with the substance of what happened, even if we limit our attention to the "collaborative" involvement of Eclipse 35 which we understand to be its case. Neither Eclipse 35 nor WDMSP Ltd nor SCI had any capability whatsoever to be a part of any strategic or day-to-day planning for the marketing or release of the Films, or to monitor or supervise the Distributor's performance relative to any agreed plan. Mr Salter, with his long experience, may have had such capability (although to achieve anything of significance he would have required substantial support), but as we shall mention his role was more limited. That capability resided within the Disney group and in particular in the various Buena Vista distribution companies.

347. Eclipse 35's case is that it (or more accurately, WDMSP Ltd for its benefit) secured for itself a portion of that capability by arranging for the Buena Vista companies, the Designee Provider, to make available to WDMSP Ltd key executive staff, the Designees. Eclipse 35 points to the Initial Marketing and Release Plans, apparently an innovation, as its principal contribution to the marketing process – a key part of the pre-launch preparation of the marketing rocket, in Mr Molner's terms. Those plans, it argues, were prepared by the Designees acting for WDMSP Ltd as seconded staff. Thereafter the Designees supplied information about performance, which was packaged and reported upon by a member of the SCI team and Mr Salter to WDMSP Ltd and to Eclipse 35.

348. Although we clearly see the contractual arrangements which set up these arrangements, and had the benefit of helpful diagrams illustrating the chain of responsibilities and the chain by which information passed back and forth, what we did not have was convincing evidence that what the documents provided for was matched by what happened in fact. We saw the theory but not the practice.

349. The credibility hurdle which Eclipse 35 has to surmount is high, in that, as the Commissioners were right to point out, the Buena Vista companies would, regardless of the involvement of Eclipse 35, use their vast resources and expertise to market and distribute the Films to the best of their considerable ability. The Disney group had a

direct interest in their so doing, to maximise the Variable Distributions which flowed back as Variable Royalties to Disney, and to maximise also the likelihood of generating Contingent Receipts (60 per cent of which went to Disney). In that circumstance clear and convincing evidence is required that the Designees stepped out of their position as employees doing for their Buena Vista employer what they did on a daily basis and performed their duties instead for WDMSP Ltd. Witness evidence from one of the Buena Vista staff involved in this process would have shed light on the commercial reality of the arrangements carefully provided for in the network of documents. Evidence of that kind was not available to us.

350. Absent evidence of such kind Eclipse 35 points to three things: its initiative to produce the Initial Marketing and Release Plan for each Film; the activities of Mr Salter; and the flow of information from the Disney group in relation to the marketing and release of the Films in the different territories, and in relation to the performance of the Films.

351. As mentioned, Eclipse 35 chose films where it considered that the planning of the marketing strategy was at a stage which was not yet complete – it developed the threshold criteria to judge how far any film was from the "launch pad". This, it argued, enabled it to have a worthwhile contribution to make to that strategy, and therefore scope to insert into the strategy process an initial overall plan. Again, though, in the key question of differentiating what the Buena Vista companies did on their own behalf and what their employees did for WDMSP Ltd evidence was lacking. It was clearly not the case, in relation to each of the Films, that there had been no preparatory work undertaken by Buena Vista, before Eclipse 35 came in view, as to how the Films would be marketed to their respective target audiences – we had no evidence on the point beyond Mr Sills's surmise, but common knowledge of the extent and apparent success of Disney's marketing effort would suggest that it is most likely to engage in a sophisticated preparatory process from the earliest moment in the production life of a film. We do not know whether, in preparing the Initial Marketing and Release Plans (and we do not question that they were prepared) the Designees were simply doing, in a different format, what they would in any event do, or, indeed, were "re-packaging" material which had already been prepared by the Buena Vista companies. Eclipse 35 simply did not justify its case from the evidence it produced.

352. As to Mr Salter, he was not engaged to undertake an executive role: as he puts it in his witness statement: "My work as a consultant does not require that I participate in making decisions for the marketing and distribution of the Eclipse Motion Pictures or that I influence the way in which those activities are carried out by or on behalf of Disney. Instead, I monitor Disney's activities in relation to the Eclipse Motion Pictures and advise WDMSP on whether these are reasonable and appropriate." Elsewhere he describes his role as that of liaising between the Buena Vista companies (and in particular their international distribution staff based in London, where he himself had previously worked) and WDMSP Ltd. He was the principal means by which information flowed from those companies to WDMSP Ltd and Eclipse 35, with an SCI employee assisting him to organise and present that information. That was how he monitored the Distributor's marketing activities and performance.

353.In the course of his reports Mr Salter made comment upon the information he was delivering. On one occasion he went beyond comment: in his report to WDMSP Ltd and Eclipse 35 of 7 August 2007 dealing with the box office revenues for "Underdog" in its first week of cinema release in the United States market, in drawing attention to its disappointing performance he said: "…it might be wise to reconsider the size of the international campaign before the film is released worldwide. In some cases, I feel it may be necessary to just release the film direct-to-video, however in most countries we should continue to pursue a theatrical release, utilizing a much smaller campaign. Of course this decision should be left to the board of directors to consider, however, I feel it is of the utmost importance that a decision be made in a very timely fashion so we can instruct the distributor how to move forward." The subsequent report speaks of a new release strategy having been laid out, listing territories where the film is no longer to have a theatrical release and mentioning that in territories where it is to be released there is to be a reduced marketing budget.

354.What is not clear from the evidence before us is whether this was a particular insight on the part of Mr Salter alone, or whether he was reflecting or enlarging upon the thinking already being developed by the Buena Vista teams, with whom he was in regular contact. We mean no disrespect to Mr Salter (who is clearly very experienced in such matters, and was, in addition, a careful and modest witness) in saying that what might have occurred to him would no doubt have occurred to those more closely engaged on a full-time basis in ensuring that "Underdog" achieved the maximum revenues for the lowest distribution costs. Indeed, he suggested as much under cross-examination by Mr Gammie: Mr Salter indicated that he had discussed the matter with the head of Buena Vista in Europe: "I discussed it with him, and we were both in sync. As I say, it's an automatic exercise really, when you have a disappointment at this level." Again, this is a matter where Eclipse 35 failed to adduce the evidence – perhaps in the form of witness evidence from a Buena Vista employee – which would have established the significance, if any, to the Distributor of Mr Salter's observations and recommendations in circumstances where the Distributor (through its Buena Vista distribution arm) was in all likelihood already apprised of both the problem and the action required to mitigate it.

355.The evidence of Mr Salter in his cross-examination by Mr Gammie in relation to a second occasion when he expressed his view (concerning the problems of releasing "Enchanted" in France at the time of a transport strike) is that he and the regional chief of Buena Vista International "were pretty much in cahoots as to what we thought should be done", and that perhaps gives some further insight into the reality of the position.

356.Notwithstanding the incident in relation to the curtailed cinema release of "Underdog" (and, for the reasons given, without in any event being able to appreciate its significance) we do not consider that Mr Salter's activities establish that Eclipse 35 was, even on a collaborative basis, engaged in directing and supervising the marketing and release of the Films. Eclipse 35 cannot be said to be directing and supervising matters in circumstances where the Distributor had already come to a conclusion as to what it should do.

357.Finally, although there was undoubtedly a well-planned and well-executed regular flow of high quality and relevant information gathered by SCI and Mr Salter from the relevant Disney companies to WDMSP Ltd and Eclipse 35, with pertinent comment by Mr Salter, and although that information was considered at board meetings of WDMSP Ltd and by the Designated Members (that is, in effect, the executive Members) of Eclipse 35, that does not in itself establish the case which Eclipse 35 is asking us to accept.

358.Whilst we can conclude that, through WDMSP Ltd, Eclipse 35 monitored the activities of the Distributor with regard to the marketing and release of the Films, and was kept fully aware of the activities in that regard which the Distributor undertook and of the financial performance of the Films, we are unable to conclude that Eclipse 35 had a part, or at least a meaningful part, in directing and supervising the marketing and release of the Films by the Distributor.

The borrowing facility, deposit and security arrangements

359.We can deal with the borrowing, banking and security arrangements more briefly. We have set out in paragraphs 139 to161 above the terms of the facility, deposit and security documents. We have set out in paragraphs 183 to 241 above our further findings as to the financial terms of the transactions and the cash flows which underlie the transactions.

360.These arrangements were the subject of extensive argument between the parties, as we have already recorded.

361.The Commissioners argue that the venture upon which Eclipse 35 embarked was no more than an elaborate exercise of structured financial engineering built around a semblance of acquiring and sub-licensing film rights and all with a view to creating an interest charge for the Members for which they can claim tax relief: as such the transactions should be considered as a composite whole. They point to the cash flows which occurred on Financial Close and to the twenty year cash flows which, they say, were based on no more than a financial model driving the financial terms of the transaction over its lifetime. They argue that these are not related to the inherent value of the Rights nor to the actual financial performance of the Films, but begin with the amount of capital (borrowed and own-resource) which Members invest and end with the interest which the Members pay on their borrowings, both prepaid for years one to ten and then annually for the remaining ten years.

362.Eclipse 35 does not deny or dispute the cash flows which underlie the transactions entered into by the various parties, although it points out that they take no account of the possibility that Eclipse 35 may receive Contingent Receipts. It says, with regard to the movement of cash at Financial Close, that the issue is not how the cash moves, but why it moves as it does – that the real issue is the different rights and obligations which the parties have created or become subject to which has resulted in the movement of the cash. As to the twenty year cash flows, it says that asset-based financing, such as leasing, is formulated on financial models which fix the financial returns engendered by the investment made, and the same approach has been adopted

in this particular form of asset-based financing: that this is the case does not detract from the commercial reality of the transactions entered into. It accepts that tax relief for the interest paid on the borrowings by the Members is an objective on their part, and that the financial terms implicit in the transactions reflect that objective. It argues, first, that the motives and actions of the Members are not relevant to the issue of whether Eclipse 35 is carrying on a trade, and, secondly, that it is in any event legitimate for the Members to seek such tax relief when entering into transactions of this kind where they have borrowed funds, as that is some kind of "hedge" against the risk of the venture failing and their being exposed to repaying borrowing when there is an insufficiency of assets to meet that liability.

363. We have set out above in our analysis of the financial terms of the transactions and our analysis of the rights acquired by Eclipse 35 our conclusions on a number of issues which are aspects of these broader arguments between the parties.

364. With regard to the movement of cash on Financial Close we have concluded that the rights and liabilities created by the transaction documents cannot be ignored or in some way disregarded so as to view cash as simply passing between the various parties. The transaction documents record the commercial transactions undertaken by the various parties and their respective rights and liabilities which result from those transactions. We concluded that Eclipse 35 acquired the Rights as licensed to it in the Licensing Agreement, and that the Licence Fees (paid as the Advance on Financial Close, but subject to repayment of part on early termination) reflected the value of those Rights as agreed between Disney and Eclipse 35 having regard to the forecast financial performance of the Films. We concluded that the Members are liable on a personal recourse basis to Eagle in respect of the advance which it made to them under the facility arrangements, and that they are at risk in this regard should Barclays fail to honour the Letter of Credit.

365. These conclusions lead us to the further conclusion that the transactions should not be viewed as a composite whole, or, perhaps, viewed in a manner which disregards the effect of the commercial transactions which the transaction documents give effect to. The fact that those transactions give rise to a particular cash flow financial model, both initially and over the twenty year term of the arrangements, or even that the terms of the transactions have been negotiated between the parties within the confines of such a financial model, does not provide a basis for treating the parties – and in the present case, Eclipse 35 in particular – as though they had not entered into the commercial transactions in question or had entered into them for a purpose divorced or different from their commercial effect.

366. As Mr Molner described it, in any asset-financing transaction of this kind there is, in reaching a concluded deal, a constant interplay between, on the one hand, the overall financial shaping of the transaction, which will be governed by a financial model which, in one way or another, is designed to deliver the investor a certain return on his investment and, on the other hand, the terms of the commercial transaction which the parties are prepared to agree having regard to such matters as the values they attribute to the relevant assets and income stream, the amount of available capital, the profit margin they require, the nature and cost of security which

is to be provided, and other factors of that kind, all of which will be a matter of negotiation. That, we are prepared to accept, is the process which was at work in Eclipse 35's case, and which resulted in a transaction which achieved certain consequences by reference to a financial model whilst meeting the negotiated requirements of the parties in entering into the commercial arrangements upon which they were intent.

367. Therefore whilst the cash flows resulting from the transactions can be said to be fundamental to Eclipse 35's participation in the arrangements it entered into, in that Eclipse 35 would not have entered into those arrangements if they did not result in those cash flows, it does not follow that the arrangements do not have the commercial purpose or effect which on their face they purport to have.

The parties' submissions on the law and our analysis of the legal issues for our decision

368. In this section we record the parties' legal submissions in summary and our analysis of the legal issues for our decision.

369. The following four propositions were agreed between the parties.

370. First, that the task of the Tribunal is to form a view on whether what Eclipse 35 actually did amounted to a trade or adventure or concern in the nature of trade. This emerges from various authorities, for example per Lord Morris of Borth-y-Gest in *Ransom v Higgs* 50 TC 1 at 84 – "it seems to me to be essential to discover and to examine what exactly it was that the person did".

371. Secondly, that our examination of what Eclipse 35 actually did must view the matter in the context of transactions taken as a whole, or, as Lord Templeman put it in *Ensign Tankers (Leasing) Ltd. v Stokes* [1992] STC 226 at 235/6, we must ascertain the fiscal consequences corresponding to the legal consequences of the scheme documents read and construed as a whole. We would only add that all the evidence of what Eclipse 35 actually did, which includes but is not limited to the licensing, distribution and marketing services documents, is clearly relevant.

372. Thirdly, that a tax avoidance motive (or scheme) incorporated within what is otherwise a trading transaction does not "de-nature" the transaction so that it is for that reason no longer a trading transaction (see, for example, per Lord Jauncey of Tullichettle in *Ensign Tankers* (*ibid* at 247) where he said that he did not consider that *FA and AB Ltd v Lupton* had that result).

373. Fourthly, that a financial model was produced which reflected the cash flows which were the product of what the parties had agreed in the documents entered into and that those cash flows were an important part of the transactions as a whole, giving a tax advantage to the Members of Eclipse 35 in the earlier years, and reversing over time.

374.Mr Peacock, in arguing the case for Eclipse 35, suggested that, at a "fairly high level of generality", we should look simply at what Eclipse 35 did, standing back and asking ourselves "Does that look like a trade?" Anticipating a positive answer to that threshold question, he suggested that we ought then to go deeper into the detail to "find good reasons why what at first glance looks like a trade is not, for some reason, as a matter of law, a trade".

375.He suggested this as a convenient approach, rather than one which we were bound by any authority to take. For the Commissioners, Mr Gammie unsurprisingly did not endorse that approach and we reject it. It seems to us that it is for Eclipse 35 to persuade us, having regard to all the evidence, and in a "one-step" process, that what it actually did was trade or engage in an adventure or concern in the nature of trade.

376.Mr Peacock submitted that the method(s) adopted by partners in a partnership to raise money to contribute as capital to the partnership cannot have any bearing on whether what the partnership actually did amounted to a trade. He referred in support to a passage in the judgment of Millett J in *Ensign Tankers* ([1989] STC 705) at 762-3 as follows:

> "In considering the purpose of a transaction, its component parts must not be regarded separately but the transaction must be viewed as a whole. That part of the transaction which is alleged to constitute trading must not be viewed in isolation, but in the context of all the surrounding circumstances. But this must mean all relevant surrounding circumstances; that is to say, those which are capable of throwing light on the true nature of the transaction and of those aspects of it which are alleged to demonstrate a commercial purpose.
>
> If the purpose or object of a transaction is to make a profit, it does not cease to be a commercial transaction merely because those who engage in it have obtained the necessary finance from persons who are more interested in achieving a fiscal advantage from their investment. Even where the trader is the creature of the financier, the two activities are distinct and the object of one is not necessarily the object of the other.
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> In *FA & AB Ltd v Lupton*, Lord Morris said ([1972] AC 634 at 647; 47 TC 580 at 620):
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> > *'It is manifest that some transactions may be so affected or inspired by fiscal considerations that the shape and character of the transaction is no longer that of a trading transaction. The result will be not that a trading transaction with unusual features is revealed but that there is an arrangement or scheme which cannot fairly be regarded as being a transaction [in the nature of trade].'*
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> In my judgment this is the true significance of a fiscal motive. Fiscal considerations naturally affect the taxpayer's evaluation of the financial risks and rewards of any proposed venture, and are often the decisive factor in persuading him to enter into it. First-year allowances, enterprise zones, government grants and the like operate as financial inducements to businessmen to engage in commercial

> activities which would be financially unattractive or unacceptably speculative without them. Such motivations, even if paramount, do not alter the character of the activities in question. But while a fiscal motive, even an overriding fiscal motive, is irrelevant in itself, it becomes highly relevant if it affects, not just the shape or structure of the transaction, but its commerciality so that, in Lord Morris's words, 'the shape and character of the transaction *is no longer that of a trading transaction*'. But nothing less will do.
>
> Accordingly, in my judgment, and adapting the words of Lord Simon in *Thomson v Gurneville* ([1972] AC 661 at 679; 47 TC 633 at 679), the question is whether, in the light of all the relevant circumstances, the transaction is capable of being fairly regarded as a transaction in the nature of trade, albeit one intended to secure a fiscal advantage or even conditioned in its form by such intention; or is incapable of being fairly so regarded but is in truth a mere device to secure a fiscal advantage, albeit one given the trappings normally associated with trading transactions."

377. We did not understand Mr Gammie to disagree with anything in this citation. His response was that before one gets to the question of whether a tax avoidance motive "de-natures" a trading transaction (which he accepted it does not) there is a prior question, namely whether in fact the transaction in issue is a trading transaction at all and that prior question is addressed by examining the context in which Eclipse 35 undertook its transactions, which brings in a consideration of how Eclipse 35, and its Members, raised the funds which enabled Eclipse 35 to entered into the Licensing Agreement.

378. Mr Gammie's submission was that the reality of the transaction ("the transaction viewed realistically" in the words of Ribeiro PJ in *Collector of Stamp Revenue v Arrowtown Assets Ltd* [2003] HKCFA 46 at [35], cited with approval by the House of Lords in *Barclays Mercantile Business Finance Ltd v Mawson* ("*BMBF*") [2005] STC 1 at [36]) was that it implemented "a sophisticated financial model developed by [Future]" which was designed on the assumption that the Members of Eclipse 35 borrowed a specific portion (94%) of their capital contribution to Eclipse 35 to enable them to shelter "tax negative reversing sale and leaseback cash flows". That is, as we have mentioned, that the tax relief on the prepayments of interest envisaged under the financial model would shelter the significant income arising from the working out of earlier and unrelated sale and leaseback arrangements the Members had individually entered into. This was the context in which Mr Gammie invited us to examine what Eclipse 35 actually did.

379. Mr Peacock accepted that we must look at what Eclipse 35 did in context – with the *caveat* that that does not extend to the personal motivations of the Members or their personal financial positions. He submitted that what Eclipse 35 did "looks like a trade"'. He summarised what Eclipse 35 did as contracting with Disney to license in rights, contracting with the Distributor to license out rights, thereby ensuring that there are going to be streams of income coming in from the Distributor, swapping Disney credit risk for bank credit risk in relation to the AODs and employing the marketing services arrangements to ensure that its interests are best protected.

380.Mr Peacock referred us to the decision of the House of Lords in *Ensign Tankers* and the later decision of the Court of Appeal in *New Angel Court Ltd v Adam* [2004] STC 779. In *New Angel Court* at [92] Jonathan Parker LJ (with whom the other members of the Court agreed) referred to Lord Templeman's speech in *Ensign Tankers* and noted that he had been able to conclude that the composite transaction in that case was (at least in part) a trading transaction "whatever its design". Lord Templeman identified a trading transaction in *Ensign Tankers* because the partnerships in that case expended capital in the making and exploitation of films. Referring to Victory Partnership, he said (*ibid.* at 243-4):

> "In the present case a trading transaction can plainly be identified. Victory Partnership expended capital in the making and exploitation of a film. That was a trading transaction which was not a sham and could have resulted in either a profit or a loss. The expenditure of $3,250,000 was a real expenditure. The receipts of $3,000,000 were real receipts."

381.Mr Peacock submitted that objectively judged, what Eclipse 35 entered into was, in the same way, a series of transactions which constituted a trade. He invited us to reach this conclusion by four "routes". The first was the case law route. The second was the statutory construction route, by which he submitted that section 362 TA 1988, properly construed, provides for relief for interest where money is borrowed to invest in a partnership carrying on a trade and that it followed that the mere fact of borrowing money or paying interest could not be sufficient to support the conclusion that the partnership was not carrying on a trade. He supported this proposition by reference to Lord Morris's speech in *FA & AB Ltd* where he said (*ibid.* at 617-618):

> "One trading transaction may result in a profit. Another may result in a loss. If each of these, fairly judged, is undoubtedly a trading transaction its nature is not altered according to whether from a financial point of view it works out favourably or unfavourably. Nor is such a transaction altered in its nature according to how the revenue laws determine the tax position which results from the financial position."

382. We note, however, that Lord Morris, later in his speech, addressed the position where there was doubt about the trading character of a transaction. He said, with reference to the earlier case of *J P Harrison (Watford) Ltd v Griffiths* 40 TC 1 (*ibid.* at 619-620) that:

> "The transactions in the *Harrison* case not only had all the characteristics of trading: there was no characteristic which was not trading. There was nothing equivocal. There was no problem to be solved as to what acts were done. To the question *quid actum est* there could be but one answer. The question *quo animo* was irrelevant. As Lord Reid said in giving the judgment of the Board in *Iswera v Commissioner of Inland Revenue* [1965] 1 WLR 663 (PC) (at page 668):
>
> > '*If, in order to get what he wants, the taxpayer has to embark on an adventure which has all the characteristics of trading, his purpose or object alone cannot prevail over what he in fact*

does. But if his acts are equivocal his purpose or object may be a very material factor when weighing the total effects of all the circumstances.' "

383.Mr Peacock's third route was to recognise that interest is a cost of capital and the fact that capital has been raised in a particular way and on particular terms, whether borrowed, not borrowed, at interest, not at interest, at interest in arrear or at interest in advance or with prepayment of interest cannot have any bearing on the question of whether the activity conducted with the use of capital so raised is a trade or not.

384.Mr Peacock's fourth route was to recognise that Eclipse 35 was a legal entity separate from its partners, under the Limited Liability Partnerships Act. By section 863 ITTOIA 2005 there is an imputation of the activities of the partnership to the partners, but no imputation of the acts of the partners to the partnership.

385.In Mr Peacock's submission all these 'routes' led to the conclusion that the motives and acts of the Members of Eclipse 35 can have no bearing on the question at issue, whether Eclipse 35 itself was trading.

386.Mr Peacock also placed some reliance on the similarities of the transactions undertaken by Eclipse 35 to a film sale and leaseback, noting that the Commissioners in the Business Income Manual (as then in force) at para. 56455 accepted that where a partnership "of wealthy individuals" purchases a master version of a film from a film production company and immediately leases all the rights of the film back to the film production company for a period of 15 years, the partnership will be carrying on a trade of exploitation of master versions of films.

387.Mr Gammie however sought to distinguish the transactions in this case from that type of film sale and leaseback, contending (as we have already discussed) that Eclipse 35 did not acquire any significant rights under the Licensing Agreement, and that if it did, by the Distribution Agreement, Eclipse 35 had for practical purposes parted with everything it had so acquired. Instantaneously Eclipse 35 received rights in the Films and gave those rights back. All Eclipse 35 retained was a share of Contingent Receipts, and, rather than trading, Eclipse 35 merely bought into a contingent future possible receipt. Normally, Mr Gammie said, the lessor in a sale and leaseback transaction is left with ownership of the leased asset. That is not the position in these transactions. Further, Eclipse 35 had not claimed that it was carrying on a financial trade, but instead a trade of exploiting films. In the *BMBF* case, although Mr Gammie recognised that "probably quite similar cash flows and financial modelling could be done in relation to the activity there", nevertheless the taxpayer in that case was not a special purpose vehicle set up for the purpose of implementing a financial model, but one of the largest finance lessors in the country for whom the transaction in issue, with the Irish Gas Board, was no more than an everyday incident of its ordinary business of providing finance by means of leasing.

388.In response to this point Mr Peacock observed that the Commissioners have not hitherto contended that a single asset lessor (for example a lessor of an aircraft or a ship where there is only one asset in a company, for liability reasons and to avoid sister vessel arrest) is not engaging in a leasing trade. He did not accept that the

combined effect of the Licensing Agreement and the Distribution Agreement was that Eclipse 35 obtained rights and gave them back. He submitted that Eclipse 35 was the grantee of rights under the Licensing Agreement and the grantor of rights under the Distribution Agreement, subject to the rights and obligations of the respective parties to those two agreements. He also submitted that it was impermissible in law to assume that there was a single composite transaction which denied the purpose and effect of each of the agreements, albeit that they were entered into at about the same time and designed to fit together

389.Mr Gammie submitted that Eclipse 35 had engaged in financial modelling to which there had been an attempt to plug in a film effectively to confer on the activity the characteristic of trade. Eclipse 35 was buying from Disney in consideration of the Studio Benefit what was effectively the facade of trade. Disney would always produce and distribute the Films in "the Disney way" without any effective interference from Eclipse 35. The profits from the transactions were not the profits of a trade. They were instead the profits of the financial modelling arrangement, which could be characterised as profits from property, akin to an annuity, where a lump sum is paid on day one and in return a stream of income is received. He recalled that the distinction between the charge to tax on profits arising from property and profits or gains arising from trade has been a feature of our taxation system since earliest times.

390.Mr Gammie also drew our attention to section 609 ITTOIA 2005, which provides for a charge to income tax on income from a business involving the exploitation of films or sound recordings where the activities carried on do not amount to a trade (a "non-trade business"). He also referred to section 687 ITTOIA 2005 under which income tax is charged on income from any source not otherwise so charged. His submission was that Parliament contemplated the possibility that income from the exploitation of films could indeed be income from a "non-trade business".

391.We have already referred in some detail above to the submissions of the parties as to the effect and significance of the marketing services arrangements: it is sufficient to note here that the tenor of Mr Gammie's arguments was that the peripheral type of activity undertaken by WDMSP Ltd in carrying out those arrangements did not lend any credence to the idea that Eclipse 35 was trading. Mr Peacock's response, in summary, was that through those arrangements Eclipse 35 had a real interest in, and a real ability to influence, the exploitation of the Films, so that the exploitation of the Rights by the grant of the sub-licence to the Distributor was thereby a matter in which Eclipse 35 had an active involvement.

392.Eclipse 35's entitlement to Contingent Receipts represented the only income stream which Eclipse 35 might receive which reflected the success of the Films. As Mr Peacock put it, the Contingent Receipts entitlement reflected Disney risk and film risk. Mr Gammie made the point that it could not be said of Contingent Receipts that they were (or would be, if they materialised) payments received from customers – which is what one might expect if they were trading receipts. His submission was that if any Contingent Receipts materialised they would represent an additional return from the financial model which Eclipse 35 was implementing – effectively additional investment income. He suggested (as we have referred to above in some detail) that

there was not any significant real value or content to what was promised in the way of Contingent Receipts.

393.In relation to the second issue for our decision, whether, if we find that Eclipse 35 carried on a trade, it did so with a view of profit, Mr Gammie pointed out that Lord Reid in *Harrison* had said that earlier cases had established that operations of the same kind as, and carried on in the same way as, those which characterise ordinary trading should be held to be trading even though there was no intention to earn a profit (*ibid.* p.295). It followed from that that the question of whether Eclipse 35's trade (if we found there to have been one) was carried on with a view to profit was a separate question.

394.As regards the main issue for our decision, in our discovery and examination of what exactly it was that Eclipse 35 did, the question of law is whether Eclipse 35 can rely on the legal effect of the agreements it entered into in order to oblige the Tribunal to conclude that it was conducting a trade (construing the statutory concept of trade purposively), or whether on the contrary we should accept (in favour of the Commissioners) that that is an unrealistic view on the facts having regard to the true legal effect of the agreements Eclipse 35 entered into, viewed in their proper context of transactions designed to give the pre-determined cash flows we have explained above. If we decide that question of law in favour of Eclipse 35, we must go on to decide what the trade was and whether Eclipse 35 was carrying it on with a view to profit. If, on the other hand, we decide that question of law in favour of the Commissioners, we will (although, it would perhaps not be strictly within our remit to do so) state our conclusion as to the character of the transactions for tax purposes.

Conclusions on the issue of whether Eclipse 35 was carrying on a trade

395.We consider, in agreement with Mr Peacock, that the manner in and extent to which the Members of Eclipse 35 financed themselves to contribute the necessary capital to Eclipse 35 is extraneous to whatever it was that Eclipse 35 did. Also, we have concluded that the banking and security arrangements entered into by Barclays and Eagle involving the Members, Disney and the Distributor are similarly extraneous to what Eclipse 35 did. We have rejected (see paragraph 364 above) the Commissioners' contention that Eclipse 35 is to be treated as not having acquired the Rights or sub-licensed them at all, or that the Rights had no significant value.

396.What Eclipse 35 did was to enter into the Partnership Consultancy Agreement with Future (on 3 October 2006), the Marketing Services Agreement with WDMSP Ltd (on 9 February 2007) and, most importantly, the Licensing Agreement with Disney and the Distribution Agreement with the Distributor (both on 3 April 2007). These transactions had legal effect according to their terms.

397.In ascertaining whether Eclipse 35 was carrying on a trade, we examine these transactions. The relevance of the Members' financing arrangements and the banking and security arrangements entered into by Barclays and Eagle is that they are part of the context in which Eclipse 35 entered into the transactions identified. As we take a realistic view of the facts of this case, these facts, which (as we have said) are

extraneous to "what exactly it was that Eclipse 35 did", may, as part of the context, indicate why the transactions referred to in paragraph 396 above were entered into by Eclipse 35. We will have to decide whether these extraneous facts affected the commerciality of what Eclipse 35 did with the consequence that "the shape and character of the transaction is no longer that of a trading transaction" (see: per Millett J in *Ensign Tankers* [1989] STC at 763). We return to this point below (at paragraph 412).

398. A purposive construction of the concept of "trade" as that word is used in the Corporation Tax Acts must take account of the definition in section 832(1) TA 1988 – that it "includes every trade, manufacture, adventure or concern in the nature of trade". We note that Lord Templeman in *Ensign Tankers* stated that the transaction which Victory Partnership entered into in that case (which he accepted was a trading transaction) "was not a sham and could have resulted in either a profit or a loss" ([1992] STC at 243). We also note that Lord Reid in *Iswera* used the expression "an *adventure* which has all the characteristics of trading" (our emphasis) to describe an activity which comes within the category of "trade" for relevant purposes ([1965] 1 WLR at 668). We consider that an element of speculation is a characteristic of the concept of trade – if a taxpayer is trading, what he does must, normally at any rate, be speculative in the sense that he takes a risk that the transaction(s) may not be as profitable as expected (or may indeed give rise to a loss).

399. In *Ransom v Higgs*, Lord Wilberforce said (in the context of identifying a trade) that "there must be something which the trade offers to provide by way of business" and that, as a norm, "trade ... presupposes a customer" (50 TC at 88). He also said that "everyone is supposed to know what 'trade' means" and that the best the Court can do is to apply the general characteristics of trade to a novel set of facts in order to see how near to, or far from, the norm the facts are (*ibid.*).

400. Eclipse 35's case is that the sub-licence to the Distributor of the rights acquired from Disney in consideration of specified periodic payments over twenty years which ensured over that period profits for Eclipse 35, together with the possibility of receiving Contingent Receipts, had the profit-making character necessary for it to be recognised as a trading transaction. Of course Mr Peacock also prayed in aid the marketing services arrangements which Eclipse 35 entered into with WDMSP Ltd, but we have concluded (at paragraph 358 above) that these did not, as a matter of fact, endow the activities of Eclipse 35 with the character of trading. In argument, however, Mr Peacock was clear that the acquisition and sub-licence of the Rights, looked at alone, was sufficient to support, even compel, the conclusion that Eclipse 35 was trading.

401. There is no doubt that the sub-licence has produced and can be expected to continue to produce profits for Eclipse 35 (see for example the audited financial statements for the periods ended 5 April 2008, 2009 and 2010 referred to at paragraphs 193 to 195 above). Disregarding for the moment the question of Contingent Receipts, the profit over a twenty year period, year by year, is determined at the outset, and is determined without any reference to the success or otherwise of the exploitation of the Rights sub-licensed. In these circumstances we cannot

realistically regard the profit as the speculative profit of a trading venture consisting of the exploitation of film rights. We accept that Eclipse 35 has taken the commercial risk that Barclays may not meet its liabilities under the Letter of Credit so that payments directly corresponding to the AODs might not be received (although it should be noted that the substitution of Barclays was a credit-enhancement arrangement designed to minimise the risk that Eclipse 35 would not receive the AODs). But the risk of Barclays not meeting its liabilities under the Letter of Credit (certainly as viewed as at 3 April 2007 but also as viewed at all times thereafter) is too remote to cause the pre-determined profit to be speculative in any relevant sense. In addition, and importantly, that risk is not associated with the acquisition and exploitation of the rights in the Films (the trade Eclipse 35 claims to be carrying on); it is associated with the solvency of Barclays, which is a factor as far removed from what Eclipse 35 actually did as the Members' financing arrangements.

402.The Contingent Receipts are the only element of the income streams which Eclipse 35 has bargained for which is affected by the performance of the Films in consequence of their exploitation. Although obviously the prospect of Eclipse 35 actually receiving any Contingent Receipts, while being possible, was highly speculative – and made more speculative by the fact that the Films were "cross-collateralised" as described above – it was in our judgment (as we have stated at paragraph 314 above) so remote as to make wholly unrealistic a conclusion that the entitlement to Contingent Receipts under the sub-licence of the rights in the Films gave the sub-licence the character of a trading transaction. Mr Molner's evidence (paragraph 312 above) was that no-one would be advised to invest in film rights by reference only to the prospect of what might be delivered by a participation such as the Contingent Receipts in this case. The truth of that is seen in the financial illustrations which were given to potential investors when the arrangements were marketed, since those illustrations disregarded the prospect of Contingent Receipts in presenting an internal rate of return which was considered by Future to render the investment attractive even if an investor did not wish to borrow part of the capital intended to be contributed (see paragraph 112 above). The prospect of Eclipse 35 receiving anything from Contingent Receipts was clearly at all times considered by everyone involved as a "bonus" rather than as a profit to be reasonably expected from entering into the acquisition and sub-licence transactions.

403.For these reasons we conclude that the transactions entered into by Eclipse 35 did not have the speculative aspect which we would expect to see in trading transactions.

404.We now turn to consider what the transactions offered to provide by way of business, and if there was any discernible customer (*cf* Lord Wilberforce's comments in *Ransom v Higgs* referred to at paragraph 399 above).

405.The acquisition by licence and the sub-licence of the Rights were not sham transactions and we have concluded (see paragraphs 289 and 320 above) that they had effect according to their terms and that the Rights were real and meaningful. The fact remains, however, that the Licensing Agreement and the Distribution Agreement are co-terminous and were intended to be (and were) entered into concurrently. They were also interdependent, in the sense that Eclipse 35 could enter into the Licensing

Agreement only if it entered into the Distribution Agreement: it could acquire a licence of the Rights only if it sub-licensed them on the specified terms to the Distributor (and it also denied itself the right to do anything else whatsoever, without Disney consent).

406. Also relevant to the question of what the transactions offered to provide by way of business is the provision that Eclipse 35 would never receive actual physical delivery of the physical manifestation or representation of the Films. By clause 8 of the Licensing Agreement, Disney contracted to provide physical delivery of the Films to Eclipse 35 by delivery of the relevant prints and negatives to a specified laboratory to be held to the account of the Distributor. Also, the provisions for termination of both agreements effectively dove-tail so that it is unrealistic to assume that either agreement could have any effective life beyond the life of the other. In addition, Eclipse 35's acceptance that the Distributor may act in the best interests of the Disney group which may not be in the best interests of Eclipse 35 is relevant to this question.

407. As we have already concluded in relation to the marketing services arrangements, the capability of strategic and day-to-day planning for the marketing and release of the Films was within the Disney group.

408. In these circumstances it is difficult to see what services Eclipse 35 realistically offered to provide to the Disney group by way of business. Eclipse 35 did sub-license the Rights to the Distributor, but it had acquired the self-same Rights a moment previously from Disney, and had acquired them on terms whereby they would be so sub-licensed. Eclipse 35's case is (and has to be) that the Distributor was its customer, but we consider it is unrealistic to conclude that this was so on any meaningful basis.

409. The Commissioners contend that the real effect of the Licensing and Distribution Agreements is that in consideration of the Studio Benefit of £6 million, Disney provided to Eclipse 35 the opportunity to participate in the arrangements and the speculative right to Contingent Receipts. Whilst we accept Mr Gammie's submission that the cash flows set up by the transactions were fundamental to Eclipse 35's participation in the arrangements, we do not endorse this submission in the broad sense of characterising the transactions in this way. It is sufficient for us to conclude that on a realistic view of the facts – that is, on any commercially meaningful basis – Eclipse 35 had no "customer" and did not offer to provide any goods or services by way of business. The acquisition and sub-licence of the Rights by Eclipse 35, although having legal effect according to their terms, cannot be characterised realistically as the provision of services by Eclipse 35 to Disney by way of business, any more than the money paid into the bank account to the credit of Victory Partnership by LPI in *Ensign Tankers* could be characterised as a loan (*cf ibid.* per Lord Goff at 246).

410. These considerations plainly point to the conclusion that Eclipse 35 was not trading. Another factor pointing in the same direction is the conclusion we have reached that the amount of AODs payable to Eclipse under the Distribution Agreement was reduced below the level payable under the earlier Eclipse tranches

(which broadly represented interest and principal payable over the lifetime of the transaction) by reference to the special feature of the Eclipse 35 transaction, which was the prepayment of interest (see above at paragraphs 200 to 205). This demonstrates that the quantum of the putative trading receipts of Eclipse 35 was affected by the extraneous factor of the financing arrangements of the Members, which highlights the unreality of regarding them as trading receipts at all.

411.We have also to consider whether the Licensing Agreement and the Distribution Agreement can be regarded as trading transactions on the analogy of a sale and leaseback transaction. We conclude that they cannot be so regarded. Where the purchase of an asset by a lessor on terms that it is leased back by a finance lease is properly to be regarded as a trading transaction, the essence of the trade is the provision of finance by the lessor. Although sometimes called a leasing trade, it is in reality a financial trade. In the case of a single asset lessor (referred to be Mr Peacock – see at paragraph 388 above) we consider that the usual case is that the financial trading activities of the group, consortium or other association to which a single asset lessor may belong, effectively endow the leasing activities of the lessor with the characteristics of a financial trade. In this case, Eclipse 35 does not claim to be carrying on a financial trade and in any case did not provide finance. It is unrealistic to regard the payment of the Studio Benefit as the provision of finance for a consideration. In addition, a trade of acquiring and exploiting film rights would, we consider in agreement with Mr Gammie, usually involve the retention by the trader of some residual film rights having commercial reality – the example given in para. 56455 of the Commissioners' Business Income Manual (*cf* paragraph 386 above) seems to have that premise. Here, Eclipse 35 effectively and realistically sub-licensed to the Distributor everything it acquired from Disney. The right to Contingent Receipts can be ignored for this purpose because it had insufficient commercial significance.

412.We return to the question of whether the Members' financing arrangements and the banking and security arrangements entered into by Barclays and Eagle affected the commerciality of what Eclipse 35 did with the consequence that "the shape and character of the transaction is no longer that of a trading transaction" (see: per Millett J in *Ensign* [1989] STC at 763). This is the question posed by *Lupton v FA and AB Ltd* 47 TC 580. We do not go so far as to conclude that, even having regard to the context in which Eclipse 35 did what it did, Eclipse 35's "paramount object" was to procure a tax advantage for the Members (*cf ibid.* at 631, 632 per Lord Donovan). This is not a case where Eclipse 35 has entered into transactions having "elements of trading" but which, viewed as a whole, cannot fairly be regarded as a trading transaction (*cf ibid.* at 598 per Megarry J, approved by Lord Morris *ibid.* at 621, Lord Guest *ibid.* at 623 and Lord Simon of Glaisdale *ibid.* at 631). Eclipse 35's paramount object was to obtain the returns inherent in the Distribution Agreement. We agree with Mr Gammie that what Eclipse 35 actually did was not a trading transaction at all. But equally, what Eclipse 35 actually did is not to be characterised, on the authority of *Lupton*, as a mere device to secure a fiscal advantage.

413.We conclude for the reasons given above that Eclipse 35 cannot rely on the legal effect of the agreements it entered into to show that it was conducting a trade.

414.We regard the activities of Eclipse 35 viewed realistically as amounting to a business involving the exploitation of films which does not amount to a trade (a "non-trade business" within section 609 ITTOIA, giving that concept a purposive construction).

415.We add that if we had concluded that Eclipse 35 was trading we would also have concluded, having regard to the terms of the Licensing Agreement and the Distribution Agreement, that it was carrying on a trade of the acquisition and exploitation of film rights and that it was carrying on that trade with a view to profit.

416.The Commissioners urged us to decide the further question of whether monies borrowed by the Members were monies used for the purposes of Eclipse 35's trade (assuming it were carrying on a trade). In view of our decision that Eclipse 35 was not carrying on a trade this is not a matter we need to decide. In any event it is not a matter which we consider should be determined in these particular proceedings. It relates to any claim which the Members might make for relief for the interest they have paid and as such is a matter which they, and not Eclipse 35, should argue. We are aware that the same might be said of the issue as to whether Eclipse 35 is carrying on its trade (assuming that to be the case) with a view to profit, but in the circumstances of this case we regard that issue as an adjunct to the issue of whether it is so carrying on a trade and hence have expressed our conclusion on the point.

417.For the reasons given we dismiss the appeal.

Right to apply for permission to appeal

This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to "Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)" which accompanies and forms part of this decision notice.

EDWARD SADLER

TRIBUNAL JUDGE

JOHN WALTERS, QC

TRIBUNAL JUDGE

RELEASE DATE: 20 April 2012

Authorities referred to in skeletons or argument and not referred to in the decision:

Ex p White, re Neville *(1871)* LR 6 Ch App 397

Joachimson v Swiss Bank Corporation [1921] 3KB 110

Snook v London and West Riding Investments Ltd [1967] 2QB 786

Garnac Grain Co v HMF Faure & Fairclough Ltd [1968] AC 1130

Overseas Containers (Finance) Ltd v Stoker 61 TC 473

Antaios Compania Naviera S.A. v Salen Redierna A.B. [1985] AC 191

Libyan Arab Bank v Bankers Trust Co. [1989] 1QB 728

Consolidated Goldfields plc v IRC; Gold Fields Mining and Industrial Ltd v IRC [1990] STC 357

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BCCI v Ali [2002] 1 AC 251

Tower MCashback LLP 1 and another v HMRC [2008] STC 3366

Re Sigma Finance Corp (In administration) [2010] 1 All ER 571

HMRC v Halcyon Films LLP [2010] STC 1125

HMRC v Micro Fusion 2004-1 LLP [2010] STC 1541

Icebreaker 1 LLP v HMRC [2011] STC 1078

HMRC v Tower MCashback LLP 1 and another [2011] UKSC 19