

**IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT**

No. 13755 OF 2009

**IN THE MATTER OF
CGNU LIFE ASSURANCE LIMITED**

-and-

**IN THE MATTER OF
COMMERCIAL UNION LIFE ASSURANCE COMPANY LIMITED**

-and-

**IN THE MATTER OF
AVIVA LIFE AND PENSIONS LIMITED
(FORMERLY NORWICH UNION LIFE & PENSIONS LIMITED)**

-and-

**IN THE MATTER OF
NORWICH UNION LIFE (RBS) LIMITED**

-and-

**IN THE MATTER OF THE
FINANCIAL SERVICES AND MARKETS ACT 2000**

**NOTE ON BEHALF OF POLICYHOLDER ADVOCATE
REGARDING SHAREHOLDER VALUE & IRR**

1. Given the lack of specific information in the FSA's second report, it is difficult to judge how the crucial question of shareholder value has been addressed. In particular, the FSA has not disclosed its methodology for calculation of the IRR of the Reattribution or the specific ranges or the comparators or criteria it has used to judge whether the projected IRR is acceptable. However, there is one central issue that does emerge from the report (and which is relied on in the Submissions of Aviva) and that is of serious concern to the PHA.

2. The FSA has said in paragraph 79 of their second report that:

'An important factor in calculating the IRR ... is the projected level of new business sales. ... this is because the effect of such sales is to tie up capital within these funds ... as a result, the projections of expected future distributions from the RIEESA to shareholders ... are sensitive to the level of new business. A substantial reduction in new business could allow capital to be paid out of the RIEESA to shareholders ... sooner than otherwise.'

3. The PHA is concerned that this paragraph betrays a serious error of analysis on the part of the FSA. In summary, this is because the IRR generated by Aviva from the Reattribution transaction is not affected by the amount of new business that is written after the reattribution. The decision to write new business (or to invest in anything else) is a subsequent investment decision that is independent of the Reattribution and that can be expected to be taken by the company on the basis of maximising shareholder value.

4. In simple terms, the IRR of the Reattribution will be calculated by comparing the cost of the deal to the shareholders (essentially the PIP plus transaction costs) with the anticipated additional returns from the transaction (the flow of funds out of the RIEESA under current projections).

5. For this purpose, any decisions as to how the funds are used by the company, except to the extent that they are subject to a legal or regulatory obligation to the contrary, can be expected to increase rather than to damage shareholder value.

6. It follows that it would be wrong in principle to make any downward adjustment to take account of possible future investment decisions. A voluntary decision to invest capital once it is 100% owned by shareholders will be driven by projected shareholder returns, and investments will only be made if they are expected to return more than the company's hurdle rate of return.

7. This applies equally to decisions whose effect would be to lock in additional capital as a result of a new business sale. Unless the company is under a legal or regulatory obligation to make such investments on uncommercial terms (which it is not), any such investments will only be made if they are expected to enhance, and not detract from shareholder value.
8. It follows that it can only be assumed that the company will engage in new business (with its inherent effect of locking in additional capital) if the overall effect of the transaction will be to enhance shareholder value.
9. As a result, if the FSA has indeed made a reduction in the projected IRR to take into account new business projections on the basis described in paragraph 79, it will have made a basic error of analysis - after the Reattribution, the company will have no incentive and will be under no obligation to engage in new with-profits business otherwise than on a basis that enhances overall shareholder value.
10. The importance of this issue for the present proceedings is, of course, that the FSA has relied on its IRR calculation to assess the overall fairness of the deal. If, as appears to be the case, the IRR calculation has been made on the wrong basis, using this incorrect IRR could make any conclusions about fairness unsafe.

RHODRI THOMPSON QC

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Wilberforce Chambers,
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16 September 2009

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