

Applicants
Gillian Eleanor Bruce
Fifth
"GEB5(A)" and "GEB5(B)"
19 July 2017

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

CR-2009-000052

IN THE MATTER OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)
AND
IN THE MATTER OF THE INSOLVENCY ACT 1986

**FIFTH WITNESS STATEMENT OF
GILLIAN ELEANOR BRUCE**

I, **Gillian Eleanor Bruce**, of PricewaterhouseCoopers LLP, 7 More London Riverside, London, SE1
2RT, state as follows:

- 1 I am a licensed insolvency practitioner and a director with PricewaterhouseCoopers LLP
(**PwC**), a professional services firm at the above address. I am, together with Steven Anthony
Pearson, Derek Anthony Howell, Anthony Victor Lomas and Julian Guy Parr, one of the
current joint Administrators (the **Joint Administrators**) of LB Holdings Intermediate 2 Limited
(in administration) (**LBHI2** or the **Company**), a company within the Lehman Brothers group of
companies, and registered in England and Wales with company number 05957878.
- 2 All the Joint Administrators are licensed to act as insolvency practitioners by the Institute of
Chartered Accountants in England and Wales. I make this statement on behalf of the Joint
Administrators and I am authorised to do so by the other Joint Administrators.
- 3 Save where the contrary is stated, the facts and matters set in this witness statement are
within my own knowledge and are true. To the extent that they are not within my knowledge,
they are true to the best of my information and belief, being facts and matters learned as a

result of work undertaken by me as Joint Administrator, or provided to me by PwC colleagues involved with the administration of the Lehman Brothers group.

- 4 There is now produced and shown to me marked "GEB5(A)" a paginated bundle of true copy documents to which I make reference in this statement. References to page numbers in this statement are to the page numbers in that bundle. Separately, there is also produced and shown to me marked "GEB5(B)" a paginated bundle of documents which are commercially sensitive and in respect of which an order pursuant to Rule 12.39(9) of the Insolvency Rules 2016 (the **Rules**) will be sought.
- 5 I make this statement in support of an application by the Joint Administrators pursuant to paragraph 63 Schedule B1 to the Insolvency Act 1986 (the **Act**) for orders that:
- (a) The four week notice requirement at paragraph 2 of the Order of Hildyard J dated 15 June 2017 is waived;
 - (b) the Joint Administrators be at liberty to enter into the Transaction Documents in the form, or substantially the same form, as those exhibited to this Witness Statement (as defined and described further below);
 - (c) the Joint Administrators be at liberty to make an interim distribution in accordance with the Transaction Documents, or agreements in substantially the same form, without reserving for a potential contribution claim;
 - (d) pursuant to Rule 12.39(9) of the Rules, exhibit GEB5(B) shall not be open for inspection without the leave of the Court; and
 - (e) the costs of the Application be paid as an expense of LBHI2's administration.
- 6 This application is made contemporaneous with similar applications being made by the administrators of two other members of the UK Lehman Brothers group, the Lehman Brothers International Europe (**LBIE**) administrators and the Lehman Brothers Limited (**LBL**) administrators. I also briefly mention the position of Lehman Brothers Holdings plc (**LBH**), of which I am also one of the joint administrators in paragraphs 52 to 54 below.

7 Notice of the Joint Administrators' intention to make this Application was posted on LBHI2's website on 10 July 2017 (see page 1 of GEB5(A)). Similar notices have been published on the LBL and LBIE websites on 10 July 2017 and 12 July 2017 respectively (pages 4-6 of GEB5(A)).

8 This witness statement comprises the following sections:

- A. Summary (paragraphs 9 to 13)
- B. Confidentiality (paragraph 14)
- C. Background to the administration (paragraphs 15 to 37)
- D. Effect of Waterfall I Supreme Court judgment (paragraphs 38 to 39)
- E. Backstop 1 proposal (paragraphs 40 to 42)
- F. Backstop 2 arrangement (paragraphs 43 to 54)
- G. Timing (paragraph 55)
- H. A potential contribution claim (paragraphs 56 to 58)
- I. Relief sought (paragraphs 59 to 60).

A. SUMMARY

9 After eight and a half years of being in administration, LBHI2 has paid its creditors nothing. In context, LBIE and Lehman Brothers Europe Limited have paid all ordinary, unsecured creditors in full; LBH has paid ordinary, unsecured creditors 6.08%; and Lehman Brothers Limited has paid ordinary, unsecured creditors 1.66%.

10 Pending the conclusion of the Waterfall litigation, described more fully below, the Joint Administrators have been unable to make any distributions out of the LBHI2 estate because of the uncertainty around the existence and quantum of any potential contributory claim that may exist under sections 74 and 150 of the Act against LBHI2 as a contributory of LBIE, an unlimited company, and how or whether that contributory liability on LBHI2 could be dealt with by LBIE whilst it is in administration, as opposed to liquidation.

- 11 On 17 May 2017 the Supreme Court handed down its judgment in the Waterfall I litigation. The impact of the judgment is that the likelihood of a contribution claim arising and being pursued against LBHI2 by a subsequently appointed liquidator of LBIE has been very substantially reduced.
- 12 An overarching settlement has been agreed in principle between LBHI2, LBIE, LBL, Lehman Brothers Europe Limited (**LBEL**), LBH and Lehman Brothers Holdings Inc (**LBHI**) (the **Transaction** or the **Backstop 2 Arrangement**) which delivers significant benefits to, amongst others, the LBHI2 estate and will enable it to make a significant first interim distribution of (possibly) circa. £1bn to its creditors with provable claims (as explained further below).
- 13 The Joint Administrators acknowledge that, in part, the decision whether to enter into the Transaction is a matter of commercial judgement for them. However, having regard to all of the circumstances – not least the very substantial sums at stake - the Administrators consider that the proposed arrangement is sufficiently "momentous" that it is appropriate for them to seek directions that they be at liberty to enter into the Transaction.

B. CONFIDENTIALITY

- 14 The Transaction Documents (as later defined) contain confidentiality clauses and are commercially sensitive and publicity would damage that confidentiality. For these reasons the Joint Administrators seek an order that pursuant to Rule 12.39(9) of the Rules, the Transaction Documents themselves which are contained in Exhibit GEB5(B) to this witness statement shall not be open for inspection without the leave of the Court.

C. BACKGROUND TO THE ADMINISTRATION

- 15 LBHI2 is a limited company which was incorporated in England and Wales on 5 October 2006 and registered with company number 05957878. LBHI2 is a subsidiary in the subgroup of LBH. Following a restructuring of the Lehman UK group in 2006, LBHI2 was created to act as an intermediate holding company for LBIE. Its primary function was to act as a conduit for the provision of regulatory capital to LBIE by way of debt and equity.
- 16 On 14 January 2009, the directors of LBHI2 filed notices of appointment of administrators with the Court appointing Anthony Victor Lomas, Derek Anthony Howell, Steven Anthony Pearson

and Michael John Andrew Jervis as joint Administrators. By order of the High Court, on 30 November 2009, Dan Yoram Schwarzmans was appointed as joint Administrator of the Company. On 22 March 2013, the High Court ordered that Gillian Eleanor Bruce and Julian Guy Parr be appointed joint Administrators and that Dan Schwarzmans and Michael Jervis cease to be Administrators of LBHI2. In this Witness Statement, the term Joint Administrators refers to the current Joint Administrators and the other joint administrators that have been appointed from time to time to LBHI2.

17 Pursuant to paragraph 3 of Schedule B1 to the Act, the statutory purpose of administration is to:

- (a) rescue the company as a going concern;
- (b) achieve a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration); or
- (c) realise property in order to make a distribution to one or more secured or preferential creditors of the company.

18 At the date of the administration, the Joint Administrators believed that it was reasonably likely that the second objective would be achieved. Their view was that administration would allow the orderly realisation of LBHI2's assets and the taking of steps to minimise its liabilities.

19 At pages 40 to 58 of GEB5(A) is a copy of the Joint Administrators' statement of proposals dated 3 March 2009 (the **Proposals**) that was provided to creditors pursuant to paragraph 49 of Schedule B1 to the Act. Page 4 of the Proposals (page 44 of GEB5(A)) contains a summary of LBHI2's business, and the activities that had been carried out by the Joint Administrators up to 3 March 2009. The proposals were approved by a meeting of creditors held by correspondence on 24 March 2009.

20 The Joint Administrators have proceeded in accordance with the Proposals. No creditors' committee was formed at the creditors' meetings, since only one nomination was received.

21 Pursuant to rule 18.6 of the Rules (and pursuant to the previous version of the Insolvency Rules), the Joint Administrators have prepared six-monthly progress reports during the

administration (the **Progress Reports**). Details of the progress made in the LBHI2 administration are set out in these Progress Reports, which have throughout the administration been posted on LBHI2's website. Only the most recent Progress Report (dated 9 February 2017) is exhibited, at pages 59 to 72 of GEB5(A).

- 22 The administration was originally due to end automatically on 13 January 2010. The Joint Administrators formed the view that it would not be possible to achieve the purpose of the administration by that date. Accordingly they applied to court for an order to extend the administration. The administration was extended by order of Mr Justice Blackburne dated 28 July 2009, to 30 November 2010, and has to date been extended on a total of 5 occasions. The administration is now due to end on 30 November 2020 (see page 73 of GEB5(A)).
- 23 On 15 June 2017, the Joint Administrators obtained permission to make interim distributions to unsecured creditors, subject to certain requirements to notify the LBIE Administrators of such before filing a notice of intended distribution (see the Court's order at page 74 of GEB5(A)).

LBHI2's assets

- 24 At the outset of the administration, LBHI2's principal assets comprised claims against other Lehman affiliates. In particular, it had:
- (a) a claim in the estate of LBL in the sum of approximately £257 million (together with statutory interest if applicable), in respect of which the Joint Administrators submitted a proof of debt in LBL's administration on 22 July 2014 (see page 77 of GEB5(A));
 - (b) an unsubordinated claim in the estate of LBIE for approximately £38 million (together with statutory interest, if applicable); and
 - (c) a subordinated claim in the estate of LBIE in the sum of £1.25 billion (together with statutory interest if applicable), in respect of both of which the Joint Administrators submitted a proof of debt in LBIE's administration on 24 April 2012 (see page 81 of GEB5(A)).

In the event that LBIE is able to pay all of its unsubordinated and subordinated creditors in full together with statutory interest, LBHI2 will also have a claim to the residual surplus in respect of its preferred and ordinary shareholding in LBIE. The level of the surplus will be dependent upon the outcome of the Waterfall II litigation.

- 25 LBHI2 has had two claims admitted in other Lehman insolvency estates as part of an October 2011 settlement agreement which the Joint Administrators entered into with LBHI and certain other affiliates previously subject to Chapter 11 proceedings in the USA in conjunction with other UK affiliates. Total realisations for LBHI2 in this regard have now reached \$100.3 million and further dividends are expected to be received on a six monthly basis (page 63 of GEB5(A)).
- 26 On 31 January 2014 the Joint Administrators entered into a joint venture (**Wentworth**) with Elliott Management Corporation (**Elliott**) and King Street Capital Management, L.P. (**KS**) in connection with the claims of LBHI2 in the estate of LBIE. As part of the joint venture, LBHI2 (a) assigned its unsubordinated claim in the LBIE estate to Wentworth Sons Senior Claims Sarl, (b) assigned its subordinated claim in the LBIE estate to Wentworth Sons Sub-Debt Sarl and (c) received approximately £650 million along with the right to receive certain sums in respect of LBHI2's economic interest in its unsubordinated and subordinated claims in the LBIE estate in the future on the occurrence of certain contingencies. In addition, LBHI2 entered into a participation agreement that gives the joint venture partners an interest in a proportion of the proceeds of the preferred equity in LBIE. The joint venture also includes a joint recovery pool which entitles LBHI2 to recoveries from certain claims against the LBIE estate held by Elliott and KS dependent on realisations from LBIE.
- 27 The most recent receipts and payments account prepared by the Joint Administrators to 13 January 2017 is at page 67 of GEB5(A). As can be seen, the current net cash balance is approximately £622 million. As part of the wider deal (described below), an amount which was loaned by LBHI2 to LBHI will be repaid by LBHI, bringing total cash to approximately £705 million as currently estimated.

Creditor claims

- 28 LBHI2 does not have any secured creditors or preferential creditors.

29 LBHI2 has two unsubordinated unsecured creditors totalling £699 million (together with statutory interest if applicable) being:

(a) LBH - £184 million

(b) LB Lux Finance SARL - £515 million

LBHI2 also has unsecured subordinated creditors totalling £5.795 billion being:

(a) LBH - £1.517 billion

(b) LB Scottish Limited Partnership III - £4.278 billion

30 Presently, the LBIE Administrators have also asserted a £10 billion claim against LBHI2 in respect of LBHI2's potential liability to LBIE as a contributory under Section 74 of the Act, which was to cover various liabilities which the Court of Appeal had decided in Waterfall I would be liabilities to which the contributories of LBIE (i.e. LBHI2 and LBL) would be required to contribute in the event of a shortfall (see page 95 of GEB5(A)). However, as a result of the Supreme Court's decision in Waterfall I litigation, that claim can no longer be maintained by the LBIE Administrators and, as part of the Transaction, the LBIE Administrators will confirm that it is withdrawn.

The Waterfall Litigation

31 As the Court is aware, a very substantial surplus of between £7bn and £8bn has arisen in the administration of LBIE. An application for directions was brought by the LBIE, LBL and LBHI2 Administrators in February 2013 (once it had become apparent that there might be a surplus in the LBIE administration, although at the time, the LBIE Administrators' estimate of the surplus was much lower than is currently the case). The applications sought directions with regard to that surplus. Together, those directions applications were known as the "Waterfall I litigation". The Waterfall I litigation commenced in February 2013 seeking directions in respect of, amongst other things, the ranking of LBHI2's subordinated debt claim as against LBIE's obligation to pay statutory interest to unsubordinated creditors and certain non provable liabilities which LBIE was said to be liable to pay from its insolvency estate (principally, what were known as "currency conversion claims").

- 32 The Waterfall I application was heard by this Court in November 2013 and a judgment given by David Richards J on 14 March 2014. The judgment was subsequently appealed, with the Court of Appeal giving its judgment on 14 May 2015. Waterfall I was subsequently appealed to the Supreme Court and judgment was handed down on 17 May 2017.
- 33 In summary, the Supreme Court held:
- (a) The subordinated debt claim owed to LBHI2 by LBIE is subordinated behind statutory interest and non provable liabilities.
 - (b) Currency conversion claims do not exist as a species of non provable liability.
 - (c) Statutory interest accruing but not paid in LBIE's administration is not payable in any subsequent liquidation of LBIE (known as the **Statutory Interest Lacuna**).
 - (d) A contributory's liability under Section 74 of the Act does not extend to creating a surplus for the payment of statutory interest but it does extend to the payment of non provable liabilities.
 - (e) The LBIE Administrators are not entitled to prove for a potential contribution claim that might arise in the event of LBIE going into liquidation.
 - (f) The contributory rule currently applicable in liquidation proceedings extends to administration proceedings.
- 34 Subsequently, a further application (termed the "Waterfall II application") was brought by the Administrators of LBIE with a view to clarifying a host of other related issues. LBHI2 is not a party to the application, but Wentworth Sons Sub-Debt Sarl is a party.
- 35 Given the scope and complexity of the Waterfall II application, the Court ordered that it be tried in three parts:
- (a) Part A deals with, among other things, certain issues relating to the calculation of statutory interest and foreign currency conversion claims.

- (b) Part B deals with, among other things, the effect on (i) claims to statutory interest, and (ii) currency conversion claims, of creditors entering into certain agreements with LBIE, including "Claims Determination Deeds".
- (c) Part C deals with, among other things, the calculation of statutory interest in connection with certain contracts, such as the ISDA Master Agreement and similar agreements governed by German, French and New York law.

36 Separate hearings on Parts A and B were held and judgments handed down by David Richards J in respect of both on 31 July 2015. At a hearing relating to consequential matters held on 10 October 2015, the parties were granted leave to appeal to the Court of Appeal all relevant findings on Parts A and B to the Court of Appeal. That appeal was heard in April 2017, with judgment reserved pending the Waterfall I judgment being handed down by the Supreme Court. A further hearing has now been set for 25 July 2017, to consider oral arguments and written submissions arising out of the Supreme Court judgment in Waterfall I that the Respondents to Waterfall II believe are relevant to the matters being dealt with in the Waterfall IIA and B proceedings. A judgment is expected to be handed down in the Autumn. A hearing of Part C took place between 9 and 25 November 2015, a judgment was handed down 5 October 2016 and permission to appeal to the Court of Appeal was granted, which is due to be heard in July 2018.

37 As the court is aware, a further application (termed the "Waterfall III Application") was issued by the LBIE Administrators and a cross-application raising similar issues by the LBL Administrators in 2016. Waterfall III includes (significantly for the purposes of this application) claims by LBL for rectification of the LBIE share register and for declarations that LBL can recharge any contribution claim made by LBIE against it to LBHI2, such that any contribution claim arising effectively falls to be discharged by LBHI2 rather than by LBL and LBHI2 together. LBL also seeks to rectify the register to substitute LBH in its place and otherwise claims that it has a right to an indemnity from LBH for any contribution liability to LBIE. The proceedings were initially divided into two parts. Part A, addressing principally legal issues, was part-heard in early February 2017 and adjourned for further submissions once the Supreme Court judgment in Waterfall I was handed down. Part B, which addresses certain fact specific issues, is listed for a two week trial commencing after 11 September 2017. The

balance of the issues arising under the Waterfall III Application have been adjourned generally.

D. EFFECT OF THE SUPREME COURT'S DECISION IN WATERFALL I

38 As a result of the Supreme Court's decision, it may very well prove to be the case that the surplus in the LBIE estate will be sufficient to meet all of its unsubordinated liabilities together with statutory interest thereon. Depending on the ultimate outcome of the Waterfall II litigation, there may also be sufficient to pay the subordinated claims and statutory interest thereon. The likelihood of a non provable liability arising giving rise to a potential contribution claim now looks highly improbable. Moreover, given the Supreme Court's decision with regard to the Statutory Interest Lacuna, placing LBIE into liquidation will be adverse to the interests of its creditors who have claims to statutory interest. Indeed the LBIE Administrators have stated that they would actively seek to resist any attempt to put LBIE into liquidation prematurely (page 136 of GEB5(A)).

39 In respect of the Waterfall II proceedings, only Waterfall IIA and Waterfall IIC remain economically relevant for the purpose of assessing whether a contribution claim against LBHI2 might arise if there is a future liquidation of LBIE. In those two sets of proceedings, the Court will determine (i) the quantum of statutory interest payable by LBIE in administration (which depends on the Bower v Marris issue in Waterfall IIA and the calculation of default rates of interest under various ISDA agreements in Waterfall IIC) and (ii) whether or not certain non provable claims exist against LBIE in connection with the payment of statutory interest (Waterfall IIA). However, it is only the outcome of Waterfall IIA in relation to the non provable claims which will, in reality, have an impact on the size of any contribution claim against LBHI2 because of the decision of the Supreme Court in Waterfall I that statutory interest cannot form part of a contribution claim. In light of the Supreme Court's decision regarding currency conversion claims and that the rules relating to foreign currency debts constitute a complete code, the respondents in those proceedings (i.e. the LBIE senior creditor group) concede that all the Waterfall IIA and IIB issues predicated on the existence of currency conversion claims as non provable claims fall away. They also concede that it is not possible for a creditor to make a non provable claim against LBIE in respect of any shortfall in interest relative to what it would have received but for the administration, because the

Supreme Court held that rule 2.88 of the Rules (as it was then before the introduction of the Insolvency Rules 2016) operates as a complete code for the recovery of interest on proved debts in an administration. Accordingly, the only extant issue in Waterfall IIA is whether there is a non provable claim against LBIE in connection with statutory interest, whereas Waterfall IIC deals with the calculation of statutory interest itself (to which LBHI2 is not liable to contribute in the event of a shortfall). Waterfall IIA has been argued before the Court of Appeal but judgment is still awaited.

E. THE BACKSTOP 1 PROPOSAL

40 Prior to the Supreme Court's decision in Waterfall I, the administrators of, among others, LBIE, LBEL, LBL, LBH, and LBHI2, together with LBHI, explored a settlement which would have had the effect of settling the Waterfall III proceedings and "unlocking" the ability of the LBHI2 Administrators to make distributions to its unsecured creditors. By way of a press announcement dated 29 March 2017 published on the PwC LBIE website, notice of the proposed outline settlement was published for the purpose of creditor consultation (pages 138 to 141 of GEB5(A)).

41 In short, the proposal envisaged:

- (a) the creation of a "Contribution Reserve Fund" which would stand in substitution for the potential claims against LBIE's contributories;
- (b) the Contribution Reserve Fund would be available to meet the claims of LBIE's creditors (subject to certain exceptions as indicated in the announcement);
- (c) the value of the Contribution Reserve Fund would be calculated on a basis such that it equalled a significant portion of the value that LBIE estimates it could otherwise eventually recover in aggregate from its contributories (such amount being acceptable to LBIE's Administrators taking into account a number of factors, including litigation risk);
- (d) LBIE would withdraw its contingent proofs of debt against its contributories and not object to them making distributions without reserving for a contingent contributory claim;

- (e) LBIE and its Administrators would also undertake not to place LBIE into liquidation without the consent of its contributories.

42 However, the completion of the deal was based on the law as stated by the Court of Appeal in Waterfall I (before the Supreme Court's judgment was handed down in May 2017), and for the reasons detailed in paragraphs 38 and 39 above, the Backstop 1 terms needed to be revisited in light of the Supreme Court's judgment.

F. THE BACKSTOP 2 ARRANGEMENT

43 Following the handing down of the Supreme Court judgment in Waterfall I, the parties recommenced discussions and have reached an agreement in principle. It has the following key advantages to the creditors of the LBHI2, LBL, LBIE, LBH and LBEL estates:

- (a) it settles the Waterfall III litigation;
- (b) it will result in the payment of c.£257 million owed to LBHI2 by LBL;
- (c) it limits the subordinated debt claim of c.£1.25bn plus interest currently owed by LBIE to Wentworth Sons Sub-Debt Sarl to those assets ultimately available in LBIE for distribution to it without recourse to LBIE's contributories;
- (d) it enables LBHI2 to make a substantial first interim distribution to its creditors (which include LBH);
- (e) by virtue of making an interim distribution, it reduces the ongoing accrual of statutory interest on the claims in LBHI2's estate, thus optimising the potential return to LBHI2's subordinated creditors (which include LBH) who are otherwise prejudiced by the delay; and
- (f) by virtue of the Inter-affiliate Settlement Deed, referred to below, it enables the other affiliates to make distributions to their stakeholders.

44 The Backstop 2 arrangement will be given effect by the following documents (the **Transaction Documents**):

- (a) Deed of Settlement

- (b) Inter-affiliate Settlement Deed
- (c) Master Framework Agreement
- (d) Limited Recourse Deed
- (e) Indemnity between LBHI and LBIE

LBHI2 and the Joint Administrators are parties to the first three documents. Albeit the documents are still subject to some negotiation on the finer points, the basic principles are agreed. Copies of the heads of terms and advanced (but not final) versions of the Transaction Documents are in GEB5(B).

Master Framework Agreement (GEB5(B) pages 67 to 98)

- 45 In this document the parties agree to dismiss the Waterfall III litigation by consent (Clauses 4 and 7, at pages 78 to 79 of GEB5(B)).

The Deed of Settlement (GEB5(B) pages 3 to 26)

- 46 In this document:

- (a) LBIE and the LBIE Administrators and LBL and the LBL Administrators release and discharge each other from all Claims (as defined) and each withdraw any proofs of debt that may have been lodged in the other's estate including the LBIE proof in respect of any potential future contribution claim and the LBL proof in respect of recharge claims (Clause 3, at pages 13 to 14 of GEB5(B));
- (b) LBIE and the LBIE Administrators and LBHI2 and the LBHI2 Administrators release and discharge each other from all Claims (as defined and excepting the claims assigned to the Wentworth parties) and each withdraws any proofs of debt that may have been lodged in the other's estate including the LBIE statement of claim in respect of any potential contribution claim (Clause 4, at page 14 of GEB5(B));
- (c) LBIE and the LBIE Administrators release and discharge LBH and the LBH Administrators from all Claims (as defined, and excepting certain claims) (Clause 5, at page 14 of GEB5(B));

- (d) LBIE and the LBIE Administrators confirm (i) that their waiver of the four-week notice period that LBHI2 is required to give them prior to issuing a notice of intended distribution is in full force and effect and continues to apply, and (ii) that they do not object to the LBHI2 Administrators, the LBL Administrators and the LBH Administrators making the payments contemplated in the Inter-Affiliate Settlement Deed without making provisions or reserves for any actual or potential claims from LBIE, the LBIE Administrators and/or any liquidator appointed to LBIE (Clause 7, at page 15 of GEB5(B)).

The Inter-Affiliate Settlement Deed (at pages 27 to 66 of GEB5(B))

47 In this document:

- (a) LBL and the LBL Administrators withdraw the LBL claim in the LBEL estate (Clause 4.4, at page 42 of GEB5(B))
- (b) The LBEL Administrators will make a distribution of statutory interest to the LBEL unsecured creditors and take steps to effect a capital reduction as a precursor to making a distribution to its shareholder, LBH (Clauses 5 and 6.14 at pages 42, 43 and 46 of GEB5(B))
- (c) LBL and the LBL Administrators admit in the LBL Administration the claims of LBEL and LBHI2 (Clause 6.4.1 at page 44 of GEB5(B))
- (d) LBHI2 and the LBHI2 Administrators admit in the LBHI2 Administration the unsubordinated claims of Luxembourg Finance Sarl and LBH (Clauses 6.4.2 and 6.4.3 at page 44 of GEB5(B))
- (e) LBH and the LBH Administrators admit in the LBH Administration the claim of LBL (Clause 6.4.4 at page 44 of GEB5(B))
- (f) Save for the inter-Affiliate claims expressly admitted as part of the Transaction and certain other claims, the Affiliates agree to certain inter-Affiliate releases (Clauses 4.4.1 and 6.5 to 6.12, at pages 42, 44 and 45 of GEB5(B)) to prevent any future satellite litigation

- (g) With effect from the transaction completion date, the Affiliates (i) pay or receive as the case may be interim distributions as set out in the agreed distribution model, such distributions to be deemed to be one single distribution and (ii) agree to make an interim distribution to non-Affiliate creditors (the dividend available having been calculated in accordance with the agreed financial model) (Clauses 6 and 7 at pages 46 to 47 of GEB5(B)).

48 A key feature of the arrangement is the existence of inter company claims between the Affiliates. Provided that the releases and distributions take effect contemporaneously (which is what the various Transaction Documents do), the amounts available for distribution by each estate can also take into account monies that will be received into the estate (including by way of recurring, circular distributions, as explained below) as a result of the operation of the Transaction with the result that each estate can make one composite distribution to its creditors. The point is best illustrated by a simple example.

- (a) Assume Party A holds £100 cash. It owes Party B £1000. Party B holds £200 cash. It owes Party C £2800 and third party creditors £200. Party C owes Party A £500.
- (b) In step 1 Party A pays £100 to Party B (so that Party B now holds £300). Party B can then pay a dividend of 10% i.e. it pays Party C £280 and the third party creditors £20. Party C can pay Party A £280.
- (c) In step 2, Party A now holds £280 cash which it can pay to Party B. Party B then holds £280 and can then pay a further dividend to its creditors of approximately 9% (i.e. approximately £260 to Party C and approximately £20 to third party creditors). Party C will receive approximately £260 which it can pay to Party A.
- (d) In step 3 Party A will pay £260 to Party B, which Party B will then pay to Party C (approximately £242) and Party B's third party creditors (approximately £18); Party C will pay its receipts (£242) on to Party A.
- (e) Party A now holds £242 which it pays to Party B and so on.

49 A distribution model (pages 140 to 144 of GEB5(B)) has been prepared which illustrates the outcome of a maximum of 10 such distributions occurring and thereby calculating the net

single payment or receipt between each Affiliate (defined in the Inter-Affiliate Settlement Deed as the **Net Payment Amounts**). In order to circumvent the need for serial interim distributions, each of the Affiliates, pursuant to the Inter-Affiliate Settlement Deed, is agreeing to pay (or receive as the case may be) the relevant Net Payment Amount. The expected Net Payment Amounts are shown in the schedule at page 57 of GEB5(B). The precise amounts will, of course be dependent on submission of claims following the service of notices of intended distribution.

50 The position of LBEL is slightly different to the other Affiliates. It has paid its ordinary unsecured creditors in full. It anticipates having a surplus sufficient to pay statutory interest in full. An additional amount of statutory interest would accrue if, in the Waterfall II proceedings, the Court of Appeal upheld an appeal currently being pursued as to the applicability of the approach adopted in *Bower v Marris*. Subject to making a reserve for such additional statutory interest, LBEL has sufficient resources to make a distribution to its shareholder, LBH. As administrators do not have the power to return capital to shareholders, the LBEL Administrators anticipate appointing a director (in fact, one of the LBH Administrators) for the purposes of effecting that part of the process. I understand that an application has been made to the court by the LBEL Administrators for certain relief so as to give effect to those steps.

51 As to those Transaction Documents to which LBHI2 is not a party, the Limited Recourse Deed is the agreement to be entered into between LBIE and the Wentworth parties which will limit the subordinated debt claim in the LBIE estate to the actual residual cash arising and thus extinguishing the possibility of a sub-debt contribution claim. The Indemnity is a capped indemnity given by LBHI to LBIE to cover the unlikely position of there being a shortfall to LBIE's unsubordinated creditors.

The Position of LBH

52 As noted above, I am also one of the joint administrators of LBH, and have participated in the negotiation of the Transaction Documents in that capacity as well as in my capacity as Joint Administrator of LBHI2. As joint administrator of LBH, I can confirm that I consider the proposed arrangements to be in the best interests of LBH as well as LBHI2. I have already outlined the advantages that will accrue to the creditors of LBHI2 (of which LBH is one). The

proposed settlement would result in material distributions to LBH from LBHI2 and also from LBEL, which would not otherwise be possible by reason of the Waterfall III litigation.

Moreover, by virtue of the Transaction, LBH will be able to make significant distributions to its own unsecured creditors (which, again, would otherwise be precluded by the Waterfall III litigation).

53 Further, the Transaction would remove any risk associated with the contested claim that is presently levelled against LBH by LBL. Like the Joint Administrators and the LBL Administrators, if the Transaction is sanctioned and goes ahead, the LBH Administrators would similarly proceed to make distributions without reserving or making provision for any contingent liability for a contribution claim by a future liquidator of LBIE. However, the LBH Administrators do not consider it necessary for sanction to be sought for such a course and for the entry by LBH into the Transaction Documents to which it is a party. The Court will recall that LBH (which, unlike LBHI2 and LBL, is not a member of LBIE) is only a party to the Waterfall III Application because it was joined at the instigation of LBL in November 2016. This was on the basis that LBL seeks to maintain that LBH should be liable to indemnify LBL for any contributory liability that LBL may have to LBIE. No other party has sought to assert that LBH would have any liability for a contribution claim and, under the Transaction Documents, the Waterfall III Application will be dismissed and LBL will release all claims against LBH (save those unconnected with Waterfall III which have already been separately admitted as unsecured claims).

54 I should add that I and my fellow joint administrators of LBH, have been very alive to the possibility of conflict between LBHI2 and LBH. In the context of the Waterfall III litigation we have sought to manage that conflict by nominating one of our colleagues, Robert Lewis, a partner in PWC and a licenced insolvency practitioner, as a representative to safeguard the independent interests of LBH. Mr Lewis has instructed a separate legal team to act for the LBH Administrators in the Waterfall III proceedings. Whilst Mr Lewis and his legal team have not participated in the day-to-day negotiation of the Transaction Documents, they have been informed of the overall architecture of the Backstop 2 arrangement and the LBEL aspect. On the latter point, Mr Lewis' advisers have been liaising with LBEL's advisers directly.

G. TIMING

55 As the court will be aware, aspects of the Waterfall III proceedings are due to be heard on an expedited basis during the long vacation. A pre-trial review is listed for 28 July 2017. All of the parties are heavily engaged in preparing for those proceedings and will shortly also have to commit to the payment of brief fees. Subject to the court giving the relief sought, it is anticipated that the Transaction Documents will be executed on or about 27th July 2017 and the service of notices of intended distribution by the various affiliates will occur shortly thereafter. Implementation of the various steps (including securing the required confirmations from Wentworth Sons Sub-Debt Sarl in respect of limiting the sub debt claim into LBIE) will commence in the week commencing 7th August 2017. It is anticipated that the transaction would become fully effective and distributions paid by the end of August or early September 2017.

H. A POTENTIAL CONTRIBUTION CLAIM

56 The Joint Administrators have considered carefully the possibility of a contribution claim arising at some point in the future and what weight should be given to that factor in light of the fact that the Backstop 2 arrangement does not require any reserve by LBHI2. In particular they have taken into account the following factors:

- (a) The unlikelihood of a contribution claim arising. As noted above, at paragraphs 38 and 39, the Supreme Court held that contributories are only required to contribute to any shortfall in the payment of proved debts and non provable liabilities of LBIE (and not to a shortfall in the payment of statutory interest on proved debts). The most significant species of non provable liability of LBIE was currency conversion claims, which the Supreme Court has held does not exist. As set out above at paragraph 39, further non provable claims have been asserted against LBIE in Waterfall IIA; those were opposed by the LBIE Administrators and were held not to exist at first instance. The tenor of the comments of the Supreme Court in the Waterfall I proceedings to the effect that statutory interest provisions in the Insolvency Act and Rules are a complete code and that one should be slow to rely on pre Insolvency Act Judge made rules might also fairly be said to support that first instance judgment.

- (b) The uncertainty of the quantum of any contribution claim, if established. Even if the court ultimately found that there was a non provable liability of LBIE in respect of damages for late payment of statutory interest (which ranked for payment out of LBIE's insolvency estate after payment in full of statutory interest), it does not follow that a contribution claim would necessarily arise against LBHI2. That would depend on (i) the quantum of statutory interest claims against the LBIE surplus and (ii) the quantum of any damages claim that is found to exist. Whether the existing surplus within LBIE would be sufficient to meet the statutory interest claim and any non provable claim for damages is uncertain. That will depend upon the outcome of Waterfall IIA and IIC which will determine the final amount of the statutory interest claim to be paid out of the surplus.
- (c) The participation of the LBIE Administrators. The LBIE Administrators (and LBIE) are parties to the Backstop 2 transaction. As part of the Backstop 2 Transaction they will (i) waive the requirement that they be given four weeks' notice before the Joint Administrators give notice of their intention to make a distribution, and (ii) confirm expressly that that they do not object to a first interim distribution being made by LBHI2 (or a further distribution being made by LBL) without any reserve being made for a contributory claim. In reaching that conclusion, the LBIE Administrators have considered the benefit of the Backstop 2 transaction to the LBIE estate and, I understand, have informed their stakeholders. I refer to the evidence of Russell Downs in support of the application filed by LBIE contemporaneously with this application, which I have seen in draft form.
- (d) The unlikelihood of LBIE going into liquidation. A contribution claim could only be made against LBHI2 if LBIE went into liquidation. That may depend on many factors, but, as noted above, given the decision of the Supreme Court on the issue of the Statutory Interest Lacuna, it is clear that liquidation of LBIE in the near to mid term would not be in the interests of its creditors with claims to statutory interest and, whilst LBIE remains in administration, there is no existing person who could be identified as a potential creditor of LBHI2 in respect of the contribution claim, but instead there is a person who may or may not in due course exist as that creditor (i.e. a future liquidator

of LBIE): see paragraphs 151 to 165 of the Supreme Court's decision in Waterfall I. By reason of the extension of the Contributory Rule to the distributing administration of LBIE, this issue is a matter for the LBIE Administrators to consider, and, as set out above, they will confirm as part of the Backstop 2 transaction that they do not object to LBHI2 making no reserve for any contribution claim liability.

- (e) If, notwithstanding there being no party able to assert a contribution claim whilst LBIE is in administration, and the present value of such claim being zero, the Joint Administrators were required to reserve for any potential contribution claim against LBHI2 they would have to take a worst case assessment of the possible value of it because there is no sensible or accurate way of discounting the value to reflect the various contingencies that would have to eventuate in order for a contribution claim against LBHI2 to be made - particularly in circumstances where there are several factors which impact on the quantum of any such claim, as well as the likelihood of it being made at all. In practice, that would mean that the LBHI2 Administrators would have to reserve for a claim, on a worst case scenario basis, in a sum of c.£2.2bn. If so, the Backstop 2 arrangement could not be completed and the advantages that accrue thereunder for the LBHI2 estate (and for that matter the other Lehman estates) would be irrevocably lost.
- (f) A "wait and see" approach is highly unattractive, particularly in circumstances where the LBIE Administrators are party to the Backstop 2 arrangement and will waive the notice requirement in relation to a notice of an intention to distribute by LBHI2. The Joint Administrators have considered whether they can wait until judgment is given by the Court of Appeal in the Waterfall IIA proceedings. Realistically, that is unlikely to be until the end of 2017. Even if the Court confirmed the first instance judgment, I understand that one might reasonably expect that the respondents would seek permission to appeal to the Supreme Court. I am advised that a realistic assessment is that a decision as to permission would not be forthcoming until April 2018. Moreover, if permission were given, I am advised that one might not receive a final decision until 2020. That is not in the interests of the creditors of LBHI2 as a whole (which include LBH) who have already had to wait many years for the determination

of the Waterfall I litigation and it is inconsistent with the purpose of the LBHI2 administration described above. I am also advised that the Supreme Court in Waterfall I acknowledged without objection the possibility that a corporate contributory might be wound up before the company of which it is a contributory goes into liquidation, thereby in some cases escaping its contributory liability: see paragraph 165 of Lord Neuberger's judgment with whom Lord Kerr, Lord Reed, Lord Sumption (see paragraph 188) and Lord Clarke (see paragraph 202) agreed. In particular, Lord Neuberger said in relation to the question of whether the LBIE Administrators could prove in a contributory's insolvency for a potential contribution claim:

"As both Briggs and Lewison LJJ said, this is not an easy point, not least because of the wide words of rule 13.12, the general principle that all potential liabilities should if possible be provable, and the practical consequences of my conclusion. In relation to this last point, I acknowledge that, at least where the company to which it is liable to contribute is not itself in liquidation, this conclusion would enable a potential contributory to escape liability to contribute, at least in some cases, by going into administration or liquidation. ... However, I am unable to accept that these points can undermine the conclusion I have reached. They are ultimately attributable to the fact that distributing administrators have, either for good reason or through oversight, not been given all the powers of liquidators, and in particular have not been given the power to call on contributories."

- (g) The LBHI2 Administrators are under a statutory duty to administer the affairs of the company promptly. As noted above, LBHI2 has been in administration for eight and a half years. Whilst LBIE has been able to pay (or otherwise provide for) its creditors in full, LBHI2 has been unable to pay anything to its creditors whilst the Waterfall I litigation has proceeded. Now that the Supreme Court has handed down judgment, the Joint Administrators are able to identify with certainty those creditors who have the ability to submit proofs of debt. Consistent with their duties and the Insolvency Act scheme for proving, the Joint Administrators consider that they should press ahead with declaring their notice of intention to distribute, advertising for proofs of debt and then paying those provable creditors who submit proofs. The Joint Administrators are

under significant pressure from their creditors to do so. At page 143 of GEB5(A) is a true copy of a letter from Weil Gotshal & Manges (London) LLP confirming its view.

- (h) The Backstop 2 arrangement delivers tangible benefits to the estate and creditors of LBHI2 which will be lost if they are unable to enter into the transaction.

57 Having regard to all the above matters, the LBHI2 Administrators believe that the benefits of the Backstop 2 transaction clearly outweigh any disbenefits for LBHI2. However, whilst the Joint Administrators have satisfied themselves that the interests of their estate are best served by entering into the Transaction, they recognise that they have to balance competing interests and make a judgement. Given the very substantial sums in issue, they consider that this judgement might fairly be said to be momentous and justifies seeking the additional assurance of the court that they be at liberty to enter into the Backstop 2 transaction.

58 In these circumstances, the Joint Administrators consider that Backstop 2 is in the interests of its creditors as a whole.

I. RELIEF SOUGHT

59 The Joint Administrators seek the following relief pursuant to paragraphs 63 and/or paragraph 68(2) and paragraph 65(3) of Schedule B1 to the Act:

- (a) The four week notice requirement at paragraph 2 of the Order of Hildyard J dated 15 June 2017 is waived.
- (b) The Joint Administrators be at liberty to enter into (on their own behalf and on behalf of LBHI2) the Transaction Documents defined in this witness statement to which LBHI2 and the Joint Administrators are party (namely, the Deed of Settlement, the Inter-affiliate Settlement Deed and the Master Framework Agreement) in a form substantially the same as those exhibited to this statement.
- (c) Following the execution of the Transaction Documents, the Joint Administrators be at liberty to make a first interim distribution without reserving for any potential claim against, or liability of, LBHI2 as a contributory of LBIE.

(d) pursuant to Rule 12.39(9) of the Insolvency Rules 1986, exhibit GEB5(B) shall not be open for inspection without the leave of the Court; and

(e) the costs of the Application be paid as an expense of LBHI2's administration.

60 In the circumstances and for the reasons set out in this witness statement, I respectfully ask this Honourable Court to make the orders in the form of the draft order before the Court.

Statement of Truth

I believe that the facts stated in this witness statement are true.

Signed:.....

Dated:.....

(d) pursuant to Rule 12.39(9) of the Insolvency Rules 1986, exhibit GEB5(B) shall not be open for inspection without the leave of the Court; and

(e) the costs of the Application be paid as an expense of LBHI2's administration.

60 In the circumstances and for the reasons set out in this witness statement, I respectfully ask this Honourable Court to make the orders in the form of the draft order before the Court.

Statement of Truth

I believe that the facts stated in this witness statement are true.

Signed:

G. O'Leary

Dated:

19 July 2017

Applicants
Gillian Eleanor Bruce
Fifth
"GEB5"
19 July 2017

CR-2009-000052

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

**IN THE MATTER OF LB HOLDINGS INTERMEDIATE 2
LIMITED (IN ADMINISTRATION)**

AND

IN THE MATTER OF THE INSOLVENCY ACT 1986

**FIFTH WITNESS STATEMENT OF
GILLIAN ELEANOR BRUCE**

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Ref: TB/NDB/058056.00651/48865928.11