**No. 7942 of 2008**

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

**IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)**
**AND IN THE MATTER OF THE INSOLVENCY ACT 1986**

**B E T W E E N:**

**THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)**

**Applicants**

**-and-**

**(1) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS LIMITED (IN ADMINISTRATION)**
**(2) THE JOINT ADMINISTRATORS OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)**
**(3) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS EUROPE LIMITED (IN ADMINISTRATION)**
**(4) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS HOLDINGS PLC**

**Respondents**

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**RESPONSE OF LBL TO THE SCHEDULE TO THE ORDER OF 16 JANUARY 2017**

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## A) INTRODUCTION

1. This is LBL's Response to the requests made by LBHI2, LBH Plc and LBEL ("**Requests**") set out in the schedule to the Order of Mr Justice Hildyard dated 16 January 2017 ("**Order**"). This Response is filed without prejudice to LBL's right to serve evidence in respect of the Recharge Agreement, and to make such submissions as are appropriate in respect of the determination of Issues 9 and 11, in due course.

2. Since serving its Position Paper, Supplementary Position Paper and Reply Position Paper, the LBL Administrators have identified further materials considered to be relevant to the determination of Issues 9 and 11. Accordingly, this Response updates the position of LBL as previously set out in its Position Papers, which should be read as subject to and/or (where appropriate) modified by the following.

3. In this Response, save where otherwise indicated, defined terms used herein are as set out in LBL's Position Paper, Supplementary Position Paper and Reply Position Paper. The

documents referred to in this Response are appended to it, including by way of answer to Request 1(g).

## B) FACTUAL OVERVIEW

4. The following is provided by way of summary of the factual background to the Recharge Agreement in light of the latest information. LBL's Responses to the Schedule are then set out in Section C below.

### (i) Group Structure and Management

5. Between 1986 and 1988 a restructuring took place amongst those Lehman Group entities incorporated or conducting business and/or having operations in the UK. This led to the establishment of LBL as the group service company for those Lehman Group entities incorporated in and/or conducting business in and/or having operations in the UK (**"UK Lehman Group"**) and to the Recharge Agreement.

6. At that time (as subsequently) the UK Lehman Group utilised the services and expertise of certain 'back-office' staff who were organised on a divisional basis and carried out administrative, accounting and operational functions on behalf of each of the entities in the UK Lehman Group and for the benefit of the UK Lehman Group, as well as for the benefit of the Lehman Group (the "**Back-Office Teams"**).

7. It is reasonably to be inferred (including upon the basis of the documentation available to the LBL Administrators and their knowledge of the UK Lehman Group derived from their conduct of the LBL Administration to date) that the entities in the UK Lehman Group authorised the Back-Office Teams to operate their respective divisional functions.

8. Further, a memorandum dated 19th June 1986 records that the detail of a "*Group Accounting Project*" (as set out further below) would be "*presented to the Management Committee for final authorisation"*. A list of members of the management committee dated 27 April 1987 records that the management committee included a representative of numerous Back-Office Teams, such that it is also reasonably to be inferred that the UK Lehman Group management (including as appropriate the management committee) had oversight of the Back-Office Teams.

### (ii) LBL as Service Company and the Recharge Agreement

9. As set out in LBL's Position Paper at paragraphs 7 to 9, LBL was (at all material times) the service company which supported the operations of the UK Lehman Group. Initially, between about January and September 1986, LBL provided such services only to the Peninsular House Commodity Departments (Peninsular House being an address from

which the Lehman Group operated on Monument Street); subsequently it came to provide such services to the UK Lehman Group. In this capacity, from about 6 October 1986 LBL directly employed and remunerated all staff in the Back-Office Teams, who operated on the divisional basis within Back-Office Teams as set out above, and performed services on behalf of and for the benefit of all and each of the entities in the UK Lehman Group.

10. LBL continued in the role of service company following, in particular, the acquisition of Broadgate 1, Finsbury Avenue, London, EC2 ("**Broadgate**"). Pursuant to an agreement dated January 9, 1986 between Shearson Lehman Broadgate North Inc. and LBL, LBL assumed the obligation to complete certain works required at Broadgate, with Shearson Lehman Broadgate North Inc. thereafter to grant LBL an occupational licence of parts of the building and parking spaces.

11. A letter from Margaret Dooley (Taxation Manager for the UK Lehman Group) to HM Inspector of Taxes dated 21 May 1986 (preceded by a draft dated 7 May 1986), records that:

    11.1. by no later than 22 January 1986 the UK Lehman Group had decided to nominate one company "*which would own all assets used to fit out the Broadgate development and which would recharge out these costs by way of rental. It had not been decided which would be the most suitable company; for various management & contractual reasons [LBL] has now been chosen. In addition, [LBL] will also act as the service company incurring all overhead, employment costs etc. and recharging these to group and third party companies in relation to a pre-set formula*" (emphasis added);

    11.2. LBL would engage in three distinct business activities:

        11.2.1. Commodity trading as an agent for Shearson Lehman Brothers Inc (**"SLBI"**) taxed on a cost plus 10% basis;

        11.2.2. "*Service company, charging out overheads at cost to UK group members and at cost plus a commercial mark up to third parties; … taxed based on the accounting profit*"; and

        11.2.3. Equipment leasing, whereby LBL would retain the costs of all capital expenditure relating to Broadgate and charge a commercial leasing rental to all occupiers of floor-space at Broadgate over the term of the head-lease, taxed based on the accounting profit.

12. The minutes of a meeting of the directors of LBL (including Philip Lynch, who was also a director of LBH Plc) which took place on 18 June 1986 further record that:

12.1. In light of changes in the management structure in London it was agreed that Philip Lynch and Craig Black be appointed joint managing directors of LBL; and

12.2. "*After a series of meetings including the Group Taxation Manager, it had been agreed that out of three service companies in the group that LBL was preferred. The Directors formally approved this arrangement unanimously*."

13. These minutes were subsequently approved in a further meeting of the directors of LBL held on 18 September 1986.

14. A memorandum from Edward Donnelly to Peter Morris dated 19 June 1986 records that a meeting was also held on 18 June 1986 by the "*Group Accounting Project Team*" regarding the "*Service Company Project*". The memorandum records that this meeting was attended by employees of the UK Lehman Group and a representative of the UK Lehman Group auditors, Coopers & Lybrand and its main conclusions were as follows:

14.1. "*The service company would be set up in July* [1986]";

14.2. "*Group wide administration and operations costs will be captured within the service company in July and reallocated front end on a group basis*"; and

14.3. "*The basis of allocation will be presented to the Management Committee for final authorisation*".

15. On 1 August 1986, in a memorandum from Edward Donnelly (Financial Planning) to Margaret Dooley (Taxation Manager) regarding "*Service Company* – [LBL]", the set-up structure of LBL, then to be effective from 1 September 1986, it was recorded that:

15.1. "*Administration and operations group wide costs will be captured within* [LBL] *and recharged out as a one line allocation to the relevant front end departments on a monthly basis*";

15.2. "*All administration and operations employee service contracts will be held by* [LBL] *and all invoices were to be addressed to* [LBL]";

15.3. "*All other overhead costs (excluding other personnel costs), which can be directly allocated to specific front end departments, although to be paid by* [LBL] *and invoiced to* [LBL], *were to be charged directly to the relevant profit and loss account via the intercompany accounts*"; and

15.4. "*Personnel costs for front end departments were to be processed and paid for by* [LBL] *and charged out to the relevant profit and loss account via the intercompany accounts"*.

16. In the event, LBL commenced its role as service company for the UK Lehman Group on 1 October 1986. Accordingly, as recorded in the minutes of a meeting of the directors of LBL held on 6 October 1986, it was agreed that "*Following discussion of the Company acting as service company for the UK Group… administrative, operations and accounting staff at other locations be transferred to [LBL] and that the Personnel Department be instructed to issue appropriate terms and conditions of employment"*.

17. At an extraordinary meeting of LBL held on 20 March 1989 LBL's memorandum of association was then amended to reflect the fact that it had become the service company for the UK Lehman Group.

18. From the outset of its assumption of the role of service provider on 1 October 1986, LBL met costs, expenses and liabilities incurred in the course of the operations of the UK Lehman Group, and recharged all such costs, expenses and liabilities either directly to the UK Lehman Group entity on behalf of which such costs had been incurred at cost, or otherwise by way of an allocation method known as the sweep mechanism which, from time-to-time, was subject to an uplift ("**Sweep Mechanism**"). From or about 1989 LBL conducted no other business sufficient to generate the income that would have been required to meet the costs, expenses and liabilities that were recharged by it and, but for the Recharge Agreement (as set out further below), it would swiftly have become insolvent[1].

19. A presentation prepared by Coopers & Lybrand entitled "[LBL] *1988 Coopers and Lybrand Audit Presentation*" dated 2 November 1988, together with a similar presentation for the following year dated 13 October 1989, recorded in writing that from October 1986 to the date of the presentations:

[1]Since before 1986, LBL owned 100% of Shearson Lehman Hutton Commodities Limited (**"LBCL"**) and from 1994 LBL acquired a 5% interest in PML, each shareholding being by way of investment.

*"January – September 1986-* [LBL] *acted as 'service' company for Peninsular House Commodity Departments. Operated at 'cost + 10%' on certain departments for statutory accounts purposes.*

*October – December 1986* - [LBL] *commenced role of overall service company for all London operations. No uplift carried on costs recharged from service company. Certain Departments uplifted at 'cost + 10%' for statutory accounts purposes.*

*January – December 1987 – Costs recharged from service at costs + 5% across all London Departments. Costs recharged by a variety of bases (Headcount, Floor Space, Set Percentage…) 5% Uplift charged at corporate adjustment level. Certain departments uplifted at cost + 10% for statutory accounts purposes.*

*January – December 1988 – Costs recharged at cost + 10% on all items. Costs recharged on two methods:*

- *Management Accounting Basis at departmental level.*
- *Headcount Basis at legal entry level.*
- *Certain Departments operated at cost + 10% from January to April.*

*January – December 1989 – Costs recharged at cost + 10% on all items. Costs recharged on two methods:*

- *Management Accounting Basis at departmental level.*
- *Headcount basis at legal entry level."*

20. Further, the statutory accounts prepared and filed on behalf of LBL provide the following descriptions of LBL's activities from 1986 until 2006 (being the last accounts filed on behalf of LBL):

20.1. Year ending 1986 – "*The principal activities of the company are to provide market information to Shearson Lehman Brothers Inc, to act as its agent on certain commodity exchanges in the United Kingdom, to act as agent on behalf of Shearson Lehman Brothers Inc for UK customers on principal United States Stock and commodity exchanges and <u>to act as service company to the other United Kingdom subsidiaries of [Lehman Brothers].</u> The company has a wholly owned*

*subsidiary Shearson Lehman Metals Limited which is engaged in metal trading and is a ring-dealing member of the London Metal Exchange*" (emphasis added);

20.2. Years ending 31 December 1987 to 31 December 1991 – "*The principal activity of the company is to provide administrative services to associates with business operations in the UK. The company has a wholly owned subsidiary Shearson Lehman Hutton Commodities Limited which is engaged in metal trading and is a ring-dealing member of the London Metal Exchange*" (emphasis added);

20.3. Years ending 31 December 1992 to 30 November 2006 – "*The principal activity of the company is to provide administrative services to fellow group companies with business operations in the UK*" (emphasis added)

21. The statutory accounts prepared on behalf of LBIE, LBH Plc, LBEL and LBHI2 (including where filed at companies house), for the years ending 31 December 1990 and onward, record, among other things, that:

21.1. Administrative expenses for each entity comprised of direct costs and expenditure recharged by LBL for central costs and services, representing costs borne by LBL on behalf of the entities;

21.2. All employees, including the directors for each entity, were employed by LBL, which recharged those costs; and

21.3. Payments made to suppliers were made through LBL.

LBL reserves the right to refer to the full terms of each of the statutory accounts at trial.

**(iii) Implementation of the Recharge Agreement**

22. The Lehman Group utilised a central accounting system for all Lehman Group entities, including the UK Lehman Group (the "**Centralised Accounting System**"), so that it could operate a unified reporting process internationally. A variety of different programmes were used to perform the accounting function, but primarily during the material time the Centralised Accounting System comprised Dun & Bradstreet Software ("**DBS**"), and, from 2003, a reporting system known as, Essbase. The Centralised Accounting System was operated on behalf of (at least) the UK Lehman Group by a Back-Office Team having responsibility for the accounting function for the entire UK Lehman Group on a divisional basis, the members of which team were employed by LBL.

23. The processes and procedures embedded in the Centralised Accounting System enabled the recharge of costs, expenses and liabilities incurred by LBL. By way of very broad summary only:

23.1. When a legal entity became part of the Lehman Group on incorporation or acquisition (as applicable), a new legal entity ID and a trial balance was created for it in the Centralised Accounting System. LBL contends that pursuant to the general arrangements set out in paragraphs 6 and 7 above, and in particular by its acceptance of a legal entity ID, each member of the UK Lehman Group delegated its accounting function to the Back-Office Team having responsibility for the UK accounting function;

23.2. LBL discharged all UK operational and administrative costs, expenses and liabilities (including payroll costs) incurred by or on behalf of members of the UK Lehman Group;

23.3. Integrated reporting allowed for costs incurred on behalf of a specific entity to be directly recharged to that entity by LBL without uplift. Those costs did not appear in LBL's profit and loss account;

23.4. Where costs were incurred by LBL but were not attributable to any one particular entity ("**Sweep Costs**") these were apportioned between certain UK Lehman Group entities at cost plus an uplift using the Sweep Mechanism. These recharges were identifiable in LBL's profit and loss account. The uplift charged was 10% from 1 January 1988 until 1 January 1991, and thereafter (until or about December 1999) 1%.

23.5. Certain specific costs (such as net interest accrued on intercompany accounts and provision for future costs in respect of the Broadgate lease) were subject to recharge using a different methodology reflecting particular tax, regulatory and other concerns.

24. The above arrangements were in operation from October 1986. They necessarily encompassed the recharge of costs attributable to LBL itself (including its employment of personnel working within the Back-Office Teams and serving a divisional function) since LBL had no other substantial source of revenue to meet these costs.

**(iv) The APB23 Assertion and Global Transfer Pricing Review**

25. As set out in LBL's Position Paper at paragraphs 29 to 37, 84 to 86 and 88, in 1999-2000, an APB23 assertion was made for each of LBL and LBEL. As part of this process and of a

concurrent Global Transfer Pricing Review, a decision was taken to restore the uplift on intercompany charges raised by LBL from 1% to 10%, and part of the Recharge Agreement was recorded in writing.

26. On 11 July 2000 it was noted by Jackie Dolby, an employee of LBL and member of the European Taxation Department, that "*monitoring on a day to day basis is probably not required but we should ensure that there is a legal secondment agreement to support the fact that these secondments do take place*" Likewise, Ms Dolby stated that although the recharge arrangements were well known, "*I am unsure if we have a legal agreement to support this recharge. I would be grateful if you advice if such an agreement exists or if one needs to be created*."

27. In a reply email dated 13 July 2000, Teresa South, an employee of LBL and an attorney in the Legal Department and (inter alia) director of LBL from 13 January 1997 to 13 March 1998, confirmed that the only written intercompany service agreement was between LBL and Bankhaus London in respect of seconded employees. Even by 2000 Ms South considered recharge arrangements to be "*ancient history about LBL*".

28. In the event, part of the intercompany recharge arrangements between LBL and LBIE, and LBL and LBEL, were then documented by the written service and secondment agreements executed on 22 August 2000, stated to be effective from 1 December 1999. The LBL Administrators have identified that like service and secondment agreements were entered into by LBL with Lehman Brothers Inc. and Lehman Brothers Holdings Inc. on 28 August 2000, as well as a services agreement dated 2 September 2002 between LBL and Lehman Brothers Lease & Finance No. 1 Limited.

29. LBL's case in relation to the service and secondment agreements is as set out in its Position Paper at paragraphs 37, 86 to 89, and its Reply Position Paper at paragraphs 25 to 27. It is, in summary, that they recorded only part of the arrangements that were already subject to the Recharge Agreement, and were not intended to and did not replace, limit or affect the terms of the Recharge Agreement already in place. Indeed, they were not entered into in order to establish new legal relations between the parties, but simply to reflect part of the preceding arrangements for recharge of costs incurred by LBL as a service company. Similarly, although the service agreements between LBL and LBIE and LBL and LBEL were modified on 20 May 2004, effective from 1 April 2004, the only modification was to deal with capital adequacy concerns and did not affect the operation of the Recharge Agreement.

30. Otherwise, LBL notes that LBIE and LBEL contend that the 2004 service agreements were superseded by a costs recharge agreement dated 23 December 2008. This agreement

was entered into very shortly after the entry into administration of LBL, LBIE, LBEL and LB UK RE Holdings Limited. The LBL Administrators will contend that the 2008 agreement was entered into without the various administrators having then had the opportunity to investigate the pre-existing arrangements for recharge and was not intended or expressed to alter the pre-existing rights of the parties, including by reason of the Recharge Agreement.

31. In any event and as set out in LBL's Reply Paper at paragraph 28, the 2008 agreement did not encompass the costs which LBL now seeks to recharge to LBIE, LBEL, LBH Plc and/or LBHI2 (namely any liability by way of Contribution Claim, Bad Debts and/or Administration Expenses), not least where the Contribution Claim and/or Bad Debts were incurred by LBL on a contingent basis including as a shareholder in LBIE prior to its entry into administration.

## C) REQUESTS AND RESPONSES TO THE SCHEDULE

**Request**

**(1) As to the LBL Administrators' case that LBHI2, LBEL, and LBH are each alleged to be liable to LBL pursuant to the alleged Recharge Agreement please provide details of:**

**(a) The original parties to the alleged Recharge Agreement;**

**(b) The means by which and from which date each of the aforesaid original parties became parties to the alleged Recharge Agreement;**

**(c) The terms and scope of the alleged Recharge Agreement, including:**

**(i) The nature of the costs, expenses, other liabilities or items to which it applied;**

**(ii) The proportions in which such sums were to be recharged to each Lehman Group entity (including but not limited to LBHI2, LBEL, and LBH) said to be liable to LBL; and**

**(iii) Each other term (whether express or implied and, if implied, the basis for such implication) of the Recharge Agreement on which the LBL Administrators rely against one or more of the parties.**

**(d) Any further term of the alleged Recharge Agreement on which the LBL Administrators rely against one or more of the parties and which is alleged to have been introduced by amendment of the alleged Recharge Agreement.**

**Response**

32. The LBL Administrator's primary case is that the Recharge Agreement was in origin an oral agreement entered into in the circumstances set out above, and is evidenced and recorded by (without limitation) the documents referred to above and appended to this response. Alternatively the Recharge Agreement was made by conduct, namely by the actions of the Back-Office Team members employed by LBL, acting in accordance with authority given by the UK Lehman Group and as set out in paragraphs 6 to 7 and 22 to 24 above.

33. When, on or about 1 October 1986, LBL assumed the role of the UK Lehman Group service company, the parties to the Recharge Agreement included, but were not limited to:

    33.1. LBH Plc (which had been incorporated in October 1984 and which had acquired a legal entity number);

    33.2. LB Securities;

    33.3. LBGL;

    33.4. Lehman Brothers International Inc ("**LBII**")

    33.5. LBMBL;

    33.6. Shearson Lehman Metals Ltd;

    33.7. Shearson Lehman Messel Ltd;

    33.8. Messels Futures Ltd.

34. As regards the terms and scope of the Recharge Agreement, it was agreed that:

    34.1. LBL would provide services for the benefit of the UK Lehman Group. For example, LBL would be the entity which directly employed and remunerated the staff of the UK Lehman Group, with these staff to perform services for the UK Lehman Group via the Back-Office Teams in LBL, or to be seconded to members of the UK Lehman Group;

    34.2. In consideration for LBL acting as service company, and in recognition of the fact that LBL did not have the financial resources to incur substantial costs on its own account other than income tax and/or that, for tax reasons, LBL's activities were required to be carried out on a commercial basis (so as not to put at risk the UK Lehman Group entities' group tax relief), all costs, expenses and liabilities howsoever incurred by LBL would be recharged;

34.3. In general, sums incurred on behalf of a particular entity within the UK Lehman Group would be recharged to that entity without any uplift and that entity would be liable to reimburse LBL for the costs, expenses and liabilities incurred for and on behalf of it at cost;

34.4. Where costs were not attributable to a single UK Lehman Group entity in this way, the Sweep Mechanism applied such that the cost plus any uplift would be apportioned. Initially (from October 1986) no uplift was applied. However, to achieve the commercial purpose of the Recharge Agreement and having regard to the considerations set out in paragraph 34.2 above, the uplift and apportionment aspects of the Sweep Mechanism were at all times capable of variation having regard to (among other things) prevailing tax, regulatory, profitability and other concerns. Such variations were implemented following discussions between the Back-Office Teams having responsibility for these matters, LBL infers at all material times subject to the supervision of the UK Lehman Group management (whether in the form of the Management Committee or otherwise). Accordingly, each UK Lehman Group entity would be liable to reimburse LBL for the costs, expenses and liabilities incurred for or in connection with the business of the UK Lehman Group on the basis of the Sweep Mechanism from time to time in place; and

34.5. Further or alternatively, it was an implied term of the Recharge Agreement (necessary to give it business efficacy), that having regard to the considerations set out in paragraph 34.2 above, LBL would be kept fully indemnified from all costs howsoever incurred by it in acting as the service company to the UK Lehman Group.

35. Having regard to the amendment of the Recharge Agreement, in furtherance of the term set out in paragraph 34.4 above alternatively by way of variation of that term, the level of uplift charged by LBL on Sweep Costs was determined from time to time by consultation between the personnel having responsibility for the tax affairs of the UK Lehman Group and, from time to time, liaising with the Revenue. Further to this (and as regards the UK Entities):

35.1. From October to December 1986, there was no uplift on costs recharged;

35.2. From January to December 1987, costs were recharged at costs plus 5%;

35.3. From 1 January 1988 the uplift increased to 10%;

35.4. From 1 January 1991 the uplift decreased to 1%; and

35.5. On 1 December 1999 the uplift was restored to 10%.

36. Similarly, as regards apportionment of Sweep Costs between the relevant UK Lehman Group entities, in furtherance of the term at paragraph 34.2, 34.4 and/or 34.5, or alternatively by way of variation thereof, Sweep Costs were apportioned upon the basis of headcount of personnel (save for the period from January to December 1987 when Sweep Costs were apportioned across the group having regard to a variety of matters including headcount and a set percentage). From 2000 a reapportionment of Sweep Costs also occurred as between LBIE and LBEL, such that between 2000 and 2004 these were reapportioned as between LBIE and LBEL in the ratio 98:2, and between 2004 and 2007, as between LBIE and LBEL in the ratio of 75:25. Further, from 2007, Sweep Costs were reapportioned as between LBIE, LBEL and other UK Lehman Group entities in the ratios of 54.55; 40.66 and 4.79% (see further LBL's Supplementary Position Paper at paragraph 19.3).

37. Further and in addition to the above, it should be noted that certain costs, such as net interest accrued on intercompany accounts and provision for the future costs of the lease of Broadgate, whilst falling within the scope of the Recharge Agreement, were subject to a specific method of recharge having regard to (among other things) tax, regulatory, profitability and other concerns. The precise detail of these arrangements will be a matter for evidence to be served by LBL in due course.

**Request**

**(1)(e) In respect of each of the alleged parties (in particular LBHI2, LBEL and LBH), how and when each such further term became an effective and binding contractual term of the alleged Recharge Agreement.**

**Response**

38. The particular positions of LBIE, LBEL, LBH Plc and LBHI2 are addressed below. However, for the reasons given above, it is LBL's case that the Recharge Agreement included provision for variations to be effected as set out in paragraph 34.4 and/or 35 above. Accordingly, the variations to the Recharge Agreement were effected pursuant to its terms, in particular on the dates set out in paragraphs 35 and 36 above.

**Request**

**(1)(f) How each of LBHI2, LBEL and LBH is alleged to have become a party to the alleged Recharge Agreement and from what date each of those parties is alleged to have become bound by the terms of the alleged Recharge Agreement.**

**Response**

39. As set out above, each UK Lehman Group entity became party to the Recharge Agreement on incorporation or acquisition (where relevant), at which time a legal entity number would be allocated to it and a trial balance created for it in the Centralised Accounting System. From this time, the entity would automatically share in and benefit from and owe obligations pursuant to the Recharge Agreement.

40. As regards each of LBHI2, LBEL and LBH Plc:

    40.1. LBH Plc was incorporated in October 1984 and was a party to the Recharge Agreement from its effective date on or about 1 October 1986, at or about which time it was allocated a legal entity ID.

    40.2. LBEL became a party to the Recharge Agreement on about 14 March 2000 when it was incorporated, at or about which time it was allocated its legal entity ID. Further or alternatively, by a business purchase agreement dated 7 July 2000, LBIE sold and LBEL purchased LBIE's corporate finance business on terms that LBEL would assume, discharge and fulfil all obligations, debts, liabilities, engagements and contracts of LBIE in connection with that business (at clause 3). LBL reserves the right to refer to the full terms of this agreement at trial but will aver that, insofar as the corporate finance business of LBIE had previously had been conducted pursuant to the Recharge Agreement and was then acquired by LBEL, LBEL accordingly became privy to the Recharge Agreement in respect of this business.

    40.3. LBHI2 became party to the Recharge Agreement on about 5 October 2006 when it was incorporated, at or about which time it was allocated its legal entity ID. Given that LBHI2 was incorporated only a short time before the collapse of the Lehman Group into administration, there is limited activity recorded in the financial data relating to its affairs. The data identified to date by the LBL Administrators does not indicate any historic costs directly attributable to LBHI2 having been recharged to it (such that no liability appears for recharges on its Profit and Loss account). However, there would have been costs associated with (i) the incorporation of LBHI2, (ii) the advance of subordinated debt to LBIE by LBHI2 and (iii) the 2006/2007 'European Holding Company Restructure and LBIE Recapitalisation' and (iv) the issue of certain notes by LBHI2 in 2007. There is no cost, expense or liability associated with the aforementioned matters appearing in LBHI2's Profit and Loss account and so, in all the circumstances, it is reasonably to be inferred that LBL would have incurred costs, expenses and liabilities on

behalf of LBHI2, which would have been recharged via the Sweep Mechanism or otherwise. Yet further:

40.3.1. The LBL Administrators have not identified any documentation that suggests that LBHI2 or any other holding company should be excluded from the Recharge Agreement (as set out above), or subject to separate arrangements;

40.3.2. LBL further notes and relies on the following reference made in the notes to the financial statements in the LBHI2 draft statutory accounts covering the period from incorporation on 5 October 2006 to 30 November 2007: "*The Company has no employees. All personnel, including directors, who perform services for the company are employed and remunerated by Lehman Brothers Limited*."

41. For the avoidance of doubt, LBL avers that LBIE became a party to the Recharge Agreement on or about 10 September 1990, at or about which time it was provided with legal entity ID and subscribed to the use of the Centralised Accounting Systems in which the Recharge Agreement was embedded.

42. Further or alternatively, by written agreement dated 30 November 1990, LBIE agreed to acquire the UK business of LBII. This agreement made explicit provision:

42.1. At clause 2, for the transfer of the benefit of all subsisting contracts relating to the business of LBII (clause 2);

42.2. At clause 5 for LBIE to assume all liabilities and obligations acquired from LBII;

42.3. At clause 6, for the assignment, novation and/or transfer of all contracts, agreements, engagements and arrangements comprising the business; and

42.4. At clause 10, for the employees seconded (by LBL) to LBII to be informed that they would cease to be seconded to LBII and would be seconded instead (by LBL) to LBIE.

43. LBL reserves the right to refer to the full terms of this agreement at trial but will aver that, insofar as LBII had been privy to the Recharge Agreement for the purpose of conducting its business, LBIE acquired LBII's business subject also to the Recharge Agreement.

**Request**

**(1)(g) Whether any written document is relied on by the LBL Administrators as evidence of the alleged Recharge Agreement as against any of the parties and, if so,**

**(i) give the date of that written document and (ii) provide a copy of the relevant document.**

**Response**

44. As set out above, the LBL Administrators have been unable to identify a single written document recording all of the terms of the Recharge Agreement. However, LBL relies in particular upon the documents referenced in and appended to this Response as evidencing the Recharge Agreement, including insofar as they apply to each of LBHI2, LBEL, and LBH Plc.

**Request**

**(1)(h) If it is alleged that the alleged Recharge Agreement was contained in, and/or was recorded "*in part*" by, any written document identified in response to (b) above:**

**(i) In relation to, respectively, each of the Contribution Claim, the Bad Debt Claim and/or the Administration Expenses (as defined in paragraph 78 of the LBL Administrators' Position Paper) as well as each category of "*administrative cost*" set out in Appendix 3 to the LBL Administrators' Position Paper, whether it is alleged that each category of such Recharges falls within the written agreement or outside of the written agreement;**

**(ii) To the extent that it is alleged that a particular category of such Recharges falls within the written agreement, each term of the written agreement on which the LBL Administrators rely against one or more of the parties (whether express or implied and, if implied, the basis for such implication).**

**Response**

45. LBL does not contend that any written document expressly refers to the recharge of the Contribution Claim, Bad Debt Claim and/or Administrative Expenses. However, it contends that these claims are covered by the Recharge Agreement, which encompassed all costs, expenses and liabilities incurred by LBL, and including for the reasons set out in LBL's Reply Position Paper at paragraph 27. To this extent, therefore, all documents evidencing the Recharge Agreement bear upon the ability of LBL to recharge these claims.

46. Where the LBL Administrators have claimed that the Recharge Agreement was subsequently recorded "*in part*" in writing, that is having regard to the service and secondment agreements entered into in the context of the APB23 assertion and/or Global Transfer Price Review in 1999/2000, as set out in paragraphs 25 to 29 above.

47. Insofar as the Recharge Agreement was subsequently recorded "*in part*" in writing in this context:

47.1. In order to maximise the tax advantages of making an APB23 assertion in respect of LBL, it was determined that the maximum possible expense should be booked to LBIE; put another way, the maximum possible expense should be recharged from LBL to LBIE. This commercial consideration led to the uplift on sweep costs being altered from 1% to 10%. The very same considerations meant that at no point during the process did any of the parties consider that the scope of the Recharge Agreement was to be in any way narrowed from that which had previously been as a matter of practice recharged. Except insofar as it was decided to increase LBL's uplift on sweep costs from 1% to 10%, there was no intention to vary, derogate from, restrict or otherwise alter the terms of the Recharge Agreement which had then been in operation for over a decade. Nor did the entering into the service and secondment agreements have such effect.

47.2. The written service agreements (which were in substantially identical form) were non-exhaustive. In particular:

47.2.1. clause 4 of the service agreement provides as follows:

> *"Consideration*
>
> *In consideration of LBL providing services to [LBIE/LBEL], [LBIE/LBEL] agrees to pay LBL a fee. Such fee is to be calculated on the basis of the total cost of such services plus a mark up of ten percent (10%) or such other basis of the calculation which may be agreed from time to time between the parties. For the purpose of this agreement the definition of total cost is set in Appendix A."*

47.2.2. Appendix A then provides:

> *"For the purpose of this agreement "total cost" comprises of costs relating to:*
>
> *Compensation and Benefits*
>
> *Technology &Communications*
>
> *Business Development Expenses*
>
> *Occupancy*
>
> *Professional Fees*
>
> *Brokerage & Clearance*
>
> *Other miscellaneous expenses."*

47.3. The service agreement is therefore incomplete in a number of ways:

47.3.1. These provisions only cover one aspect of the Recharge Agreement, being the Sweep Costs. Consideration is expressed to be on the cost plus uplift basis, which was only ever applicable to costs that could not be directly allocated to LBIE, LBEL or any other entity. No provision is made for directly allocated costs, which was an entirely separate category of costs subject to reimbursement on an entirely separate basis (recharge at cost with no uplift). To the extent that any of the items listed in Appendix A were the identifiable expenses of LBIE or LBEL only, those costs would not have been charged as per clause 4 above, but would have been directly charged through the Centralised Accounting System;

47.3.2. Appendix A, referring as it does to "*other miscellaneous expenses*", is expressly non-exhaustive;

47.3.3. The service agreement is expressed to relate to "*administrative and operational support services in order to carry out [LBIE/LBEL]'s business activities*". So expressed, it does not cover LBL's own operative and other costs, yet the Recharge Agreement was prior to December 1999 and subsequently continued to be operated on the basis that such costs were recharged. For example, Ms Dolby noted in an email dated 11 July 2003 that such costs were recharged as part of the sweep costs, "*LBL is the UK service company. We tend to recharge it's* [sic] *costs (which will include office equipment & other assets) to other group companies on a cost plus 10% basis. I do not have a soft copy of this agreement but Emily Upton in the UK Corporate Counsel group will have…*".

47.4. Further or alternatively, LBL will contend that when considered in their commercial context, and/or on a true interpretation of these agreements, there is an express, alternatively implied term, in the written service and secondment agreements that the written agreements were not intended to derogate from the wider Recharge Agreement, the greater scope of which they were not intended to document.

47.5. Yet further or alternatively, if and to the extent that it is found that certain of LBL's costs fell outside the scope of the written service and secondment agreements, the consistent continued recharge of all such costs amounted to a collateral contract to the written service and secondment agreements on the terms

of the Recharge Agreement identified above, which continued to be applied in practice.

48. In the circumstances, LBL's position is that each of the Contribution Claim, the Bad Debt Claim and/or the Administration Expenses, were entitled to be recharged under the Recharge Agreement or, if and insofar as applicable, the non-exhaustive terms of clause 4 and Appendix A of the service agreements.

**Request**

**(1)(i) If it is alleged that any of LBHI2, LBEL and/or LBH became party to the alleged Recharge Agreement by means of an oral agreement, (i) which individual(s) (on behalf of each of LBL and each of LBHI2, LBEL and LBH) made such oral agreement and (ii) full particulars of what was orally agreed, including when and where it was made and its terms; and**

**Response**

49. See Response to Request (1)(f) above.

**Request**

**(1)(j) If it is alleged that the existence of the alleged Recharge Agreement between LBL and any one or more of LBHI2, LBEL and LBH is to be inferred from conduct, the particular conduct and/or documentary evidence on which the LBL Administrators rely in support of that inference.**

**Response**

50. LBL's primary case is that LBHI2, LBEL and LBH were party to the oral agreement comprising the Recharge Agreement, as evidenced in writing, set out above. Alternatively, the LBL Administrators will aver that, if and insofar as necessary, the Recharge Agreement may be inferred or implied from the conduct of, among others, LBHI2, LBEL and LBH Plc, in particular:

50.1. In delegating their accounting and other back-office functions to the Back-Office Teams employed by LBL, in particular the Back-Office Team having responsibility for the accountancy function which was operated on a group-wide, divisional basis having regard to the Recharge Agreement;

50.2. In permitting LBL to incur costs, expenses and other liabilities on their behalf;

50.3. In permitting LBL to incur costs, expenses and other liabilities on behalf of the UK Lehman Group, which costs were then recharged by LBL pursuant to the Sweep

Mechanism, including substantially by LBEL (as set out in paragraph 36 above); and

50.4. In not employing any staff directly, but instead relying on LBL for the secondment of personnel and their remuneration, the costs of which were then recharged.

**Request**

**(2) As to the LBL Administrators' case that, further or alternatively, LBHI2, LBEL and LBH are each alleged to be liable to LBL pursuant to an agreement by custom (and/or, where applicable, collateral contract) (as alleged at paragraph 93 of the LBL Administrators' Position Paper):**

**(a) The original parties to the agreement by custom and/or collateral contract (and, in the case of the collateral contract, the parties to the relevant principal contract);**

**(b) The matters relied on to show, (i) the existence of the agreement by custom and/or collateral contract and (ii) that each of the aforesaid original parties became party to the agreement by custom and/or collateral contract;**

**(c) The terms and scope of the agreement by custom and/or collateral contract (and, in the case of the collateral contract, the scope of the relevant principal contract), including:**

**(i) The nature of the costs, expenses, other liabilities or items to which it applied;**

**(ii) The proportions in which such sums were to be recharged to each Lehman Group entity (including but not limited to LBHI2, LBEL, and LBH) said to be liable to LBL; and**

**(iii) Each other term of the agreement by custom and/or collateral contract (and, in the case of the collateral contract, each other term of the relevant principal contract) on which the LBL Administrators rely against one or more of the parties;**

**(d) Any further term of the agreement by custom and/or collateral contract on which the LBL Administrators rely against one or more of the parties and which is alleged to have been introduced by amendment to the agreement by custom and/or collateral contract;**

**(e) The matters relied on to show that each such further term became an effective and binding contractual term of the agreement by custom and/or collateral contract;**

**(f) The matters relied on to show that each of LBHI2, LBEL and LBH became a party to the agreement by custom and/or collateral contract and from what date each of those parties is alleged to have been bound by the terms of the agreement by custom and/or collateral contract;**

**(g) Whether any written document is relied on by the LBL Administrators as evidence of the agreement as against any of the parties and, if so, (i) give the date of that written document and (ii) provide a copy of the document;**

**(h) If it is alleged that any of LBHI2, LBEL and/or LBH became party to the said agreement by means of an oral agreement, (i) which individual(s) (on behalf of each of LBL and each of LBHI2, LBEL and LBH) made such oral agreement and (ii) full particulars of what was orally agreed, including where and when it was made and its terms.**

**Response**

51. As set out above in answer to Request 1 it is the principal case of LBL that the Recharge Agreement was made orally or alternatively by conduct. As also set out above it was thereafter varied.

52. As to LBL's further or alternative case to that set out above, that the Recharge Agreement is an agreement by custom (and/or where applicable, collateral contract), LBL will rely upon the matters set out above, in particular at paragraphs 6 to 8, 22 to 24 and 50.

**Request**

**(3) In relation to each of the categories of costs identified in Appendix 3 to the LBL Administrators' Position Paper, please identify:**

**(a) The alleged nature of each of the categories of costs identified in Appendix 3;**

**(b) The dates on which each category of costs identified in Appendix 3 were recharged to each such Lehman Group entity; and**

**(c) The proportions in which the costs identified in Appendix 3 were allegedly recharged to each such entity.**

**Response**

53. As regards request (3)(a), it is not understood what is meant by the "*alleged nature of each of the categories of costs*". Appendix 3 to the LBL Administrators' Position Paper records the different expenses that appeared in LBL's corporation tax computations for all years for which such computations have been located by the LBL Administrators (1993 – 2006). Not all cost lines appeared in each year.

54. As set out in LBL's letter of 30 January 2017, and pursuant to paragraph 1 of the Order, a response to question (3)(b) will be given by LBL on or before 28 February 2017.

55. The categories of cost listed in Appendix 3 are examples of Sweep Costs incurred from time to time, and recharged pursuant to the Sweep Mechanism set out above, and thus recharged on the basis of an allocation referable to headcount or otherwise as re-apportioned. Without prejudice to the same, in the event that such costs were incurred on behalf of a particular UK Lehman Group entity then they will have been directly recharged to the same.

**Request**

**(4) The examples of recharges made to holding companies (including any examples of recharges made to LBHI2 and/or LBH, if any) referred to by the LBL Administrators in their Reply Position Paper dated 30 December 2016 at paragraph 32.1 (as requested in Dentons' letter to Dechert of 6 January 2017).**

**Response**

56. At the present time, LBL relies upon the following examples of recharges made to holding companies at these effective dates:

    56.1. On 8 August 2005, LBL recharged a payment of £170 made to Lehman Brothers UK Holdings Limited made on its behalf;

    56.2. On 3 September 2006, LBL recharged to LBH Plc a total payment of £65,971.66 made on behalf of LBH Plc;

    56.3. On 29 September 2006, LBL recharged to LBH Plc a total payment of £13,008.50 made on behalf of LBH Plc; and

    56.4. On 2 September 2005, LBL recharged to LBHI a total payment of £17,851.02.

**Request**

**(5) Without prejudice to the matters set out above, whether it is asserted that the holding of a share in LBIE by LBL was a service provided to one or more of LBH, LBHI2 or LBIE within the ambit of the Recharge Agreement and if so:**

**(a) What is the basis of such assertion, in particular by reference to the specific terms of the alleged Recharge Agreement;**

**(b) Specifically, to which of the alleged parties to the Recharge Agreement the said service was provided;**

**(c) Insofar as it is said that the costs and expenses of holding a share in LBIE was analogous to other expenses incurred and recharged by LBL (see paragraph 19.4 of LBL Administrators' Supplemental Position Paper) the precise basis upon which it is asserted that such an analogous expense was capable of being recharged under the alleged Recharge Agreement, including in particular by reference to the specific terms of the alleged Recharge Agreement.**

**Response**

57. As to 5(a), LBL contends that the holding of a share in LBIE by LBL was a service provided within the ambit of the Recharge Agreement (the terms of which are as set out above) for the following reasons.

58. As set out above, on 1 October 1986 LBL assumed the role of the service company for the UK Lehman Group. Subsequently it ceased to conduct any other substantial business (i.e. save for continuing to hold an interest in PML from 1994 and/or LBCL from prior to 1986, such holdings being characterised as an investment).

59. LBL's holding of a share in LBIE was consistent with its operations as a service company. As set out in LBL's Position Paper at paragraph 59, the directors of LBL agreed in both 1994 and 1997 to hold the share in LBIE without exercising any independent judgment as to whether this was in LBL's best interests and/or for an improper purpose: in order to promote the interests of LBIE and/or LBH Plc and/or the Lehman Group (including the UK Lehman Group), rather than LBL's own interests. Further, it was not in the best interests of LBL to accept a share in LBIE as an unlimited company and it is thereby reasonably to be inferred that LBL accepted this share only to confer a perceived benefit on LBIE and/or the Lehman Group, in its capacity as service provider.

60. Further or alternatively, the holding of a share in LBIE by LBL was considered to confer a benefit upon LBIE and/or LBH Plc and/or latterly LBHI2 because it was thereby (erroneously) considered that LBIE complied with the (mistaken) mandatory requirement that an unlimited company was required to have two shareholders, and so supported the UK Lehman Group structure that had been put in place following the 1992 Profitability Review.

61. Whereas a value was afforded to LBL's interest in PML and LBCL in LBL's statutory accounts, no value was afforded to its shareholding in LBIE. As set out in LBL's Position Paper (at paragraphs 41 to 47) LBL was not treated as, or routinely represented to be, a shareholder in LBIE. Notwithstanding that LBIE declared dividends at times when LBL was registered as a shareholder, LBL received no dividend payments in respect of its share. There is no record in LBL's accounts of any value being attributed to the share or any actual monetary investment being made by LBL to acquire the share. If such investment had been made, the percentage of shares in LBIE held by LBL would have been infinitesimal, at no time being more than 0.001% of the shares. The risk associated with such a shareholding in an unlimited company carrying on a very large, exceptionally complex business many times larger than LBL's business outweighed on any possible measure the profits LBL might have been entitled to or expected from the share, such that the share cannot on any rational basis be characterised as an investment. In contrast, the shareholdings in LBCL and PML were genuine commercial investments, comprising respectively 100% and 5% of the shares of each entity.

62. As to 5(b), LBL contends that it held a share in LBIE for the benefit of LBIE, LBH Plc and/or (from November 2006) LBHI2, or alternatively the UK Lehman Group. Its case in this regard is set out in its Supplementary Position Paper at paragraphs 19 and 20.

63. As to 5(c), the costs of holding a share in LBIE fell within the scope of the Recharge Agreement, in particular the terms pleaded at paragraph 34 above. The question of whether the costs, expenses and liabilities associated with LBL's holding of a share in LBIE are analogous to other costs, expenses and liabilities incurred by LBL and then recharged is a matter of fact for determination at trial.

20 February 2017

Philip Marshall QC

Ruth den Besten

Sophia Hurst