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 (IN ADMINISTRATION)

Respondents

LBL REPLY POSITION PAPER

INTRODUCTION

1. This paper is served by LBL, pursuant to the directions made by Mr Justice Hildyard on 4 November 2016 ("**Order**"), in reply to the Position Papers of LBIE, LBHI2, LBEL dated 18 November and LBH Plc dated 16 December 2016.

RESPONSE POSITION PAPERS

2. The service of the parties' Position Papers has served substantially to narrow the Issues requiring determination by the Court. In particular:

   2.1. As regards Issues 1 and 2, LBL, LBIE, LBHI2 and LBH Plc are agreed that in the event that the Sub-Debt falls to be re-paid, any Sub-Debt Contribution

Claim is to be, or otherwise has already been, dealt with in LBIE's administration by way of set-off as against LBHI2 [LBIE/14 and 56(3); LBHI2/2.1; LBL/118; LBH Plc/15-17 and 19 and 23][1].

2.2. Save for LBIE, the above parties also agree that no Sub-Debt Contribution Claim, or no valuable Sub-Debt Contribution Claim, is to be raised against LBL [LBHI2/3.1; LBH Plc/20 and 23]. Further, whilst LBIE contends that a Sub-Debt Contribution Claim might be raised as against LBL on a contingent basis and/or for the limited purpose of adjusting the rights of LBL and LBHI2 *inter se* [LBIE/28 and 29(4)], no adjustment of rights *inter se* is sought by LBHI2 and, in all the circumstances, there is no need for a Sub-Debt Contribution Claim to be made as against LBL.

2.3. As regards Issue 3, the parties are agreed as to the legal principles applicable to the question of valuation of the Sub-Debt Contribution Claim, and specifically that the Sub-Debt Contribution Claim is to be valued as a contingent claim, having regard to the likelihood of the relevant contingencies occurring [LBL/121; LBIE/25; LBHI2/3.5-3.6; LBH Plc/20]. For the avoidance of doubt, LBL also agrees that the hindsight principle may apply to enable an office-holder to re-visit the value attributed to a contingent claim where there is a change in the likelihood of the contingency occurring, per Wight v Eckhardt Marie GmbH [2004] 1 AC 147 and In re MF Global UK Ltd (in special administration) (No 2) [2013] EWHC 92 Ch, [2013] Bus LR 1030 [LBIE/26(2)].

2.4. As regards Issue 4, the parties are agreed that, to the extent that the Sub-Debt Contribution Claim is extinguished by way of set-off as between LBIE and LBHI2, there will be no value attaching to a Sub-Debt Contribution Claim as against LBL [LBL/126, 127; LBIE/28[2]; LBHI2/4.3]. LBH Plc likewise claims that, to the extent that it is the registered holder of a single share in LBIE, there

[1] LBEL takes no position in relation to those Issues addressing the Sub-Debt and Sub-Debt Contribution Claim.

[2] As above LBIE nonetheless contends that it may raise a Contribution Claim as against LBL on a contingent basis or for the purposes of the adjustment of rights *inter se*.

is no value attaching to any Sub-Debt Contribution Claim as against it [LBH Plc/23].

2.5. As regards Issues 5 and 6, LBIE [LBIE/32-33], LBHI2 [LBHI2/5.1-5.2], LBEL [LBEL/23] and LBH Plc [LBH Plc/27-28, 30] are agreed that, where there are multiple distributing administrations, the set-off which is taken to have occurred in the first estate will not be altered, disturbed or affected by the operation of an insolvency set-off in a subsequent administration. This is accepted by LBL to the extent that any debts are indeed mutual and caught, within the first administration, by IR 2.85 (and so excluding those debts set out in IR 2.85(2)) and further where the circumstances do not invite the re-drawing of the net balances and/or reconsideration of any values attributed (which will in each instance, including in the event of a subsequent administration, be a question of fact).

2.6. As regards Issue 7, the parties are agreed that there is no requirement that the members contribute an equal amount to meet any deficit arising in LBIE's estate, and, it appears, that the objective following a Contribution Claim is for the members to contribute rateably to the number of shares they hold (see in particular the authorities relied upon by LBIE [LBIE/43]). See too [LBH Plc/34].

2.7. As regards Issue 9, LBIE and LBEL accept the principle that recharge occurred, albeit that the basis and scope of such recharges are in issue. In particular, LBEL admits that "*In relation to (typically) costs incurred by LBL in respect of services provided to or for the benefit of the entire Lehman Group (and where it was not possible to identify a single beneficiary of the service provided, such as the payment of rent charges relating to business premises occupied by several Lehman OpCos), such costs were apportioned as between certain Lehman entities*" [LBEL/42].

2.8. As regards Issue 12 (which concerns only LBL and LBEL) the parties are agreed that any set-off occurring in LBIE's estate is irrelevant to LBEL's liability to LBL [LBL/140; LBEL/27-32].

3. Where not addressed above or further below, LBL's position in respect of the Issues remains as set out in its Position Paper dated 30 September 2016 and further Supplementary Position Paper dated 11 November 2016. Otherwise, in this paper LBL:

3.1. First addresses those issues which the Court has directed be determined as part of the "Part A" trial commencing on 30 January 2017 (Issues 1-8, 9A, 10 and 12), and second those issues which the Court has directed be determined as part of the "Part B" trial (Issues 9, 11, 13 and 14).

3.2. Responds to the principal points taken by each of the other parties in respect of the various Issues without prejudice to LBL's right to expand upon all relevant matters in submission and/or evidence as appropriate in due course. In particular, by its letters to the other parties of 10 November 2016 and to the Court of 17 November 2016 LBL set out its position that the resolution of Issues 1, 3, 7 (and therefore 8) requires factual evidence, and that Issue 9A may serve no useful purpose.

3.3. Adopts the abbreviations used in its Position Paper dated 30 September 2016 and in the other parties' Position Papers as appropriate.

3.4. Refers to the other parties' Position Papers in the form [Party/Paragraph number], for example [LBIE/1].

PART A ISSUES

Issue One

4. As indicated above, the parties are agreed that to the extent that the Sub-Debt is a provable claim, the conditions for the repayment of the Sub-Debt are met and a Contribution Claim is made in order to do so, then the Sub-Debt Contribution Claim is to be dealt with by way of set-off in LBIE's estate as between LBIE and LBHI2 [LBIE/14 and 56(3); LBHI2/2.1; LBL/118; LBH Plc/15-17]. This being so, there

may be little purpose in determining the ancillary issues relating to the Sub-Debt and any Sub-Debt Contribution Claim: (i) LBIE's asserted right to make a contingent Sub-Debt Contribution Claim as against LBL (and/or LBH Plc) and (ii) the ability of LBIE to make a Contribution Claim as against LBL for the purpose of adjusting the rights of LBL and LBHI2 *inter se* [LBIE/28, 29(4)]. The question of such adjustment is addressed further below in relation to Issues 4 and 7, but LBL resists the contention that such adjustment is appropriate in all the circumstances and where not sought by LBHI2.

5. Without prejudice to the above, by way of reply to the other points taken by LBIE, LBL will say:

   5.1. As matters stand, it is unclear whether the conditions required for repayment of the Sub-Debt will be met, and in particular whether LBIE has sufficient assets to discharge all of its prior ranking liabilities. If the conditions for repayment of the Sub-Debt are not met, then there will be no need to raise any Sub-Debt Contribution Claim; the Sub-Debt will not itself be repayable. In this regard, LBL adopts and supports the position of LBH Plc [LBH Plc/8(i),(ii)(b)-(c), 11(ii)(b)]. Similarly, LBL agrees with LBH Plc that to the extent that LBIE has a surplus available for repayment of the Sub-Debt, then any Contribution Claim must reflect the availability and amount of that surplus [LBH Plc/8(ii)(a)].

   5.2. LBIE's position that there is no express term precluding recourse to LBIE's members for the purpose of meeting the Sub-Debt, or alternatively no implied term to this effect, is misconceived in that it ignores entirely the nature of the Sub-Debt, and indeed the relevant commercial and regulatory context as against which the Sub-Debt Agreements were entered into.

   5.3. LBL has not had the opportunity to serve evidence in respect of the full context (the need for which is uncontroversial at least as between itself and LBHI2; see LBHI2's Skeleton Argument in Waterfall I at paras 14 to 20). Nonetheless, it appears to be common ground that:

5.3.1. The Sub-Debt Agreements were entered into as part of the 2006-2007 restructuring [LBL/38-40] in order to provide part of LBIE's regulatory capital and to meet the FSA's capital adequacy requirements.[3]

5.3.2. The purpose of the Sub-Debt was, as regulatory capital, to reduce risk and to absorb losses, including in the event of LBIE's insolvency; see further Waterfall I, per David Richards J. at paras 33, 35 to 47 and 60-63: "*Although subordinated loans may rank only as lower tier 2 or even tier 3 capital, they are nonetheless to be treated as part of the capital or own funds of the institution for the purposes of providing protection to those dealing with institutions and for the purposes of absorbing losses*" (at para 60).

5.3.3. The above purpose is expressly stated in both Basel I (at para 23) and Basel II (para 49(xii) and (xiv)): "*For short-term subordinated debt to be eligible as Tier 3 capital, it needs, if circumstances demand, to be capable of becoming part of a bank's permanent capital and thus be available to absorb losses in the event of insolvency...*" (at para 49(xiv)).

5.4. In these circumstances, LBL contends that it is inherent in the nature of the Sub-Debt that the Sub-Debt was to be available to meet losses in the event of LBIE's insolvency. Conversely, it was no part of the Sub-Debt Agreement that the Sub-Debt was to be repaid by recourse to a call on ordinary shareholders, themselves comprising a different class of LBIE's capital.

5.5. Furthermore, it is LBL's position that:

5.5.1. The role of LBL as a shareholder in LBIE played no part in the calculation of LBIE's capital, and/or the decision to restructure. Indeed, the entire restructuring appears to have been predicated upon LBIE being a wholly owned subsidiary of LBH Plc, and subsequently LBHI and LBHI2 [LBL/41, 43-44].

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[3] See the Statement of Agreed Facts prepared for the purpose of Waterfall I, at para 42.

5.5.2. The Sub-Debt Agreements expressly refer to the application of IPRU (INV) 10 in the FSA handbook, which must therefore be read together with the Sub-Debt Agreements. IPRU (INV) 10-62 does not include the product of a Contribution Claim as an asset of the Company. This supports the sole liability of LBIE as borrower to repay the Sub-Debt.

5.5.3. In the circumstances, it was an implied term of the Sub-Debt Agreements that the Sub-Debt would not be repaid by LBL.

5.5.4. This is particularly so where, as part of this restructuring, LBHI2 was to replace LBH Plc as the principal holding company of LBIE, and both LBH Plc and LBIE were aware that insofar as LBL held an interest in LBIE, it was as a nominee for LBH Plc [LBL/22.4 and 76].

5.6. Further and in any event, the sole liability of LBIE to meet the Sub-Debt reflects clauses 6(a) and (f) of the Sub-Debt Agreements (standard terms) which recorded LBIE's representations and undertaking that it was not, without the prior written consent of the FSA, to *"(a) secure all or any part of the Subordinated Liabilities*" or *"(f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under [the Sub-Debt agreement] to be entered into*" and (otherwise than as disclosed in writing to the FSA) had not done so prior to entry into the Sub-Debt.

5.7. Similarly, clauses 7(d) and (f) record LBHI2's representation and undertakings not, without the prior consent of the FSA, to enforce the Sub-Debt otherwise "*than in accordance with the terms of [the Sub-Debt agreement]*" or to "*(f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower*" and (otherwise than as disclosed in writing to the FSA) had not done so prior to entry into the Sub-Debt.

5.8. These provisions correspond exactly with the application of s.74(2)(e) IA86 as contended for by LBL, precluding, as they do, any recovery of the Sub-Debt from a third party without the prior sanction of the FSA.

5.9. In these circumstances, the Sub-Debt Agreements are to be interpreted as precluding recourse to LBIE's members for the purpose of meeting the Sub-Debt, or alternatively that a term is to be implied to this effect.

6. Otherwise:

6.1. LBL supports the analysis and reasoning of LBH Plc in respect of Issue 1 [LBH Plc/12(ii)].

6.2. LBL rejects the contention that its analysis is inconsistent with the Court of Appeal judgment in Waterfall I [cf. LBIE/12(1)(ii)]. The Court of Appeal was not considering the Sub-Debt in the same context as now arises, including having regard to the application of s.74(2)(e) IA86.

6.3. It is not accepted that In re Great Britain Mutual Life Assurance is of no relevance. It is one of the few cases that concerns the predecessor to s.74(2)(e) IA86 and the terms of the policy in that case clearly precluded any liability on policyholders to contribute to the society's debts, and were duly given effect to by the Court (Jessel MR, at 252).

6.4. It is of no import that the authorities relied upon by LBL [LBL/111] concern express rather than implied terms; the only relevant question is whether a term engaging s.74(2)(e) IA86 applies here [cf. LBIE/12(1)].

6.5. The fact that the Sub-Debt Agreements are in standard form does not exclude the implication of terms in all circumstances; any presumption in respect of this is rebuttable in the appropriate circumstances; see further Greatship (India) Ltd v Oceanografia SA de CV 1 All ER [2013] 1244 at 1256. Again, the only relevant question is whether these arise here.

6.6. The assignability of the Sub-Debt is not to be afforded undue weight where it is merely an aid to construction. In any event:

6.6.1. The Sub-Debt Agreements are to be treated as addressed to the parties alone, and/or to the FSA, rather than to a wider audience.

6.6.2. The construction of the Sub-Debt agreements contended for by LBL does not involve reliance upon any background which would not have been equally available to any prospective assignee or lender; Chartbrook v Persimmon [2009] 1 AC 1101 at para 40.

6.6.3. Even if recourse to such background materials were to be required, the Sub-Debt Agreements were not public documents so as to justify a restrictive approach to the use of such materials.

7. Further and in addition to the above, in light of the parties' agreed position that if the Sub-Debt in fact falls due it is to be extinguished by way of set-off in LBIE's estate as against LBHI2, and LBHI2's position that no adjustment as between itself and LBL is required, LBL will contend that if the LBIE office-holders were to proceed to raise a Sub-Debt Contribution Claim as against LBL such claim would be unnecessary and/or unreasonable, and susceptible to challenge under paragraph 74(1) of Schedule B1; see further Re Edennote Ltd Tottenham Hotspur v Ryman [1996] BCC 718.

Issue Three

8. To the extent that the Sub-Debt Contribution Claim is to be dealt with by way of set-off in LBIE's estate as between LBIE and LBHI2, the question of the valuation of the Sub-Debt Contribution Claim will not concern LBL since no further Contribution Claim is necessary, alternatively the value of any Sub-Debt Contribution Claim raised against LBL will be zero. LBL refers to and adopts the reasoning put forward in this regard in [LBHI2/3.1] and [LBH Plc/19-20].

9. Without prejudice to this, in the event that LBL is nonetheless concerned by a Sub-Debt Contribution Claim, LBL will say as follows:

9.1. Whilst noting LBIE's stated position that "*if and to the extent that there are any debts or liabilities falling within section 74 which remain unpaid in LBIE's administration and it is necessary for LBIE to move into liquidation to make a call against its contributories, the LBIE administrators will cause LBIE to go into liquidation*" [LBIE/25(4)], there is no basis to reassess the zero valuation placed on the Sub-Debt by the Court of Appeal. The valuation of the Sub-Debt must correspond with a like zero valuation to be placed upon a Sub-Debt Contribution Claim.

9.2. This is especially so where the Sub-Debt Contribution Claim is contingent, and the contingencies which permit the making of a Sub-Debt Contribution Claim are more remote than the meeting of the conditions requiring repayment of the Sub-Debt. Furthermore:

9.2.1. The onus is on LBIE to demonstrate that the Sub-Debt will be repayable, so as to provide a proper basis for any Sub-Debt Contribution Claim, and similarly on LBIE to demonstrate the amount of any surplus which it has to apply against repayment of the Sub-Debt, which might be applied to reduce the amount called upon by way of Sub-Debt Contribution Claim. LBIE has not adduced any evidence to support a re-valuation of the Sub-Debt as determined by the Court of Appeal, or a valuation of the Sub-Debt Contribution Claim which exceeds the zero valuation of the Sub-Debt (indeed LBIE has resisted the service of any such evidence).

9.2.2. The Court would require evidence in order to assess how likely the applicable contingencies are to arise so as to determine whether any valuation afforded to the Sub-Debt Contribution Claim is genuine and fair. No such evidence has been served.

9.2.3. Pending final determination by the Supreme Court the question of whether the Sub-Debt is a provable debt remains at large.

9.2.4. Similarly, pending final determination by the Supreme Court in Waterfall I, and otherwise in the Waterfall II proceedings, LBIE's liability to meet currency conversion claims and/or to pay statutory interest accrued during the administration in any subsequent liquidation remain in issue, and create uncertainties in respect of the financial position of LBIE and its need to raise a Sub-Debt Contribution Claim [LBL/109-110].

10. Further, whilst it is accepted by LBL that the LBIE Administrators are able to make calls in respect of future liabilities, the authorities relied upon by LBIE [LBIE/26] do not support the proposition that such calls are intended to secure the full value of such claims, irrespective of the likelihood of any relevant contingencies occurring; see In re Danka Business Systems Plc (in members' voluntary liquidation) [2013] EWCA Civ 92. Further, it is noted that where in In re Contract Corporation (1866) LR 2 Ch App 95 and Barned's Banking Co (1867) 36 LR Ch 251 calls were made in respect of future liabilities, there was no question that the company's debts would exceed the calls made. The same cannot now be said here, were the LBIE Administrators to make a call on LBHI2 and LBL valuing the Sub-Debt Contribution Claim in full.

Issue Four

11. The parties are agreed that, to the extent that the Sub-Debt is repaid and the Sub-Debt Contribution Claim is extinguished by way of set-off as between LBIE and LBHI2, there will then be no value attaching to such claim as against LBL [LBL/126, 127; LBIE/28; LBHI2/4.3]. Otherwise, LBL resists the proposition that LBIE can raise a Sub-Debt Contribution Claim, or a valuable Sub-Debt Contribution Claim, against it on a contingent basis, or that any adjustment of rights as between itself and LBHI2 is required, so that no question arises in respect of their set-off.

Issue Seven

12. As regards Issue 7, the parties appear to be broadly agreed that the objective intended to be achieved by a s.74 Contribution Claim is a rateable allocation per share of any liability to raise the funds necessary to discharge the company's debts; see in particular Re Hodges Distillery Co; Ex p Maude (1870) 6 Ch App 51 at 56, Paterson v M'Farlane (1875) 2 R 490 (Ct of Sess.) and McPherson at 10-025, "*...the object here is to ensure that losses suffered by the company are distributed rateably among all the members in proportion to the amounts subscribed for and not the amounts paid up...*" [per LBIE/44(2); see too LBH Plc/34(ii)].

13. The main differences between the parties, therefore, concern the question of an adjustment of rights *inter se*, and the relevance of any contribution or indemnity claim asserted by LBL as against LBIE, LBHI2 and/or LBH Plc.

14. In the absence of factual evidence, LBL contends that the Court is unable to determine what adjustment (if any) might be appropriate as between LBIE's members save having regard to the number of shares held by each, thus on the assumption that LBL holds one ordinary share of $1 in LBIE and LBHI2 owns 2 million 5% redeemable Class A preference shares of $1000 each, 5.1 million 5% redeemable Class B shares of $1000 each and 6,237,113,999 ordinary shares of $1 each in LBIE, and there being no other relevant circumstances.

15. Having regard to the number of shares held by LBHI2 and LBL, there must be a strong commercial imperative against pursuing any claims in adjustment. Thus by way of example, any rateable adjustment in respect of the Sub-Debt as against LBL would amount to less than £1, whether the Sub-Debt Contribution Claim is equal to the sum proved by LBHI2 and so £1,254,165,598.48, or valued on the most pessimistic assumption, of some £3bn.. Any Sub-Debt Contribution Claim to be raised as against LBH Plc, if a registered shareholder in LBIE, for the purposes of adjustment would likewise be *de minimis* [LBH Plc/8(i)].

16. In any event, where LBHI2 does not itself press for any adjustment *inter se* in relation to the Sub-Debt Contribution Claim, LBL contends that it is not necessary

for LBIE's office-holders to make a Contribution Claim as against LBL for this specific purpose. The cases cited by LBIE at paragraph 30(2) of its Positon Paper in support of such adjustment were each pursued at the shareholders' suit, save for Re Shields Marine Insurance Association, in which the question of adjustment was obiter, it being there determined that the obligation to contribute did not apply to a mere debtor.

17. Otherwise, LBL contends that any contribution or indemnity claim it has as against LBIE (i.e. by reason of its holding a share as nominee, or otherwise for the benefit of LBIE) is central to the question of whether LBIE is in any event entitled to raise a Contribution Claim as against it. Indeed, whilst LBIE contends that the doctrine of circuity of action operates to prevent LBL raising any recharge claim against LBIE [LBIE/56(4)], in fact circuity of action takes effect as complete defence to LBIE's proof against LBL in respect of the Contribution Claim whether entirely or in respect of the Sub-Debt Contribution Claim. As regards the Sub-Debt Contribution Claim, LBIE's proof is only submitted as a result of a claim by LBHI2 and were LBL liable to make payment in respect of that proof, LBL would immediately be entitled to recover the money paid from LBHI2. As to LBL's entitlement to an indemnity providing a complete defence in such circumstances of circuity; see Farstad Supply AS v Enviroco Ltd & Anor (the MV Far Service) [2010] UKSC 18, [2010] Bus LR 1087 at paras 31-32 and 44.

18. Without prejudice to this, LBL rejects LBIE and LBHI2's contention that, as a matter of principle, no contribution or indemnity claim can lie as between LBIE's members in respect of a Contribution Claim because this eventuality is not provided for by statute and/or is inconsistent with the adjustment mechanism contained in s.74 IA86.

    18.1. The fact that a contribution or indemnity claim is not expressly provided for by the Act does not preclude its existence. IA86 does not provide a complete

code applicable to insolvencies; amendment has been required and lacunae identified[4];

18.2. Such a claim is not inconsistent with the adjustment mechanism contained in s.74; either such mechanism is to be operated within LBIE's estate (i.e. by LBIE's liquidator having regard to the existence of a contribution or indemnity claim alleged as part of the adjustment of the rights of members *inter se*), or the contribution and indemnity claim is a corollary to and follows from that process.

19. In the above circumstances, LBL also takes issue with LBIE's position that it would be wrong in principle for the Court to direct that the LBIE Administrators assert less than a full, 100% against LBL and/or LBHI2 by way of Contribution Claim:

19.1. No claim at all should be directed where it could not be maintained by reason of circuity of action;

19.2. A 100% claim as against LBL would ignore the discharge of the Sub-Debt Contribution Claim by set off, any surplus that LBIE already has to apply for the purposes of repaying the Sub-Debt and the likely ability of LBHI2 to contribute otherwise to any call; and

19.3. Such direction would also ignore the rights as between members which are themselves enshrined in s.74.

20. LBL also adopts and supports the further reasoning of LBH Plc in respect of the Court's ability to direct a contribution of less than 100% of the amount required to discharge LBIE's liabilities in full [LBH Plc/34], subject to its contention that its rights of recharge and indemnity as against LBIE and/or LBHI2 and/or LBH Plc are relevant to this issue.

[4] Notably (on LBL's case) as to the payment of statutory interest in a liquidation preceded by an administration in respect of the period of administration.

Issue 9A

21. At the CMC on 4 November 2016 the LBIE Administrators proposed the introduction of a further "legal" issue for determination at the Part A Trial: whether as a matter of law, it is possible for a member of a company to enter into with that company an enforceable agreement which has the effect of enabling that member to avoid what would otherwise be its obligation to contribute to the assets of the company under s.74 IA86 in the event of the company's winding up or otherwise to reverse the effect of that section (whether by claiming contractually to be entitled to reimbursement from that company in respect of such contributions or otherwise).

22. LBL does not accept that the issue is suitable for preliminary determination. It is eminently fact-sensitive as to the terms of the agreement alleged and the factual circumstances which pertain to such agreement. No detailed assumptions for the determination of Issue 9A have been formulated, and the parties are agreed that the factual issues which found this proposed issue (i.e. Issues 9 and 11) are to be dealt with as part of the Part B Trial.

23. Without prejudice to this, LBL will contend that there is no difficulty in principle with it having contracted with LBIE or otherwise so as to exclude its liability to meet a s.74 Contribution Claim:

    23.1. Section 74 IA86 is not mandatory in the sense that it is of automatic application. In order for section 74 to bite, a decision must be taken by the relevant office holder that it is necessary to make a call in order to raise funds; the office-holder may then make a call in different amounts as against different members. Accordingly and to this extent, the operation of s.74 is discretionary.

    23.2. IA86 does not contain any express prohibition on parties seeking to exclude the nature and extent of a member's liability. Indeed s.74(2)(e) provides a statutory basis for a company to accept liabilities which will not be passed on to a member.

23.3. In any event the arrangements and/or agreements relied upon by LBL (as set out in its Position Paper) were not effected with the intention of avoiding LBL's statutory obligations under s.74 of the Act. Indeed, the Recharge Agreement was principally entered into as a means of redistributing liabilities incurred by LBL as a service company.

23.4. The consequence of LBL avoiding the effect of s.74 of the Act was not foreseen and is remote.

23.5. In any event LBIE is entitled to agree to waive its statutory rights, including such rights as might otherwise serve a public purpose where as a matter of fact that purpose is not jeopardised. This is so here where LBL's shareholding in LBIE was *de minimis*, it is agreed that the *prima facie* obligation of shareholders to contribute to a company's deficit is rateable, and it is not alleged that LBIE entered into a like agreement with LBHI2.

23.6. In the unusual event of there being multiple concurrent administrations, there is a public policy imperative to consider not only the position of LBIE's creditors, but also the position of LBL's creditors, which are principally ordinary trade creditors, former employees and HMRC [LBL/113.2.3.2].

PART B ISSUES

Issues 9 and 11

24. As regards Issues 9 and 11, LBL will in due course supply evidence addressing the precise mechanics of recharge, including the items recharged and the parties to the Recharge Agreement.

25. For present purposes, LBL takes issue with LBIE and LBEL's contention that, from 2004 until its termination, the 2004 Services and Secondment Agreements set out exhaustively the contractual obligations as between the parties [LBIE/62(4); LBEL/57]. These written agreements were drawn up for the reasons given in LBL's Position Paper [LBL/86] which were principally tax driven, arising in the context of the APB23 election then made in respect of LBL and a global transfer pricing

review, and in order to address specific tax or regulatory requirements. The written agreements were certainly not intended to be comprehensive. It was also for tax reasons that the uplift charged by LBL was increased from 1 to 10% in 2000.

26. LBL also takes issue with LBIE's contention that the costs capable of recharge pursuant to the Recharge Agreement do not extend to the Contribution Claim, Bad Debts and/or Administration Expenses (being those expenses which are referable to the costs of LBL's administration) [LBIE 62(6)].

27. In addition to the matters set out in LBL's Position Paper:

27.1. The recharge of each of these items is consistent with the costs as a matter of fact recharged by LBL prior to entry into administration; each follows from LBL's existence as a service company, with no or no substantial means of generating income save for recharge, and which as a matter of fact did not incur any costs or liabilities that were not recharged.

27.2. There is no reason in principle to preclude the Contribution Claim, Bad Debts and/or Administration Expenses from the Recharge Agreement if and insofar as they do arise during the course of LBL's administration (which LBL does not admit). The Recharge Agreement was not limited to costs incurred by LBL in its capacity as a trading, rather than an insolvent, company and no party contends that such provision should be implied into the Services and/or Secondment Agreements. Rather, the Recharge Agreement endured into administration and entry into administration did not (even on LBIE's case) automatically terminate the Recharge Agreement [LBIE/62(7) and (8)].

27.3. In any event, the Contribution Claim and/or Bad Debts are contingent liabilities which arose prior to LBL's entry into administration and, as such, during the currency of the Recharge Agreement, to which they are subject.

28. Further, as regards the 2008 Agreement LBL will say as follows:

28.1. The 2008 Agreement was entered into very shortly after the entry into administration of LBIE, LBEL, LB UK RE Holdings Limited and LBL in order to regularise the basis upon which costs incurred in the administrations of these entities (and in particular payroll) would be met on an ongoing basis. No detailed factual enquiries into pre-existing arrangements were conducted prior to entry into the 2008 Agreement, which was simply intended to provide an immediate mechanism for the parties thereto to operate whilst in administration. Accordingly, the 2008 Agreement expressly provided at clause 5.1 "*This Agreement will formalise agreements in place since 15 September 2008*" (on which date, or shortly thereafter, the above companies entered into administration).

28.2. The LBL Administrators reserve the right to refer to the full terms of the 2008 Agreement. However, on a proper construction of the 2008 Agreement:

28.2.1. The 2008 Agreement did not capture the Contribution Claim and/or Bad Debts, which were incurred on a contingent basis prior to LBL's entry into administration.

28.2.2. The 2008 Agreement did not, and was not expressed to, alter the rights of entities that had accrued prior to entry into administration, including by reason of the Recharge Agreement.

28.3. The 2008 Agreement was drafted by Linklaters, acting on behalf of each of the above Lehman entities including LBL. At no material time was LBL advised that, in entering into the 2008 Agreement, its rights would be altered or affected, and that its position might be prejudiced in the manner now alleged by LBIE and/or LBEL (each of which continues to be represented by Linklaters).

29. In the above circumstances, the 2013 Termination Agreement is of no relevance or effect. That agreement was entered into when it became apparent that most of the

services incurred during the course of the parties' administrations were incurred by LBIE, and in order to terminate LBIE's obligation to pay LBL the costs of providing services to it.

30. In any event, the 2013 Termination Agreement was expressed as terminating only such rights and liabilities as arose under the 2008 Agreement. Rights and liabilities arising under the Recharge Agreement did not come within this category. Accordingly, the limitation provision contained in clause 2.7.4 (which bites only on claims relating to services provided under the 2008 Agreement, as defined therein at clause 1.1 and recital B) is of no effect.

31. Further or alternatively, if the Recharge Agreement was superseded by the 2008 Agreement then LBL claims a right to recharge the Contribution Claim, Bad Debts and Administration Expenses upon the basis set out in clause 3 thereof, which is to say "*on a fair and reasonable basis*" (and clause 3.1.2) and contends that such rights are ongoing pursuant both to clause 5.3 of the 2008 Agreement ("Survival of Rights on Termination") and clause 2.6 of the 2013 Termination Agreement. Further, such rights are therefore exempt from clause 2.7.4 of the 2013 Termination Agreement.

32. Otherwise,

    32.1. LBHI2's position that it was a holding company and so cannot have been privy to the Recharge Agreement is wrong as a matter of fact (of which evidence will be adduced in due course); holding companies within the Lehman Group were privy to the Recharge Agreement and routinely subject to recharge.

    32.2. As regards LBEL's particular position:

        32.2.1. It is accepted that, having been incorporated in 2000, LBEL can only then have become privy to the Recharge Agreement. However, having done so it may now be liable to a recharge of any Contribution Claim raised as against LBL on the basis set out in LBL's Supplementary Position Paper/19.3.

32.3. Whilst LBL is unable to identify any evidence that payment was made by it in respect of its acquisition of either the $1 or £1 share in LBIE, that is immaterial where it took such shareholding by reason of mistake purportedly to benefit LBIE and/or the other members of the Lehman Group, and where all services provided by LBL in any event fall within the scope of the Recharge Agreement [cf. LBEL/63.4].

Issue 13

33. In respect of Issue 13, LBL rejects LBIE's position that there was no operative mistake. In particular:

33.1. Sub-section 1(1) of the Companies Act 1985 applies simply in respect of the incorporation of a company (and then only as a formality; see Buckley on the Companies Acts, 1st, 3rd, 7th, 9th and 12th edition, on s.1, and Salomon v Salomon & Co. [1897] AC 22). The requirement that LBIE have two shareholders was met upon its incorporation in 1990 [LBL/11-12].

33.2. The requirement for a minimum shareholding upon incorporation does not equate with an ongoing requirement that there continue to be two shareholders; were this the case, s.24 of the Companies 1985 would be otiose.

33.3. Moreover, no support for LBIE's proposition can be derived from s.122(1)(e) of Insolvency Act which, until revoked, permitted a company having fewer than two members to be wound up. Section 122(1)(e) did not provide a mandatory basis for winding up such a company, but was discretionary, and only to be invoked where there was a genuine interest in winding up the company. That would only be so where a single shareholder wished to terminate their ongoing liability for the company's debts; see In Re Kilner's Limited [1914] WN 158; In Re Natal & C, Company (Ltd) 71 ER 280; Buckley 12th ed. at 220. See too In re New Gas Generator Company (1877) 4 Ch D 874: "*...when the Court is called on to exercise its equitable authority ... it must be satisfied that there is some rational ground for its interference, a reason for incurring the costs which are the effects of making an order on the*

petition, and the prospect of some good being done to somebody..." (at 876-877, *per* Bacon VC). It is not contended by LBIE that LBH Plc, or LBHI2, would as shareholders have had any such interest in seeking to wind up LBIE, the group's principal trading entity, under s.122(1)(e).

34. Contrary to LBIE/78(3) and/or (7), the mistake made was fundamental to the circumstances in which LBL came to be a shareholder in LBIE. Indeed, LBL contends that, had the parties appreciated that the law was as it is averred by LBL to be, LBH Plc would not have transferred a share to LBL, and nor would a further share subsequently have been allotted; this would have been unnecessary and there would have been no intelligible basis or requirement for this to have been done; Brennan v Bolt Burdon [2005] QB 303 at [59-60].

35. However, even if this were not so, that would not affect LBL's claim in mistake. In circumstances where there is no evidence that LBL in fact paid for its shareholding, the 1994 transfer and/or 1997 allotment was a voluntary disposition of a share to LBL. Alternatively, in circumstances in which LBL received no consideration or benefit from its holding a share in LBIE, its custodianship of the share in LBIE was a voluntary disposition by LBL. In either instance the mistake made, as to the mandatory obligation that LBIE have two shareholders, was sufficiently serious as to make it unconscionable that LBL remain a shareholder in LBIE; Pitt v Holt [2013] UKSC; [2013] 2 AC 108.

36. Otherwise:

    36.1. As regards LBIE/79(1), LBL contends that both the transfer of a share in LBIE (in 1994) and the allotment of a share in LBIE (in 1997) were void for breach of fiduciary duty. This is the clear effect of these transactions having been unauthorised and in breach of fiduciary duty; Colin Gwyer & Associates Limited v London Wharf (Limehouse) Limited [2003] BCC 885 at paras 72-76, and see too para 94: "*If directors pass a resolution otherwise than in good faith in the interests of the Company the exercise may be declared ineffectual and void. That is especially the case when the resolution is to make an agreement with a third party and the third party is aware of all the relevant*

facts and has actual knowledge of the breach of fiduciary duty: see Rolled Steel Products (Holdings) Ltd v Steel Corporation [1986] Ch 246 at 295H-296A, per Slade LJ...". See too Bowstead & Reynolds on Agency, 20th ed. at 8-217 and 8-220, and GHLM Trading Ltd v Maroo [2012] EWHC 61, per Newey J. at paras 162-180.

36.2. If LBIE is correct that the test identified in Charterbridge applies [LBIE/79(3)] (see too HLC Environmental Projects Limited v Horacio Luis de Brito Carvalho [2014] BCC 337) then LBL contends that no intelligent and honest man in the position of the directors of LBL could, in the whole of the existing circumstances, have reasonably believed that LBL's receipt of a share in LBIE was in its best interests. As set out in LBL/59.2 and 63, it was not in the interests of the Lehman Group that LBIE have two shareholders where this requirement was not mandatory, and jeopardised the tax benefit sought to be achieved by re-registering LBIE as an unlimited company and a branch of LBH Plc. In addition:

36.2.1. Holding a share in an unlimited company would inevitably jeopardise the solvency of LBL to the detriment of its creditors. This was especially so where the relevant company, LBIE, was the principal trading company within the Lehman Group.

36.2.2. Contrary to LBIE/79(4)(i), at the relevant time, LBIE was not a profitable company but was making a loss.

36.2.3. There was no benefit to LBL in holding a share as nominee in LBIE because the beneficial interest was held (at this time) by LBH Plc.

36.2.4. Whilst LBL charged an uplift on items recharged to LBIE, the majority of "profit" made in this way was not retained but redistributed for the benefit of the group.

36.2.5. In any event, such profit as LBL made by reason of recharging items to LBIE was made by reason of the fact that LBL provided services to LBIE,

and was irrespective of its shareholding in LBIE [cf. LBIE/79(4)(iii)]. Thus LBL took a like "profit" from other entities with the Lehman Group such as LBEL, irrespective of the fact that it was not a shareholder in such entities.

36.3. Whilst LBIE alleges that LBH Plc (as LBL's parent) ratified LBL's shareholding in LBL and/or LBL affirmed the same, and LBHI2 alludes to "*ratification of LBL's board's acts*" *and* "*estoppel by convention*" neither pleads any facts in support of these assertions [LBIE/79(6)(i) and (8); LBHI2/13.5]. In the circumstances LBL is unable properly to understand and to answer the points made. In any event, however, it is LBL's position that:

36.3.1. Any such ratification and/or affirmation and/or estoppels would have been based upon the same mistake as led LBL to take such shareholding, and so have been ineffective.

36.3.2. The Duomatic principle is of no application where, as LBL contends to be the case here, the directors of LBH Plc did not turn their minds to the question of whether it was in LBL's best interests that it take a share in LBIE.

36.3.3. Even if the Duomatic principle were to apply and/or the directors of LBH Plc did purportedly ratify the breach of duty of LBL's directors (which is not admitted), that ratification was not valid given that the relevant breach put in jeopardy LBL's solvency; Bowthorpe Holdings Ltd & Anor v Hills & Anor [2002] EWHC 2331 (Ch) at [50-51].

36.4. LBL contends that the transfer and allotment were void. Without prejudice to this, to the extent that they were, as LBIE contends, voidable, then the principle provided by Oakes v Turquand (1867) LR 2 HL 325 is of no application in an administration where the members have not yet become contributories and there is no relevant interference with any creditors' rights.

36.5. Whilst LBIE and LBHI2 allude to the possible loss of rights by reason of "delay" [LBIE/79(6)(iii)] and/or limitation or laches [LBHI2/13.5], again no details of the same are provided. LBL reserves its right to respond to these allegations if proper details of them are provided.

Issue 14

37. Issue 14 was introduced by the Order and applies as between LBL and LBHI2 and LBH Plc. LBL has stated its position in respect of this Issue:

37.1. By its Cross-Application, dated 17 October 2016;

37.2. In its Position Paper in particular at 76, 95.2 and 101-102; and

37.3. In its Supplementary Position Paper at paragraph 19.

38. At present, LBHI2 has taken no stance on this issue [LBHI2/14.1].

Philip Marshall QC
Ruth den Besten
30 December 2016