Waterfall III Application

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

BETWEEN:-

(1) 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

Supplementary Position paper of the Joint Administrators of

Lehman Brothers Limited (In Administration)

A) INTRODUCTION

1. This paper is served by the LBL Administrators in response to requests for particulars contained in the letter of Dentons UKMEA LLP dated 6 October 2016. In this paper the LBL Administrators adopt the abbreviations contained in their Position Paper dated 30 September 2016 ("**LBL Position Paper**"). References to paragraphs are, save where

otherwise stated, to the paragraphs of the LBL Position Paper. The LBL Administrators case as set out in this Supplementary Position Paper and the LBL Position Paper are to be the subject of further evidence and submissions in due course and the LBL Administrators reserve their right to rely on such further materials and make such further arguments as may in due course become appropriate for the determination of the Issues.

B) Issue 13: Rectification of the Register

2. The first matter in respect of which LBHI2 has sought clarification is as to the consequences of LBL's case on rectification, and specifically whether it is LBL's case that if it is entitled to rectification, LBH Plc was the sole member of LBIE between 1994 and 1997 and thereafter until 2006, when LBHI2 was interposed between LBIE and LBH Plc, and when LBHI2 replaced LBH Plc as LBIE's sole member: "*If so, is LBL's case that rectification involves the removal of LBL but does not involve the substitution of LBH [Plc]? Alternatively, is it suggested that LBH [Plc] remains a shareholder?*"

3. LBL's case in this regard is as follows.

   3.1. In 1994 a share was transferred from LBH Plc to LBL, as nominee for LBH Plc, as a result of an operative mistake common to LBL and LBH Plc and/or LBIE, that section 24 of CA85 required an unlimited company to have two shareholders; see further LBL's Position Paper at paragraphs 20 to 22, 58.2 and 58.3.

   3.2. LBL's case is that had this mistake not been made LBH Plc would not, in 1994, have transferred one ordinary share in LBIE to LBL. Having been occasioned by an operative common mistake, the transfer of one share from LBH Plc which occurred in 1994 was void, and should be set aside and/or cancelled.

   3.3. Further and in addition to the above, the mistake that was made in 1994 that LBIE was required to have two shareholders was continued and repeated in 1997 so that, upon the restructuring of LBIE's share capital which then took place (as set out in paragraph 25) a $1 share was allotted by LBIE to LBL; see further paragraphs 58.2 and 58.3.

3.4. Save for the aforesaid mistake(s), the resolutions of LBIE to allot a $1 share to LBL, and of LBL to accept such a share, would not have been passed, and no such share would have been allotted to LBL. Accordingly, the allotment of one share in LBIE to LBL in 1997 was also void and should be set aside and/or cancelled.

3.5. Further and alternatively to the above, insofar as LBL acquired and held a share in LBIE in 1994 and in 1997 only as a result of acts of the directors of LBL that were unauthorised (as set out in paragraphs 59 to 70), LBL contends that the 1994 transfer and/or the 1997 allotment were void and should be set aside and/or cancelled.

3.6. Yet further and alternatively to the above, insofar as LBL acquired and held a share in LBIE in 1994 and in 1997 only as a result of acts of the directors of LBL that were in breach of duty (as set out in paragraphs 59 to 70), LBL contends that the 1994 transfer and/or the 1997 allotment should be set aside and/or cancelled.

4. In the event that the transfer of a share to LBL in 1994, and/or the allotment of a share to LBL in 1997, is void and/or set aside and/or cancelled, it is LBL's case that it is to be removed from the register of LBIE's members, including so that it shall not be called upon to contribute to the assets of LBIE or to meet any liability of LBIE, whether directly or indirectly and whether pursuant to section 74 of the Insolvency Act 1986 or otherwise, by virtue of having been registered as a member of LBIE (See LBL's Cross-Application dated 17 October 2016 ("**Cross-Application**"), Declaration 1).

5. Further, it is LBL's case that, but for the mistake and/or breach of authority and duty referenced above, LBH Plc would have continued to be the sole shareholder in LBIE. In 1994, the share transferred to LBL would have remained with LBH Plc and in 1997 would have been cancelled and extinguished. Further or alternatively, in 1997 the share allotted to LBL would either have remained with LBIE (and so not been allotted at all) or it would have been allotted to LBH Plc, being LBIE's only other shareholder. In the latter event the share would have remained with LBH Plc until 2006, as set out below.

6. The precise terms upon which LBHI2 agreed, in 2006, to accept the transfer of LBH Plc's shareholding in LBIE (via LBHI1) are a matter as between LBHI2 and LBH Plc (and/or LBHI1). However, it is LBL's position that when, in the circumstances set out in

paragraphs 38 to 40 (and in particular 40(a)), LBH Plc transferred the entire issued share capital of LBIE which it held to LBHI1, which subsequently transferred the same entirely to LBHI2, such transfer would have included the share otherwise transferred to LBL in 1994 and subsequently extinguished and replaced by allotment in 1997 (there being no reason for such share to have been distinguished from those shares otherwise held by LBH Plc and/or LBHI2).

7. Accordingly (and insofar as it need be concerned with the same, which is not admitted) LBL contends that if it is to be replaced on the register of members of LBIE it should be replaced by LBHI2 (as the holder of the entire issued share capital of LBIE since 2006) or (subject to the terms of the transfer which took place as between LBH Plc and LBHI2) by LBH Plc for whom, prior to 2006, LBL held the share as nominee.

8. Dentons proceeds to ask whether, since rectification is contended to have retrospective effect and assuming the same, it is suggested by LBL that "*independently of the s.74 liability, LBH [Plc] and LBHI2 are exposed to liability under s 24 for the periods during which each was the sole member of LBIE"*? This would indeed follow from the terms of section 24 of the CA 1985, which provides in full that "*If a company carries on business without having at least two members and does so for more than 6 months, a person who, for the whole or any part of the period that it so carries on business after those 6 months (a) is a member of the company, and (b) knows that it is carrying on business with only one member, is liable (jointly and severally with the company) for the payment of the company's debts contracted during the period or, as the case may be, that part of it*."

C) Indemnity

9. LBL asserts, in the alternative to its principal case in rectification, that if it is to be considered a shareholder in LBIE it took a single share in 1994, and in 1997, as nominee for LBH Plc; this was expressly recorded by the resolutions pursuant to which the share was transferred to LBL and on the LBL Stock Transfer Form (as set out in paragraph 22) in 1994. There was no alteration of the capacity in which LBL held the single share that was allotted to it in 1997.

10. The basis upon which LBL asserts, in paragraph 76.1, that after 2006 it may have held a share in LBIE as nominee for LBHI2 corresponds with the restructuring that then occurred, as set out in paragraphs 38 to 40, and in paragraph 6 above. Subject to any particular terms that were then agreed between LBH Plc and LBHI2 (to which LBL is not privy), LBL contends that insofar as before the re-structuring it held a share in LBIE on behalf of LBH Plc, it will thereafter either have continued to hold such share for the benefit of LBH Plc (which even after the 2006 restructuring, remained the main holding company for the UK Lehman Group) or have held such share for LBHI2, to whom LBH Plc's shareholding in LBIE was then transferred.

11. It follows from the above that if, contrary to its primary case, LBL holds a share in LBIE it held such share from 1994 as nominee for LBH Plc and, from 2006, as nominee for LBH Plc or LBHI2, and that LBL is entitled to an indemnity from LBH Plc and/or, LBHI2, as the party on behalf of whom it held such share; see further paragraph 76.2.

12. The claim to indemnification set out in paragraph 76.3 is an alternative claim based upon the Recharge Agreement. Thus, and having regard to the above, LBL seeks a declaration of its rights as against LBH Plc and/or LBHI2 upon the basis set out in its Cross-Application at declaration 3: that "*in respect of any liability of LBL to meet a call to contribute to the assets of LBIE or LBIE or to meet any liability of LBIE, whether directly or indirectly and whether pursuant to section 74 of the Insolvency Act 1986 or otherwise, LBL shall be entitled to an indemnity by virtue of its contractual rights of recharge and/or its rights of reimbursement and indemnity as a nominee shareholder and/or other rights of reimbursement and indemnity as set out in [LBL's Position Paper]*" (emphasis added, as reflecting this part only of LBL's case).

13. As regards section 148(3) of the Insolvency Act it is LBL's position that, if the register is not rectified, it would *prima facie* be liable as a contributory at such time as LBIE moves into liquidation. However, in the event that LBL is prima facie liable as a contributory it claims to be entitled to indemnification and/or to recharge such liability as thereby arises, or otherwise that there should be an adjustment of rights as between the shareholders of LBIE upon the various grounds explained in the LBL Position Paper.

D) Recharge

14. At paragraphs 79 to 95 LBL has set out its claim (made in the alternative to its primary case in rectification) that it is entitled to recharge any liability arising by reason of a Contribution Claim, Bad Debt Claim and/or Administration Expenses by reason of the Recharge Agreement. Dentons has, on behalf of LBHI2, raised the following further questions in relation to this claim, in summary:

    14.1. Which Lehman Group entities were party to the Recharge Agreement, and did these include LBH Plc?

    14.2. To which entity or entities is the Contribution Claim said to be capable of recharge and, if more than one entity, in what proportions?

    14.3. So far as benefit is relied upon as a basis of recharge, what benefits are relied upon by LBL and, where more than one company or entity benefitted, what apportionment of liability would apply as between them and on what basis?

15. LBL responds to these questions below, without prejudice to its position that the detailed operation of the Recharge Agreement is a matter for evidence to be served in due course.

(i) The Parties to the Recharge Agreement

16. Each of the Lehman Group entities to which LBL provided services, or on whose behalf LBL incurred costs, expenses and liabilities, was privy to the Recharge Agreement, including each of LBIE, LBHI2, LBEL and LBH Plc. The Recharge Agreement existed between LBL and the Lehman Group entities since at least 1990 and, from time to time as a new entity was incorporated, that entity became privy to the Recharge Agreement.

17. Without limitation, some of the Lehman Group entities which LBL has identified as being party to the Recharge Agreement are set out in Appendix 1.

(ii) Recharge of the Contribution Claim

19. The various means by which LBL recharged costs, expenses and liabilities incurred by it are set out in paragraph 81. It follows from the same that:

19.1. Insofar as LBL incurred or incurs costs, expenses and liabilities in respect of its shareholding in LBIE where it holds this share on behalf of another particular Lehman Group entity, those costs, expenses and liabilities are to be recharged by LBL to that particular Lehman Group entity at cost (paragraph 81.1). Accordingly:

19.1.1. Insofar as LBL held the share as nominee and/or on behalf of LBH Plc, the Contribution Claim will be capable of recharge to LBH Plc;

19.1.2. Alternatively, insofar as LBL held the share as nominee and/or on behalf of LBHI2, the Contribution Claim will be capable of recharge to LBHI2; and

19.1.3. Yet further or alternatively, insofar as LBL held the share for and/or on behalf of LBIE the Contribution Claim will be capable of recharge to LBIE, see further paragraph 20.2 below.

19.2. The above will also be the case if the holding of a share by LBL is characterised as a service provided by LBL to LBH Plc, LBHI2 and/or LBIE (paragraph 81.2).

19.3. Further or alternatively, if LBL's holding of a share in LBIE is characterised as a service provided to and shared by multiple Lehman Group entities, rather than a service attributable to a single entity, then the costs, expenses and liabilities associated with that shareholding (and including the Contribution Claim) will be capable of recharge by apportionment across a number of Lehman Group entities, whether subject to an uplift of 10% (at paragraph 81.3) or without uplift (at paragraph 81.4). As at 14 September 2008 this apportionment occurred (i) on the basis of a headcount of personnel and (ii) a further reapportionment as between LBIE and LBEL, in the following amounts:

19.3.1. LBEL, as to 40.66%;

19.3.2. LBIE, as to 54.55%; and

19.3.3. various other Lehman Group entities, as to 4.79%.

19.4. Yet further or alternatively to the above, insofar as LBL's holding of a share in LBIE and the costs, expenses and liabilities associated therewith are characterised as analogous to particular expenses incurred and recharged by LBL, then they will be capable of recharge by a combination of the above means, i.e. of direct allocation to specific entities and apportionment (at paragraph 81.5).

(iii) The Benefits of LBL Holding a share in LBIE

20. The benefits upon which LBL will rely as relevant to its right to recharge any Contribution Claim raised will include:

20.1. That LBL held the share as nominee and/or for the benefit of LBH Plc and/or LBHI2 (as set out above), including because LBH Plc and/or LBHI2 thereby avoiding joint and several liability for LBIE's debts arising under section 24 of CA 1985 (i.e. following their being a shareholder in LBIE for 6 months, and for the period during which they held such shareholding); and

20.2. Alternatively, that it was (erroneously) considered that LBIE complied with the (mistaken) mandatory requirement that it have two shareholders.

21. Insofar as such benefits are found to have accrued to only one entity, no apportionment of liability as between these entities will be required. However, in the event that such benefit were found to have been received by multiple parties, the apportionment set out at either paragraph 18.3 or 18.4 above would apply.

Philip Marshall QC

Ruth den Besten

11 November 2016

Appendix 1

Lehman Brothers Inc
Lehman Brothers Europe Limited
LBAM (Europe) Limited
Lehman Brothers International (Europe)
LB Holdings Inc – UK Branch
Lehman Brothers Bankhaus AG
LB Commodities Limited
LB Holdings Intermediate 2
Lehman Brothers Holdings PLC