

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 LEHMAN BROTHERS LIMITED

(IN ADMINISTRATION)

AND IN THE MATTER OF LB HOLDINGS INTERMEDIATE 2 LIMITED

(IN ADMINISTRATION)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN:

(1) The Joint Administrators of Lehman Brothers International (Europe) (in administration)

(2) The Joint Administrators of Lehman Brothers Limited (in administration)

(3) The Joint Administrators of LB Holdings Intermediate 2 Limited (in administration)

Applicants

-and-

(1) Lehman Brothers Holdings Inc.

(2) Lydian Overseas Partners Master Fund Limited

Respondents

POSITION PAPER ON BEHALF OF LBHI

A. QUESTION 1

*Are the members of LBIE (being LBHI2 and LBL) (together the “**Members**”) entitled to prove in LBIE’s administration in respect of sums owed by LBIE to the Members (other than in respect of sums owed to LBHI2 pursuant to three subordinated loan agreements entered into on 1 November 2006 between LBHI2 (as lender) and LBIE (as borrower) (the “**LBHI2 Subordinated Debt**”) notwithstanding that LBIE is an unlimited company and, in the event of LBIE being wound up, one or both of the Members may be called upon to contribute, pursuant to Section 74 of the Act, to LBIE’s assets an amount sufficient for payment of LBIE’s debts and liabilities, and the expenses of the winding up, and for the adjustment of the rights of the contributories amongst themselves (hereinafter defined in respect of each member as the “**Potential Liability as Contributory**”)? In particular, what (if any) is the effect of Section 74(2)(f) of the Act on each of the Member’s Potential Liability as Contributory?*

1. LBHI2 is entitled to prove in LBIE’s administration in respect of debts (other than the LBHI2 Subordinated Debt) owed to it because:
 - 1.1. Such debts are provable with other ordinary unsecured debts pursuant to Rules 12.3 and 13.12(1) and are not postponed by Rule 12.3(2A).
 - 1.2. Section 74 does not apply and has no effect unless and until LBIE goes into liquidation at a time when it is unable from its own resources to pay its debts and liabilities and the expenses of the winding up.
 - 1.3. Even if section 74 were otherwise to apply, section 74(2)(f) has no effect and would not apply so as to prevent LBHI2 from proving in relation to such debts in any event because they are not due to LBHI2 in its character as member by way of dividends, profits or otherwise within the meaning of that provision.

2. As regards any entitlement LBL may have to prove in LBIE's administration, LBHI currently proposes to adopt a neutral position but reserves the right to change its position if it considers that it would be in its interests to do so.

B. QUESTION 2

If LBIE were wound-up, would the Members be entitled to prove in LBIE's liquidation in respect of sums owed by LBIE to the Members (other than in respect of the LBHI2 Subordinated Debt). In particular, to what extent would the Members' ability to prove in a winding-up of LBIE be affected by: (i) each of the Member's Potential Liability as Contributory; and (ii) Section 74(2)(f) of the Act.

3. LBHI2 would be entitled to prove in LBIE's liquidation in respect of debts (other than the LBHI2 Subordinated Debt) owed to it because:
 - 3.1. Such debts would be provable pursuant to Rules 12.3 and 13.12(1) and would not be postponed by Rule 12.3(2A).
 - 3.2. Section 74 would not apply unless LBIE, having gone into liquidation, were unable from its own resources to pay its debts and liabilities and the expenses of the winding up.
 - 3.3. Subject to any question of set-off (as to which see below), section 74 (if it were to apply at all) would not operate to prevent LBHI2 proving in respect of such debts.
 - 3.4. Even if section 74 were otherwise to apply, section 74(2)(f) has no effect and would not apply so as to prevent LBHI2 from proving in relation to such debts in any event because they would not be due to LBHI2 in its character as member by way of dividends, profits or otherwise within the meaning of that provision.

4. As regards any entitlement LBL may have to prove in LBIE's liquidation, LBHI currently proposes to adopt a neutral position, but reserves the right to change its position if it considers that it would be in its interests to do so.

C. QUESTION 3

Is LBHI2 entitled to prove in LBIE's administration, or would LBHI2 be entitled to prove in any subsequent liquidation of LBIE, in respect of the LBHI2 Subordinated Debt notwithstanding: (i) the terms of the LBHI2 Subordinated Debt; and (ii) LBHI2's Potential Liability as Contributory? What (if any) is the effect of Section 74(2)(f) of the Act?

5. LBHI2 is entitled to prove in LBIE's administration in respect of the LBHI2 Subordinated Debt because:
 - 5.1. The LBHI2 Subordinated Debt is provable pursuant to Rules 12.3 and 13.12(1).
 - 5.2. The LBHI2 Subordinated Debt is not postponed by Rule 12.3(2A). In particular, it is not postponed by virtue of the Act, whether by section 74(2)(f) or otherwise, or by virtue of any other enactment, including any legislation intended to implement applicable EC Capital Adequacy Directives.
 - 5.3. The terms of the LBHI2 Subordinated Debt do not operate to prevent LBHI2 from proving in respect of it. On the contrary, clause 4(5) specifically permits LBHI2 to institute proceedings for LBIE's administration or liquidation to enforce payment of the Subordinated Debt, from which it necessarily follows that LBHI2 is to be permitted to prove in respect of the LBHI2 Subordinated Debt. LBHI accepts that LBHI2 will not rank for dividend until all other provable debts have been paid in full.
 - 5.4. Section 74 does not apply and has no effect unless and until LBIE goes into liquidation and is unable from its own resources to pay its

debts and liabilities and the expenses of winding up.

- 5.5. Even if section 74 were otherwise to apply, section 74(2)(f) has no effect and would not apply so as to prevent LBHI2 proving in respect of the LBHI2 Subordinated Debt because it is not due to LBHI2 in its character as member by way of dividends, profits or otherwise within the meaning of that provision.
6. LBHI2 would be entitled to prove in LBIE's liquidation in respect of the LBHI2 Subordinated Debt because:
- 6.1. The LBHI2 Subordinated Debt is provable pursuant to Rules 12.3 and 13.12(1).
 - 6.2. The LBHI2 Subordinated Debt would not be postponed by Rule 12.3(2A). In particular, the LBHI2 Subordinated Debt would not be postponed by virtue of the Act, whether by section 74(2)(f) or otherwise, or by virtue of any other enactment, including any legislation intended to implement applicable EC Capital Adequacy Directives.
 - 6.3. The terms of the LBHI2 Subordinated Debt do not operate to prevent LBHI2 from proving in respect of it. On the contrary, clause 4(5) specifically permits LBHI2 to institute proceedings for LBIE's liquidation to enforce payment of the Subordinated Debt, from which it necessarily follows that LBHI2 is to be permitted to prove in respect of the Subordinated Debt. LBHI accepts that LBHI2 will not rank for dividend until all other provable debts have been paid in full.
 - 6.4. Subject to any question of set-off (as to which see below), section 74 (if it were to apply at all) would not operate to prevent LBHI2 proving in respect of the LBHI2 Subordinated Debt.
 - 6.5. Even if section 74 were otherwise to apply, section 74(2)(f) would have no effect and would not apply so as to prevent LBHI2 from

proving in respect of the LBHI2 Subordinated Debt because it is not due to LBHI2 in its character as member by way of dividends, profits or otherwise within the meaning of that provision.

D. QUESTION 4

*In the case of each of paragraphs 1 to 3 above, to the extent that there is an entitlement to prove, in so proving, is credit required to be given or is any deduction to be made in respect of each of the Member's Potential Liability as Contributory either: (i) by way of set-off (set out in rules 2.85 and 4.90 of the Insolvency Rules 1986 (the "Rules") as applicable; and/or (ii) pursuant to the rule in *Cherry v Boulton* 41 ER 171; and/or (iii) otherwise?*

7. LBHI currently proposes to adopt a neutral position in relation to Question 4 but reserves the right to change its position if it considers that it would be in its interests to do so.

E. QUESTION 5

Is LBIE entitled to prove in the administrations (or would LBIE be entitled to prove in any subsequent liquidations) of the Members in respect of each of the Members' Potential Liability as Contributory?

8. LBHI currently proposes to adopt a neutral position in relation to Question 5 but reserves the right to change its position if it considers that it would be in its interests to do so.

F. QUESTION 6

If LBIE is entitled to prove in the Members' administrations (or any subsequent liquidations) as described in paragraph 5 above, what effect (if any) does:

(1) insolvency set-off have on the LBHI2 Subordinated Debt?

(2) insolvency set-off have on the Members' respective non-subordinated

debt claims?

(3) the rule in Cherry v Boulton have on the LBHI2 Subordinated Debt?

(4) the rule in Cherry v Boulton have on the Members' respective non-subordinated debt claims?

(5) any other relevant form of set-off or deduction have on:

(a) the LBHI2 Subordinated Debt; and/or

(b) the Members' respective non-subordinated debt claims?

9. LBHI currently proposes to adopt a neutral position in relation to Question 6 but reserves the right to change its position if it considers that it would be in its interests to do so.

G. QUESTION 7

What (if any) is the effect of Section 149 of the Act on:

(1) any proof submitted by either of the Members in LBIE's administration or (if LBIE were wound-up) liquidation?

(2) any proof submitted by LBIE in either of the Member's respective administrations or (if either of the Members were wound-up) liquidations?

10. LBHI currently proposes to adopt a neutral position in relation to Question 7 but reserves the right to change its position if it considers that it would be in its interests to do so.

H. QUESTION 8

To the extent that LBIE is entitled to prove in respect of it, or it is required to be brought into the account on any proof which either of the Members is entitled to file in LBIE's administration or a subsequent liquidation, in circumstances in which each Member's Potential Liability as Contributory is

contingent, is that Member's Potential Liability as Contributory capable of being ascertained and quantified and, if so, how should the quantum of the Member's Potential Liability as Contributory be quantified?

11. LBHI currently proposes to adopt a neutral position in relation to Question 8 but reserves the right to change its position if it considers that it would be in its interests to do so.

I. QUESTION 9

Whether, and in what circumstances each of the Member's Potential Liability as Contributory extends to contributing to LBIE's assets an amount sufficient for payment of:

(a) interest provable and/or payable pursuant to Rule 2.88 of the Rules on the principal of the debts and liabilities owed to LBIE's creditors by LBIE; and/or

(b) the LBHI2 Subordinated Debt; and

(c) Currency Conversion Claims (as defined at paragraph 12 below), to the extent that paragraph 12 is answered in the affirmative.

12. The debts and liabilities (but not the expenses) to which liability to contribute extends pursuant to section 74, in the event that the company is unable from its own resources to discharge them (ie the company suffers a shortfall), are only those which are or would be provable in the liquidation.

13. In the event of a shortfall in LBIE's liquidation, LBHI2's Potential Liability as Contributory would extend to contributing to LBIE's assets an amount sufficient for payment of:

13.1. Interest provable pursuant to Rule 4.93(1) (being the same interest as would be provable pursuant to Rule 2.88(1)); and

13.2. The LBHI2 Subordinated Debt (subject to any set-off, as to which

see above), if the LBHI2 Subordinated Debt is provable (but not otherwise).

14. LBHI2's Potential Liability as Contributory would not extend to:
 - 14.1. Interest payable (if at all) pursuant to Rule 2.88(7);
 - 14.2. The LBHI2 Subordinated Debt, if it is not provable; and
 - 14.3. Currency Conversion Claims, even if Question 12 is answered in the affirmative.
15. LBHI currently proposes to adopt a neutral position in relation to the extent of LBL's Potential Liability as Contributory, but reserves the right to change its position if it considers that it would be in its interests to do so.

J. QUESTION 10

In the event that the Members are obliged to contribute to the assets of LBIE pursuant to Section 74 of the act, and in light of the fact that LBL owns 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 6,273,113,999 ordinary shares of \$1 each in LBIE:

- (a) whether their obligations are joint, several or otherwise as against LBIE;*
- (b) whether they are entitled to seek a contribution or indemnity from one another in respect of any payments made pursuant to any such obligation and, if so, the nature and extent of such right of contribution or indemnity;*
- (c) to what extent any right to contribution or indemnity as referred to in subparagraph (b) above is affected by any other claims which LBHI2 and LBL have against one another.*

16. LBHI currently proposes to adopt a neutral position in relation to Question 10

but reserves the right to change its position if it considers that it would be in its interests to do so.

K. QUESTION 11

In the event that there are sufficient funds in LBIE's administration to permit the LBIE Joint Administrators to make payment in full to LBIE's general, unsecured creditors in respect of the principal of the debts and liabilities owed to them by LBIE, in what order would the LBIE Joint Administrators be required to apply any surplus in discharging the following:

- (a) interest payable on such debts and liabilities in respect of the periods during which they have been outstanding since LBIE entered administration pursuant to Rule 2.88(7) of the Rules;*
- (b) currency Conversion Claims (as defined at paragraph 12 below), to the extent that paragraph 12 is answered in the affirmative;*
- (c) to the extent that the Members have been unable to prove in respect of them, debts owed by LBIE to the Members (other than in respect of the LBHI2 Subordinated Debt); and*
- (d) to the extent that LBHI2 has been unable to prove in respect of it, the LBHI2 Subordinated Debt.*

17. In the event that there are sufficient funds in LBIE's administration, the LBIE Joint Administrators would be required to discharge claims in the following order:

- 17.1. Debt owed by LBIE to LBHI2 (other than in respect of the LBHI2 Subordinated Debt), as a provable debt.
- 17.2. The LBHI2 Subordinated Debt, as a provable debt, after payment of all other unsubordinated provable debts.
- 17.3. Interest payable pursuant to Rule 2.88(7).

- 17.4. If, for any reason, LBHI2 has been unable to prove in respect of the same, debt owed to LBHI2 (other than the LBHI2 Subordinated Debt) and the LBHI2 Subordinated Debt.
- 17.5. Currency Conversion Claims, if Question 12 is answered in the affirmative.
18. LBHI currently proposes to adopt a neutral position in relation to the order in which LBL's unsubordinated claims should rank for payment, but reserves the right to change its position if it considers that it would be in its interests to do so.

L. QUESTION 12

*Is an unsecured creditor, with a contractual entitlement to payment from LBIE in a currency other than sterling (the "**Contractual Currency**") entitled, following payment in full of:*

- (i) All creditors' proved debts; and*
- (ii) Interest on such debts in respect of periods during which they have been outstanding since LBIE entered administration pursuant to Rule 2.88(7) of the Rules,*

*to payment from LBIE in a sum equal to the difference between (a) the amount of its contractual entitlement to payment in the Contractual Currency and (b) the amount received by it in respect of its proved debt against LBIE, converted into the Contractual Currency as at the date of payment (such claims being referred to as a "**Currency Conversion Claim**")?*

19. An unsecured creditor is not entitled to payment of a Currency Conversion Claim in the circumstances envisaged. This is principally because:
- 19.1. If and insofar as reliance for the contrary view is placed on the obiter dicta of Brightman and Oliver LJJ in *Re Lines Bros Ltd* [1983] Ch 1 (CA), the legislative framework has fundamentally changed with the

result that the answer they tentatively posited is not available.

- 19.2. In particular, the Rules expressly require conversion of foreign currency debts to take place at the date of entry into administration, and this applies whether or not the administration is solvent or insolvent.
- 19.3. A Currency Conversion Claim, if it were to exist, would be inconsistent with, and would render unworkable, the mandatory statutory provisions for set-off in the event that the debtor company had a claim against the creditor.
- 19.4. A Currency Conversion Claim, if it were to exist, would work only to the advantage of the creditor with such a claim. To apply a later conversion date only where it has moved to the advantage of the creditor concerned would be unprincipled, discriminatory and unfair.

BARRY ISAACS Q.C.

MARK ARNOLD Q.C.

24 May 2013

Nos 7924 and 7945 of 2008 and No 429 of 2009

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POSITION PAPER ON BEHALF OF LBHI

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