

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

**IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN  
ADMINISTRATION)**  
**IN THE MATTER OF LEHMAN BROTHERS LIMITED  
(IN ADMINISTRATION)**  
**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 (a company incorporated in the  
State of Delaware, USA)**  
**(2) LYDIAN OVERSEAS PARTNERS MASTER FUND LIMITED**

**Respondents**

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**POSITION PAPER OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN  
ADMINISTRATION)**  
**pursuant to the Order of Briggs J dated 27 March 2013**

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**Scope of this position paper**

1. The defined terms adopted in this position paper are the same as those set out in the Amended Application at Schedule 1 to the Order of Briggs J dated 27 March 2013 in these proceedings.

2. LBHI2 sets out below a summary of its position as to the issues raised in the Amended Application. It reserves its rights to amend its position following disclosure and exchange of evidence.

### **Factual background**

3. LBIE was the principal trading company with the UK-regulated group of Lehman Brothers companies. It went into administration on 15 September 2008.
4. LBHI2 is a shareholder in LBIE. It went into administration on 14 January 2009. Its shareholdings in LBIE are as follows:
  - (a) 2 million 5% redeemable Class A preference shares of \$1000 each;
  - (b) 5.1 million 5% redeemable Class B shares of \$1000 each; and
  - (c) 6,273,113,999 ordinary shares of \$1 each.
5. LBL is the other shareholder in LBIE (it holds one ordinary share of \$1). LBHI2 is an unsecured creditor of LBL in the sum of around £257,000,000.
6. LBHI2 is a creditor of LBIE. On 24 April 2012, LBHI2 lodged a proof of debt in LBIE's administration in respect of:
  - (a) an unsecured claim for £38,089,911.30 (the "**LBHI2 Non-Subordinated Debt**"); and
  - (b) an unsecured claim of \$2,254,165,598.48 pursuant to three loan agreements entered into on 1 November 2006 between LBHI2 (as lender) and LBIE (as borrower), one 'long term' agreement for

3,000,000,000 Euros, one ‘long term’ agreement for 4,500,000,000 Euros and one ‘short term’ agreement for \$8,000,000,000 (the “**LBHI2 Subordinated Debt**”).

7. No dividend has been paid by LBIE’s administrators to LBHI2. LBHI2 has not yet invited proofs in its administration.
8. It now appears that LBIE may well be able to pay all its unsecured, unsubordinated creditors in full. It is a distributing administration and has made an interim dividend payment of 25.2 pence in the pound to unsecured creditors (totalling around £1,611,000,000) on 30 November 2012. Recently (on 8 May 2013), the LBIE administrators announced that they intend to pay a second interim dividend (and a first preferential dividend) to LBIE’s creditors on or around 28 June 2013. None of the LBIE reports to creditors indicates that LBIE is likely to be put into liquidation; there are other preferred exit routes.

**LBHI2’s position on the LBHI2 Subordinated Debt and statutory interest claims**

9. Although the factual circumstances which have given rise to this Joint Application require the consideration of a large number of inter-related issues (as set out in the Amended Application), the driving force has been the issue of whether any claim for payment of statutory interest payable on the principal debts proved in LBIE’s insolvency (under s. 189 of the Insolvency Act 1986 (the “**Act**”) or r. 2.88 of the Insolvency Rules 1986 (the “**Rules**”)) arises prior to any payment to LBHI2 by LBIE in respect of the LBHI2 Subordinated Debt.
10. Section 189 of the Act and r. 2.88(7) of the Rules provide that interest is payable in the insolvency on any debt proved, but only where there is a surplus remaining after the payment in full of all proved debts; where there

is a surplus after such payment, the surplus shall be applied to pay interest on the proved debts “*before being used for any other purpose*”, i.e. where debts have been paid in full, interest is payable on those debts (“*whether or not the debts on which it is payable rank equally*”: s. 189(3) of the Act and r. 2.88(8) of the Rules) before any money is returned to shareholders.

11. LBHI2’s position is that all of LBIE’s unsecured non-subordinated and subordinated debt claims must be discharged in full before any claim for statutory interest by any creditor can arise. The LBHI2 Non-Subordinated and the LBHI2 Subordinated Debt are provable as debts in LBIE’s administration or liquidation and, accordingly, must be paid by LBIE before there is any “surplus”, the existence of which (according to s. 189 of the Act and r. 2.88(7) of the Rules) triggers a claim for the payment of statutory post-administration or post-liquidation interest on any debts (regardless of the priority as between those debts, which indicates that all debts, including debts containing ‘subordination’ provisions, must be discharged before there is any trigger for a claim for payment of statutory interest). That is what the insolvency legislation requires and any contention to the contrary by LBIE (for example, based on the subordination provisions in the loan facilities which make up the LBHI2 Subordinated Debt) fails to engage properly with the strict terms of those facilities.

### **Summary of LBHI2’s position on issues set out in the Amended Application**

12. LBHI2 sets out here a summary of its answers to the issues raised in the Amended Application. The numbering of the questions set out in the Amended Application is not followed precisely here, but the issues are all covered in summary.

- (1) Is LBHI2 entitled to prove in LBIE's administration in respect of sums owed by LBIE to LBHI2 (other than in respect of the LBHI2 Subordinated Debt)?

LBHI2's answer: Yes.

- (2) What effect do LBHI2's Potential Liability as Contributory and/or Section 74(2)(f) of the Act have on that ability to prove?

LBHI2's answer: None.

- (3) If LBIE were wound-up, would LBHI2 be entitled to prove in LBIE's liquidation in respect of sums owed by LBIE to LBHI2 (other than the LBHI2 Subordinated Debt)?

LBHI2's answer: Yes.

- (4) What effect do LBHI2's Potential Liability as Contributory and/or Section 74(2)(f) of the Act have on that ability to prove?

LBHI2's answer: None.

- (5) Is LBHI2 entitled to prove in LBIE's administration or any subsequent liquidation for the LBHI2 Subordinated Debt?

LBHI2's answer: Yes, in both.

- (6) What effect do the terms of the LBHI2 Subordinated Debt and/or LBHI2's Potential Liability as Contributory and/or Section 74(2)(f) of the Act have on that ability to prove?

LBHI2's answer: The Potential Liability as Contributory and Section 74(2)(f) do not affect LBHI2's ability to prove in any insolvency of LBIE, but they do affect the priority in which payments are made out of LBIE's insolvency.

- (7) If LBHI2 is entitled to prove in LBIE's insolvency in respect of the LBHI2 Non-Subordinated Debt and the LBHI2 Subordinated Debt, does insolvency set-off (set out in rules 2.85 and 4.90 of the Rules) apply, and/or can LBIE's administrators/any subsequent liquidators invoke the 'rule' in *Cherry v Boulton*, in respect of LBHI2's Potential Liability as Contributory?

LBHI2's answer: No.

- (8) Is LBIE entitled to prove in the administration or any subsequent liquidation of LBHI2 in respect of LBHI2's Potential Liability as Contributory?

LBHI2's answer: LBHI2's primary position is that LBIE is not so entitled because the Potential Liability as Contributory is not a "debt" within the meaning of r. 13.12 of the Rules and is, accordingly, not a claim provable as a debt within the meaning of r. 12.3 of the Rules. If that is not right and LBIE is entitled to prove, LBHI2 is entitled to set off both the LBHI2 Non-Subordinated Debt and the LBHI2 Subordinated Debt against the Potential Liability as Contributory to reduce the amount of the provable claim.

- (9) If LBIE is entitled to prove in LBHI2's administration or any subsequent liquidation in respect of LBHI2's Potential Liability as Contributory, what effect (if any) does insolvency set-off and/or the

'rule' in *Cherry v Boulton* have on LBHI2's claims for the LBHI2 Non-Subordinated Debt and the LBHI2 Subordinated Debt?

LBHI2's answer: Insolvency set-off can only operate to reduce LBHI2's claim in LBIE's insolvency once a value has been placed upon LBIE's proof by LBHI2's administrators/any subsequent liquidators. LBIE's administrators/any subsequent liquidators could not invoke the 'rule' in *Cherry v Boulton* against LBHI2 in respect of the Potential Liability as Contributory.

(10) What (if any) is the effect of Section 149 of the Act?

LBHI2's answer: If LBIE were entitled to prove in LBHI2's insolvency for the Potential Liability as Contributory, LBHI2 would be entitled to set off against such proof its claims in LBIE's insolvency in respect of the LBHI2 Non-Subordinated Debt and the LBHI2 Subordinated Debt under s. 149(2)(a) of the Act. Section 149 of the Act has no impact on any proof which LBHI2 is entitled to lodge in LBIE's insolvency.

(11) If LBIE is entitled to prove in LBHI2's insolvency in respect of the Potential Liability as Contributory, how should it be quantified?

LBHI2's answer: LBHI2's administrators/any subsequent liquidators would have to take into account all the circumstances (including the various matters that would have to take place before the Potential Liability as Contributory would actually be 'triggered' and would crystallise into a liability that needed to be paid).

- (12) Does LBHI2's Potential Liability as Contributory extend to contributing to LBIE's assets an amount sufficient for payment of:
- (a) interest provable and/or payable pursuant to Rule 2.88(7) of the Rules on the principal of the debts and liabilities owed to LBIE's creditors by LBIE?
  - (b) the LBHI2 Subordinated Debt?
  - (c) the Currency Conversion Claim?

LBHI2's answers are: (a) No, (b) Yes and (c) No.

- (13) If LBHI2 and LBL are obliged to contribute to the assets of LBIE:
- (a) are their obligations joint, several or otherwise as against LBIE;
  - (b) are they 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 sub-paragraph (b) above is affected by any other claims which LBHI2 and LBL have against one another.

LBHI2's answer: it is a matter for the Court to determine the respective contributory liability for each contributory and then make an order that the contributory pay the sum the Court has determined it owes.

- (14) 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;
- (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.

LBHI2's position is that the LBHI2 Non-Subordinated Debt and the LBHI2 Subordinated Debt must be paid by LBIE (as principal debts) before any surplus can arise to trigger payment of statutory interest or the Currency Conversion Claim (if the same is, in fact, provable, contrary to LBHI2's contention).

- (15) Is the Currency Conversion Claim a provable claim in LBIE's insolvency?

LBHI2's answer: No.

### **Further analysis**

#### **Proof by LBHI2 in LBIE's insolvency**

- 13. LBHI2 has lodged a proof of debt in respect of the LBHI2 Non-Subordinated Debt and the LBHI2 Subordinated Debt in LBIE's administration. LBHI2 is entitled to do this and it would, similarly, be entitled to do so, were LBIE to be subsequently placed into liquidation.

14. The only claims that fall outside the scope of r. 12.3 of the Rules are those in respect of which payment is postponed by the insolvency legislation. The treatment of sums outstanding under the three loan facilities which together make up the LBHI2 Subordinated Debt in LBIE's insolvency is to be determined strictly by reference to their contractual terms, including the specific definitions (for example, of "solvency") contained therein. Those terms (which are the same in each of the three loan agreements) say nothing either (i) to prevent LBHI2 proving in LBIE's insolvency for the sums outstanding, either at all or until certain other debts have been paid in full, and, accordingly, do not in any way interfere with the concept of provability as set out in the insolvency legislation or (ii) to indicate that the sums outstanding should be subordinated, in LBIE's insolvency, to potential claims by LBIE against LBHI2 for statutory interest (which is not a claim provable as a debt; a claim for its payment only arises on full payment of all proved debts). Had that been intended, the loan facilities would have made provision for the same.
  
15. LBHI2's ability to prove in LBIE's administration (or any subsequent liquidation of LBIE) is not affected by:
  - (a) its Potential Liability as Contributory; or
  
  - (b) s. 74(2)(f) of the Act.
  
16. The analysis of LBHI2's Potential Liability as Contributory is dealt with below. As to s. 74(2)(f) of the Act, which provides that sums due to a member "*in his character as a member whether by dividends, profits or otherwise*" are not deemed to be a debt of the company in liquidation, payable to that member in competition with the claim of someone who is not a member, LBHI2's position is that both the LBHI2 Non-Subordinated Debt and the LBHI2 Subordinated Debt do not fall within the scope of that sub-section. In particular, as set out above, the sums outstanding under the

three loan facilities which make up the LBHI2 Subordinated Debt are not to be treated as equity of LBIE, but as debt strictly in accordance with their terms. The meaning of sums due to a member “*in his character as a member*” was explained in *Soden v British & Commonwealth Holdings plc* [1998] 1 AC 298 at 322 to 326 by Lord Browne-Wilkinson as sums falling due under and by virtue of the statutory contract between members and the company and the members *inter se*, with the “*statutory contract*” being defined as the bundle of rights and liabilities created by the company’s memorandum and articles together with the rights and obligations of members conferred and imposed on members by the Companies Acts. The LBHI2 Subordinated Debt is not a sum due to LBHI2 by virtue of the statutory contract.

17. *If* LBIE is able to prove in LBHI2’s insolvency in respect of the Potential Liability as Contributory:

(a) LBIE’s administrators/liquidators could assert that insolvency set-off operates such that LBHI2’s Potential Liability as Contributory can be set off against the liabilities which LBIE has to LBHI2 (for the LBHI2 Non-Subordinated Debt and the LBHI2 Subordinated Debt). That set-off can only operate once a value has been placed upon the Potential Liability as Contributory, if such a claim is capable of proof and, if so, if such a proof is in fact submitted by LBIE in LBHI2’s insolvency;

(b) LBIE’s administrators/liquidators could not assert an entitlement to refuse payment to LBHI2 until LBHI2 contributes the full amount it owes to LBIE to LBIE (pursuant to the ‘rule’ in *Cherry v Boulton*) because LBHI2’s Potential Liability as Contributory is a contingent claim (contingent on the happening of various eventualities, such as *inter alia* LBIE actually going into liquidation and there actually being a shortfall) and any sum

payable by LBHI2 to LBIE for the Potential Liability as Contributory may only become payable (if at all) in the future.

What is included in LBHI2's Potential Liability as Contributory?

18. If LBIE were to go into liquidation and the LBIE liquidators were to consider claiming a sum from LBHI2 as contributory in the event of a shortfall in LBIE's assets, LBIE's liquidators should, in ascertaining the total shortfall to which LBHI2 may have to contribute under s. 74(1) of the Act:

- (a) take into account both the LBHI2 Non-Subordinated and the LBHI2 Subordinated Debt (neither of which is within the scope of s. 74(2)(f) of the Act, as set out above);
- (b) not take into account an amount sufficient to cover any statutory interest payable to any creditors under s. 189 of the Act;
- (c) not take into account an amount sufficient to cover the Currency Conversion Claim (see below at paragraphs 38 and 39).

Proof by LBIE in LBHI2's insolvency

19. LBHI2's primary position is that the LBIE administrators (or liquidators) would not be entitled to prove in LBHI2's administration (or subsequent liquidation) for LBHI2's Potential Liability as Contributory, because the Potential Liability as Contributory is not a "debt" within the meaning of r. 13.12 of the Rules (since it is not a debt or liability to which LBHI2 may become subject after it entered administration by reason of an obligation incurred before it went into administration; the obligation has not yet been incurred) and, accordingly, not a claim provable as a debt within the meaning of r. 12.3 of the Rules.

20. Alternatively, if LBIE would be entitled to prove in LBHI2's administration for LBHI2's Potential Liability as Contributory, such contingent claim by LBIE against LBHI2 being provable as a debt for the purpose of r. 12.3 of the Rules, then the LBHI2 administrators would be required to value LBIE's proof if such a proof were allowed to be submitted (see below at paragraphs 24 to 28 on valuation).
21. If LBIE were to go into liquidation and the LBIE liquidators were to consider claiming a sum from LBHI2 as contributory, in ascertaining the total sum to which LBHI2 may have to contribute under s. 74(1) of the Act, LBIE's liquidators:
- (a) could include both the LBHI2 Non-Subordinated Debt and the LBHI2 Subordinated Debt (neither of which is within the scope of s. 74(2)(f) of the Act);
  - (b) could not include an amount sufficient to cover any statutory interest payable to any creditors under s. 189 of the Act;
  - (c) could not include an amount sufficient to cover the Currency Conversion Claim (see below at paragraphs 38 and 39).
22. If LBIE were to submit a proof in either LBHI2's administration or any subsequent liquidation of LBHI2 for the Potential Liability as Contributory, LBHI2 should be entitled to set off both the LBHI2 Non-Subordinated Debt and the LBHI2 Subordinated Debt against that Potential Liability as Contributory, by virtue of:
- (a) s. 149(2)(a) of the Act; and/or

(b) insolvency set-off under r. 2.85 (administration) or r. 4.90 (liquidation) of the Rules.

23. Further, LBHI2's administrators or liquidators would be entitled to refuse to make any payment to LBIE until LBIE had contributed the funds it owes LBHI2 to the LBHI2 estate (pursuant to the 'rule' in *Cherry v Boulton*) in respect of which LBHI2 has submitted a proof of debt (i.e. the LBHI2 Non-Subordinated Debt and the LBHI2 Subordinated Debt).

#### Valuation of LBHI2's Potential Liability as Contributory

24. R. 2.81 and r. 4.86 of the Rules require the LBHI2 office-holders (in the present administration or in any subsequent liquidation of LBHI2) to value any contingent liability taking into account all relevant circumstances.
25. They should give weight to the likelihood of the contingency occurring at all and of the contingency occurring during the period of the insolvency arrangement in which a proof is submitted by LBIE (be that administration or liquidation). The value can be revised if circumstances change.
26. The valuation process in respect of contingent debts is fact-specific and is a matter for the LBHI2 office-holders. The process must be conducted by them, taking into account all the circumstances, including those matters which have actually occurred between (i) the date on which LBIE went into administration and (ii) the time when it becomes necessary to ascertain the state of the account between LBHI2 and LBIE.
27. If the valuation of the Potential Liability as Contributory takes place when LBIE is still in administration, the LBHI2 administrators would need to take account of the likelihood of LBIE eventually being placed into liquidation in addition to the matters set out in paragraph 28 below.

28. If the valuation of the Potential Liability as Contributory takes place when LBIE is already in liquidation, the LBHI2 administrators would need to take into account *inter alia* (i) the likelihood of there being a shortfall to which LBHI2 may have to contribute under s. 74(1) of the Act, (ii) the likelihood of the making of a call on LBHI2 to contribute and (iii) the likely sum in which any such call would be made.

Statutory interest under r. 2.88(7) of the Rules if LBIE remains in administration

29. If there is a surplus after LBIE has paid all the debts proved in its administration, such surplus is to be applied in paying interest on those claims proved as debts for the period post-administration.

Statutory interest under s. 189 of the Act if LBIE is wound up

30. If LBIE is wound up, its past and present members may be required under s. 74(1) of the Act to contribute to LBIE's assets to meet any shortfall in payment of LBIE's "*debts and liabilities*". That sub-section means that LBHI2 is potentially liable to contribute to LBIE's assets so as to meet any shortfall in LBIE paying claims provable as debts in LBIE's liquidation.
31. As with r. 2.88(7) in the context of administration, section 189(1) of the Act provides that interest is payable in a liquidation on any debt proved in the winding-up, but only where there is a surplus remaining after the payment in full of all proved debts including proved interest (section 189(2) of the IA 1986). Where there is a surplus after such payment, the surplus shall be applied to pay interest on the proved debts "*before being used for any other purpose*", i.e. where debts have been paid in full, interest is payable on those debts ("*whether or not the debts on which it is payable rank equally*": s. 189(3) of the Act and r. 2.88(8) of the Rules) before any money is returned to shareholders.

32. The LBHI2 Non-Subordinated Debt and the LBHI2 Subordinated Debt and pre-insolvency interest thereon are provable as debts in LBIE's liquidation (see above at paragraphs 13 and 14) and, accordingly, must be paid before there is any "surplus" which can be applied in paying statutory post-administration or post-liquidation interest (whether LBIE is in administration or liquidation) on any debts.

The nature of a claim to post-insolvency interest on proved debts

33. Post-insolvency interest payable under r. 2.88(7) of the Rules (administration) or s. 189 of the Act (liquidation) is not a provable debt. It is provable debts that have to be paid in full before post-insolvency interest becomes payable. Accordingly, post-insolvency interest is not something which can form part of a contributory's potential liability under s. 74(1) of the Act and it cannot and does not form party of LBHI2's Potential Liability as Contributory to LBIE (if in fact, contrary to LBHI2's primary position, LBIE can prove for such a liability in any event).

The position as between LBHI2 and LBL

34. LBHI2 has an unsecured claim against LBL for around £257,000,000. LBHI2's position as to provable debts is set out above at paragraphs 13 to 16 and 19 to 20. Accordingly, it is entitled to prove for its unsecured claim of around £257,000,000 in LBL's administration (and any subsequent liquidation).
35. As to the position between LBHI2 and LBL as contributories of LBIE, LBHI2's case is that the respective liability of each contributory is a matter to be determined by the Court, and each contributory would then be obliged to pay the determined sum (or, in circumstances where the relevant contributory is in insolvency too, the company (in this case,



LBIE) would need to prove in the contributory's insolvency for the sum determined by the Court).

36. LBL has no claim provable as a debt against LBHI2.
37. If LBL were to have a claim provable as a debt in LBHI2's insolvency (although, at present, LBHI2's position is that it never will), then (1) insolvency set-off would operate to set-off the £257,000,000 unsecured claim of LBHI2 to reduce LBL's proof, and/or (2) LBHI2's administrators/liquidators would be entitled to withhold payment from LBL pursuant to the 'rule' in *Cherry v Boulton*.

#### The Currency Conversion Claim

38. LBHI2's position is that Lydian is not entitled to payment in respect of the alleged Currency Conversion Claim (at all) either if LBIE remains in administration or goes into liquidation.
39. The conversion under r. 2.86 of the Rules of non-sterling debts into their sterling value at the date of the commencement of the insolvency arrangement to give the value of that creditor's claim in the insolvency arrangement gives effect to the *pari passu* principle of distribution between creditors. The Rules make no provision for any residual claim by the creditor for any loss suffered by reason of the conversion to sterling (and, likewise, no provision for the creditor's proof to be adjusted thereafter should the conversion later transpire to have been beneficial to the creditor by reason of later currency movements). That is to ensure that there is a 'clean break' as at the relevant date: see *Re Lines Bros* (No. 1) [1983] Ch 1 (CA) at 11B-C and 14B-C *per* Lawton LJ; *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147 at [24] *per* Lord Hoffmann.

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**Respondents**

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**POSITION PAPER OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN  
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**pursuant to the Order of Briggs J dated 27 March 2013**

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**Dentons UKMEA LLP**  
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**EC4M 7WS**

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