

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

(2) LYDIAN OVERSEAS PARTNERS MASTER FUND LIMITED

Respondents

POSITION PAPER OF LBL

1. This position paper summarises the position of the joint administrators of Lehman Brothers Limited (“**LBL**”, and the “**LBL Joint Administrators**”, respectively), in relation to the joint application for directions issued on 14 February 2013, as amended on 27 March 2013 (the “**Joint Application**”). It is filed in advance of disclosure of documents by the LBIE Administrators and in advance of witness statements, and accordingly the LBL Joint Administrators reserve their rights insofar as their position set out below is affected by matters arising out of disclosure or witness statements.

2. As to questions 1-12 raised by the Joint Application (and adopting the definitions in the Joint Application), the position of the LBL Joint Administrators is, in summary form, as follows:
 - (1) **Question 1:** The Members are entitled to prove in LBIE’s administration in respect of sums owed by LBIE to the Members (for the avoidance of doubt excluding the LBHI2 Subordinated Debt) which are not owed to the Members in their character as members. The sums owed by LBIE to LBL are not owed to LBL in its character as member. Accordingly, they are not subordinated to the claims of the company’s creditors (whether under s.74(2)(f) of the 1986 Act or otherwise), but are subject to the *pari passu* rule in Rule 2.69 (ranking equally along with LBIE’s other debts and liabilities to its unsecured creditors). Thus LBL is entitled to prove in respect of the sums in LBIE’s administration. Further, as set out at sub-paragraph 4 below, no credit is required to be given in respect of the Members’ Potential Liability as Contributory, which does not impact upon LBL’s ability to prove in LBIE’s administration.

 - (2) **Question 2:** If LBIE were wound up, the Members would be entitled to prove in LBIE’s winding up in respect of sums owed by LBIE to the Members (for the avoidance of doubt excluding the LBHI2 Subordinated Debt) which are not owed to the Members *qua* members. To the extent that such sums are not owed to the Members in their character as members, they would not be subject to s.74(2)(f) of the 1986 Act. Further, as set out at sub-paragraph 4 below, no credit is required to be given in respect of the Members’ Potential Liability as Contributory, which does not impact upon LBL’s ability to prove in LBIE’s administration; alternatively no credit is required to be given unless and until such liability crystallises by way of a valid

call being made in respect of the Members' liability under s.74, pursuant to s.150 of the Act, as delegated to the liquidator under Rule 4.202 *et. seq.* of the Rules, and only to the extent of the call.

(3) **Question 3:** LBHI2 is not entitled to prove in LBIE's administration, nor in any subsequent liquidation of LBIE, in respect of the LBHI2 Subordinated Debt:

- a. Under the terms of the LBHI2 Subordinated Debt, in particular para 5(1)(b) of the Standard Terms, payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities (as defined therein) is conditional upon LBIE being "solvent" at the time of, and immediately after, the payment by LBIE, and no such amount which would otherwise fall due for payment shall be payable except to the extent that LBIE could make such payment and still be "solvent". Para 5(2) of the Standard Terms provides that for the purposes of para 5(1)(b), LBIE shall be "solvent" if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding obligations which are not payable or capable of being established or determined in the Insolvency of LBIE, and the Excluded Liabilities (capitalised terms as defined in the LBHI2 Subordinated Debt). "*Excluded Liabilities*" are defined as "*Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower*".
- b. As set out in answer to question 11 below, interest pursuant to Rule 2.88(7) (in respect of an administration, and s.189(2) in respect of a winding up) ranks ahead of the LBHI2 Subordinated Debt in priority. There does not appear to be any prospect of LBIE being able to pay its general, unsecured creditors in full in respect of both the principal of the debts and liabilities owed to them by LBIE and statutory interest. Accordingly, under the terms of the LBHI2 Subordinated Debt, no payment is due to LBHI2.

(4) **Question 4:** As to each of sub-paragraphs 1 to 3 above:

- a. In the case of sub-paragraph 1, no credit is required to be given or deduction is to be made in respect of the Members' Potential Liability as Contributory, whether by way of insolvency set-off (set out in Rule 2.85 of the Rules), pursuant to the rule in **Cherry v Boulton**, or otherwise.
- b. In the case of sub-paragraph 2, no credit is required to be given or deduction is to be made in respect of the Members' Potential Liability as Contributory, whether by way of insolvency set-off (set out in Rule 4.90 of the Rules), pursuant to the rule in **Cherry v Boulton**, or otherwise. Alternatively, no credit is required to be given or deduction is to be made unless and until such liability crystallises by way of a valid call being made pursuant to s.150 of the Act, as delegated to the liquidator under Rule 4.202 *et. seq.* of the Rules, and only to the extent of the call.
- c. As to sub-paragraph 3, as set out above, LBHI2 is not entitled to prove in LBIE's administration or in any subsequent liquidation in respect of the LBHI2 Subordinated Debt.

(5) **Question 5:** LBIE is not entitled to prove in the administration of the Members, and would not be entitled to prove in any subsequent liquidations, in respect of each of the Members' Potential Liability as Contributory, alternatively LBIE is not entitled to prove in respect of each of the Members' Potential Liability as Contributory unless and until it is wound up and a valid call is made in respect of such liability, and only to the extent of the call. In particular:

- a. The Members' Potential Liability as Contributory is not a "*Debt*" within the meaning of Rule 13.12(1) of the Rules.
- b. In any event, as set out in answer to question 8 below, the only possible estimated value that can at present be attributed to the Members' Potential Liability as Contributory is zero.

- c. LBL is not a bankrupt and therefore s.82(4) (which provides that “*There may be proved against the bankrupt’s estate the estimated value of his liability to future calls as well as calls already made*”) has no application.

(6) **Question 6:** As set out in answer to question 5 above, LBIE is not entitled to prove in the Members’ administrations, or any subsequent liquidations, in respect of the Members’ Potential Liability as Contributory; alternatively LBIE is not entitled to prove in respect of each of the Members’ Potential Liability as Contributory unless and until a call is made in respect of such liability, and only to the extent of such a call. Accordingly, at the very least no deduction could be made as regards the Members’ respective non-subordinated debt claims unless and until LBIE is wound up and a valid call is made in respect of the Members’ Potential Liability as Contributory and only to the extent of such a call.

(7) **Question 7:** As to s.149:

- a. S.149(1) permits the court, at any time after making a winding-up order, to make an order on any contributory for the time being on the list of contributories to pay, in the manner directed by the order, any money due from him (or from the estate of the person who he represents) to the company, exclusive of any money payable by him or the estate by virtue of any call. S.149(2)(a) permits the court, in making such an order in the case of an unlimited company, to allow the contributory by way of set-off any money due to him or the estate which he represents from the company on any independent dealing or contract with the company, but not any money due to him as a member of the company in respect of any dividend or profit.
- b. S.149(1) has no effect while LBIE is in administration because it only applies “*at any time after making a winding-up order*”.
- c. Further, there is at present no indication of whether or when LBIE might be wound up, and the LBIE Administration Order has been extended to 30 November 2016.

- d. If LBIE were wound up, LBL should by that stage have been paid in respect of the sums owed by LBIE to LBL (less any sums due from LBL to LBIE which are properly subject to set-off). Accordingly, s.149(1) and (2) would not appear to be relevant.
- e. S.149(3) provides that in the case of any company limited or unlimited, when all the creditors are paid in full (together with interest at the official rate), any money due on any account whatever to a contributory from the company may be allowed to him by way of set-off against any subsequent call. As set out above, the sums in respect of which LBL has proved in LBIE's administration are provable in the same way as the claims of LBIE's other general unsecured creditors. Accordingly, there should not be any outstanding sums owing to LBL from LBIE when all the creditors are paid in full (together with interest at the official rate).

(8) **Question 8:** Unless and until calls are made in respect of it, the only possible value that can be attributed to the Members' Potential Liability as Contributory by way of estimation under Rule 2.81 (or Rule 4.86 in respect of a liquidation) is zero. In particular (and bearing in mind the position of the LBL Joint Administrators in relation to Question 9 below, i.e. that the Members' Potential Liability as Contributory does not extend to statutory interest, the LBHI2 Subordinated Debt, or the alleged Currency Conversion Claim):

- a. It is not yet known when, if at all, LBIE will be wound up, such that: (i) it is not known whether one of the triggers for the Members' Potential Liability as Contributory under s.74 will arise; and in any event (ii) it is not known how long it may be until payment would be due from the Members, such that the formula in Rule 2.105 (or, in respect of a winding up, rule 11.13) for accelerated receipt in respect of future debts cannot be applied.
- b. The market view is that there will be no shortfall in LBIE. Thus, as set out at paras 9 and 27.3 of Mr Lomas' witness statement in support of the Joint Application, there is a growing view that LBIE may be able to pay all

unsecured unsubordinated claims in full, and LBIE debt has been trading at a level significantly above par, suggesting that the market believes LBIE will pay such claims in full together with some element of statutory interest.

- c. In their 9th progress report for the period 15 September 2012 to 14 March 2013, LBIE's Joint Administrators shows a range for LBIE's (deficiency)/surplus between (£7.3bn)/£2.3bn, stating that:

“Subject to the various important assumptions set out elsewhere in this report, the potential range of House recoveries that could eventually be available for distribution to unsecured creditors is estimated to be between c. £11.7bn and c. £16.5bn and the potential range of claims that are expected to participate in any distribution is estimated to be between c. £14.2bn and c. £19.1bn, excluding Shareholders' claims and claims for the payment of interest.

The strengthening in the financial position now suggests that, in the High case scenario, there would be sufficient funds to settle in full all provable claims, excluding claims by Shareholders and claims for interest. Pending resolution of the matters covered in the Waterfall Application, there remains uncertainty regarding how any remaining funds will be applied.”

There are a number of caveats in the report showing material uncertainties as regards the range, but the report shows that there is a real possibility that there will be no shortfall in LBIE.

- (9) **Question 9:** The Members' Potential Liability as Contributories under s.74 of the 1986 Act only extends to the company's “*debts and liabilities, and the expenses of the winding up, and for the adjustment of the rights of the contributories among themselves*”. This does not include:

- 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 creditor by LBIE; or
- b. The LBHI2 Subordinated Debt; or
- c. The alleged Currency Conversion Claim (if, contrary to the LBL Joint Administrators' case as set out below, that alleged claim is valid).

(10) **Question 10:** In the event that the Members are obliged to contribute to the assets of LBIE pursuant to s.74, 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. LBL and LBHI2 are each liable to LBIE in respect of any shortfall in LBIE under s.74 in proportion to the nominal value of the shares they each hold in LBIE.
- b. Alternatively, if LBL and LBHI2 are jointly and severally liable to LBIE in respect of a shortfall in LBIE under s74, they are entitled to seek a contribution or indemnity from one another in respect of any payments made pursuant to, or deductions validly made by LBIE from claims otherwise payable to the Members in respect of, any such obligation on the basis that the shortfall in LBIE should be shared between the Members rateably in proportion to the nominal value of each of their shareholding in LBIE.
- c. It is not at present known whether LBHI2's 2 million 5% redeemable Class A preference shares of \$1000 each and 5.1 million redeemable Class B shares of \$1000 each are paid up and, pending clarification by LBHI2 or LBIE of the same, the LBL Joint Administrators' position as to the impact of this is reserved.

(11) **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 (which would, as per sub-paragraph (1) above, include claims of the members which are not claims *qua* member, for the avoidance of doubt excluding the LBHI2 Subordinated Debt):

- a. Any surplus should then be applied to the payment of interest on such debts and liabilities (including the sums owed by LBIE to LBL) 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. As set out above, it appears that there would not be any sums remaining after payment of statutory interest for further distribution (for example in respect of the LBHI2 Subordinated Debt).
- c. As set out below at sub-para 12, there is no Currency Conversion Claim.

(12) **Question 12:** There is no Currency Conversion Claim. Although, in **Re Lines Bros (No. 1)** [1983] Ch 1, Brightman LJ left open the question whether, in the case of a wholly solvent liquidation, any surplus remaining after the payment of post-liquidation interest should be paid in respect of currency losses arising from conversion in respect of foreign currency claims taking place at the date of the winding up:

- a. Since **Re Lines Bros (No. 1)**, Rule 2.86(1) was enacted, making clear that the amount of a debt incurred or payable in a currency other than sterling shall be converted into sterling at the official exchange rate prevailing on the date when the company entered administration or, if the administration was immediately preceded by a winding up, on the date that the company went into liquidation. There is no provision, express or implied, in the Act or in the Rules for any residual Currency Conversion Claim.
- b. In any event, it is conceded by the Second Respondent that the alleged Currency Conversion Claim could only rank in priority behind interest under Rule 2.88 (or s.189(2) in respect of a winding up). As set out above, it does not appear that there is any prospect of any surplus remaining in LBIE after payment of statutory interest. Accordingly, even taking the Second Respondent's case at its highest, there is no prospect of the Currency Conversion Claim arising.

David Wolfson QC

Nehali Shah

One Essex Court
Temple, London EC4Y 9AR
24 May 2013