IN THE HIGH COURT OF JUSTICE **CR-2008-000026**
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES **CR-2009-000052**
INSOLVENCY AND COMPANIES LIST (ChD)

IN THE MATTER OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)

AND IN THE MATTER OF LEHMAN BROTHERS HOLDINGS PLC (IN ADMINISTRATION)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN:-

CR 2009-000052

THE JOINT ADMINISTRATORS OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)

LBHI2 Applicants

-and-

(1) LEHMAN BROTHERS HOLDINGS SCOTTISH LP 3
(2) LEHMAN BROTHERS HOLDINGS PLC (IN ADMINISTRATION)
(3) DEUTSCHE BANK AG (LONDON BRANCH)

LBHI2 Respondents

CR 2008-000026

THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS HOLDINGS PLC (IN ADMINISTRATION)

PLC Applicants

-and-

(1) LEHMAN BROTHERS HOLDINGS INC
(2) THE JOINT LIQUIDATORS OF LB GP NO 1 LIMITED (IN LIQUIDATION)
(3) DEUTSCHE BANK AG (LONDON BRANCH)

PLC Respondents

'SUB-DEBT PRIORITY DISPUTE'

SKELETON OF THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS HOLDINGS PLC

A INTRODUCTION

1. This Skeleton has been filed and served on behalf of the Joint Administrators of Lehman Brothers Holdings plc ("**PLC**"),[1] in their capacity as PLC Application Applicants and LBHI2 Application Respondents.

2. On the PLC Application, PLC is entirely neutral. The disputes are between (a) LBHI; and (b) Deutsche Bank and GP1. On the LBHI2 Application, the disputes are between (a) SLP3; and (b) PLC and Deutsche Bank. LBHI and SLP3 comprise the same economic interest and are jointly represented.

3. The court is presented with 11 factual witness statements, together with an office-holder's statement of Derek Howell on behalf of the LBHI2 Administrators, and two expert reports. Certain of these statements, and the two reports, are concerned only with issues which arise on the PLC Application. On the LBHI2 Application, the scope for admissible and properly relevant evidence is narrow on the issues of construction, though broader on SLP3's rectification claim. As presently advised, PLC's intention is to cross-examine only Ms Hutcherson, Mr Miller and Mr Grant, though it formally reserves its position on the remaining witnesses at least until after the Applications have been opened.

4. In addition, by hearsay notice dated 18 April 2019, LBHI/SLP3 signalled an intention to rely on the transcripts of interviews of various Lehman personnel. Six of these interviews were conducted in 2013, in the context of earlier "Waterfall" proceedings. The seventh is an interview of Ms Dolby undertaken in 2019 for the purpose of these proceedings. Ms Dolby is also being called as a witness by PLC.

5. The LBHI2 Application [A/1] seeks resolution of the question of:

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[1] References to PLC are intended to be to PLC or, as appropriate, the PLC Administrators. See generally the agreed abbreviations in the Definitions document, which are adopted herein. It should be noted that in the Applications a few different abbreviations were used. PLC was referred to as 'LBH', GP1 was referred to as 'LB GP No1', the LBHI2 Sub-Debt was referred to as 'LBHI2 Subordinated Loans' and the LBHI2 Sub-Notes were referred to as 'LBHI2 Subordinated Notes'

*whether the claims of [PLC] under two long-term subordinated loan facility agreements and one short-term subordinated loan facility agreement with LBHI2, all dated 1 November 2006 [**the LBHI2 Sub-Debt**], are claims that rank for distribution before, after or* pari passu *with the claims of [SLP3] under the Floating Rate Subordinated Notes issued by LBHI2 pursuant to an offering circular dated 26 April 2007 [**the LBHI2 Sub-Notes**].*

6. PLC contends that the LBHI2 Sub-Debt ranks prior to the LBHI2 Sub-Notes. If that is right, present estimates indicate that the LBHI2 Sub-Debt will be paid in part, and the LBHI2 Sub-Notes will not be paid. This would enable PLC to discharge all of its admitted unsecured non-preferential (unsubordinated) creditor claims (plus statutory interest) in full, and would leave a realistic prospect that PLC would be able to make a part payment on its own subordinated debt. That debt, through the PLC Sub-Notes, includes the prospect of significant sums being payable ultimately to third party "market" (ie non-Lehman) creditors. SLP3 contends that the LBHI2 Sub-Debt and LBHI2 Sub-Notes rank *pari passu*, which would mean that both would be part paid, with a substantially larger payment to SLP3 given the relative size of the competing debts[2].

A.1 Summary of PLC's position on the LBHI2 Application

7. PLC contends that the proper interpretation of the LBHI2 Sub-Debt agreements and LBHI2 Sub-Notes is that the latter rank junior to the former. This was the position which obtained upon the issue of the LBHI2 Sub-Notes in 2007 (and which continued after the 2008 Amendments). The conclusion is driven by (a) the differential wording in the two sets of instruments and, in particular, the express subordination of the LBHI2 Sub-Notes to other subordinated debt and the solvency condition in those Sub-Notes; and (b) the chronological sequence, in which the

[2] When the Applications where issued, the outstanding value of the LBHI2 Sub-Debt was understood by the LBHI2 and PLC Administrators to be approximately $2.2bn. More recent reconciliation steps have identified that the value may in fact be approximately $3.1bn. The parties have been made aware of this development [H/299]. No issue of quantum is raised on the LBHI2 Application and it is not suggested that this affects the question of priority as between the LBHI2 Sub-Debt and the LBHI2 Sub-Notes.

LBHI2 Sub-Debt preceded the LBHI2 Sub-Notes (by six months) yet was not mentioned in the latter instruments by way of exception to such subordination.

8. Alternatively, and whatever the prior position, the LBHI2 Sub-Notes rank junior to the LBHI2 Sub-Debt by reason of the changes effected by the 2008 Amendments. By expressly defining the priority status of the LBHI2 Sub-Notes at the level of a class of preference shares, the 2008 Amendments necessarily subordinated the LBHI2 Sub-Notes to all other debt, including the LBHI2 Sub-Debt. The contorted and irrational alternative interpretations advanced by SLP3 underscore the reality that the 2008 Amendments are capable of no other possible meaning. Indeed, the seniority of the LBHI2 Sub-Debt over the LBHI2 Sub-Notes was recognised by the LBHI2 Administrators from the outset: see the Statement of Administrators' Proposals dated 3 March 2009 [F7/3687].

9. To the extent admissible, the underlying factual matrix is entirely consistent with these conclusions.

10. Finally, SLP3's case that a significant portion of the 2008 Amendments should be deleted by rectification is not supported on the evidence and further relies implausibly upon there being no purpose for that amendment and so it being a bizarre mistake. That case, alighted upon only recently and, it may be inferred, after SLP3 came to appreciate the weakness of its position on construction, falls far short of the convincing proof necessary to justify rectification, certainly on the law as recently restated by the Court of Appeal.

11. In this opening Skeleton, PLC responds to the case advanced by SLP3 in its Position Papers. It reserves its position as to any different or developed case asserted by SLP3 in its own skeleton or oral opening.

12. PLC first sets out below, for the assistance of the court, a broad summary of the issues which arise on the PLC Application. The remainder of the skeleton is directed to the issues on the LBHI2 Application. It is a matter for the court to determine which sets of issues it wishes to consider first. PLC suggests that it is appropriate to

address the LBHI2 Application first, followed by the PLC Application, as that is the order in which the waterfall operates.

B THE PLC APPLICATION

13. The PLC Application [A/3] seeks directions in relation to the following issues:

    13.1. Whether LBHI's claims under the PLC Sub-Debt have been released pursuant to the Settlement Agreement.

    13.2. If not, the competing ranking in PLC's administration of (i) LBHI under the PLC Sub-Debt, (ii) GP1 under the PLC Sub-Notes, (iii) ECAPS holders' claims under the PLC Guarantees.

    13.3. The method of discounting of the quantum of PLC's liability under the PLC Sub-Notes, if any.

B.1 The Release Issue

14. The first issue, whether LBHI's claims under the PLC Sub-Debt have been released, turns on the terms of the Settlement Agreement dated 24 October 2011 [E/16].

15. Deutsche Bank contends, in summary, that the claims have been released by the Settlement Agreement, as they fall within the scope of the Settlement Agreement and there is nothing excluding after-acquired liabilities from that scope, alternatively the claims were released or discharged wholly or in part by way of a distribution made by LBHI to LBUKH, under an LBHI Guarantee.[3]

16. LBHI contends, in summary, that its claims have not been released because at the time of the Settlement Agreement, the PLC Sub-Debt was held by LBUKH, and only acquired by LBHI subsequently, and clear words would be needed to release after-

[3] Deutsche Bank Position Paper [23]-[33] [A/8/132-141]. LBUKH was another Lehman company in UK administration.

acquired claims; and the part payment under the LBHI Guarantee in no way affects LBHI's claim against PLC under the PLC Sub-Debt.[4]

17. GP1 is leaving the arguments on this issue to Deutsche Bank.[5]

18. This is primarily an issue of construction. All interested parties agree that New York law applies, and expert evidence of New York law is to be adduced: LBHI relies on the report of Allan Gropper dated 5 June 2019 [D1/1]; Deutsche Bank relies on the report of Robert Smith dated 6 June 2019 [D1/2].

19. The parties disagree as to the extent to which extrinsic factual evidence (including post-contractual conduct) is admissible, but if it is, PLC understands that LBHI will call Mr Geraghty (witness statement dated 18 April 2019 [C/7]).

B.2 The Ranking Issue 1: The PLC Guarantees

20. The controversy in relation to the issue of priority of the PLC Guarantees is very limited. It has now been agreed that, if they subsist, the PLC Guarantees rank behind both the PLC Sub-Debt and PLC Sub-Notes (see para 28 of the Statement of Agreed Facts [C/23]).[6]

21. The only dispute is that LBHI contends that the PLC Guarantees terminated on dissolution of the Issuer (ie the Partnerships),[7] whereas Deutsche Bank disputes this: it submits that termination does not affect accrued liabilities and that, in any event, the PLC Guarantees only terminate on the *completion* of dissolution.[8] GP1 is neutral.[9]

22. These are construction issues of English law. No party contends for rectification of any PLC instrument.

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[4] LBHI/SLP3 Position Paper [32]-[40] [A/5/79-84], LBHI/SLP3 Reply Position Paper [59]-[64] [A/10/206-211].
[5] GP1 Position Paper [6.1] [A/9/156].
[6] Also LBHI/SLP3 Position Paper [43(2)-(3)] [A/5/85-86] and Reply Position Paper [65]-[66] [A/10/211], Deutsche Bank Position Paper [71] [A/8/154], GP1 Position Paper [6.3] and [76] [A/9/156 and 174-175].
[7] LBHI/SLP3 Position Paper [43(1)] [A/5/85].
[8] Deutsche Bank Position Paper [68]-[70] [A/8/153].
[9] GP1 Position Paper [6.3] [A/9/156].

B.3 The Ranking Issue 2: the PLC Sub-Debt and PLC Sub-Notes

23. The main ranking issue in the PLC Application is as to the competing ranking of the PLC Sub-Debt held by LBHI and the PLC Sub-Notes held by GP1.

24. LBHI contends that they rank *pari passu*, the provisions in the instruments being materially the same, and Deutsche Bank's factual matrix arguments being disputed.[10]

25. Deutsche Bank contends that the PLC Sub-Notes rank above the PLC Sub-Debt because the apparent circularity in the ranking provisions should be broken by construction or an implied term, in light of the PLC Sub-Debt having no provision permitting *pari passu*, the PLC Sub-Debt being earlier than the PLC Sub-Notes, and the tax and commercial objectives of the Lehman Group to prioritise payments to the issuers of the ECAPS to avoid the operation of the Dividend Stopper.[11]

26. GP1 advances textual arguments in support of the same outcome.[12]

27. These are construction issues of English law.

28. In relation to the factual matrix on this issue, PLC understands that:

    28.1. LBHI will call Mr O'Grady (witness statements dated 18 April 2019 and 9 May 2019 [C/8 and C/9]), Ms Hutcherson (witness statement dated 18 April 2019 [C/6]) and Mr O'Meara (witness statement dated 9 May 2019 [C/10]); and

    28.2. Deutsche Bank will call Mr Katz (witness statements dated 18 April 2019 and 9 May 2019 [C/5 and C/11]).

[10] LBHI/SLP3 Position Paper [9]-[16] [A/5/58-66], LBHI/SLP3 Reply Position Paper [4]-[30] [A/10/177-190].
[11] Deutsche Bank Position Paper [34]-[52] [A/8/141-146].
[12] GP1 Position Paper *passim* [A/9].

B.4 The Discounting Issue

29. LBHI contends, in summary, that the quantum of liability under the PLC Sub-Notes falls to be discounted under Rule 14.44 of the Insolvency (England and Wales) Rules 2016 as a provable future debt, and the only interest claim for the period after the administration is to statutory interest.[13]

30. Deutsche Bank disputes discounting, on the basis that the relevant liability is not a future debt, or should not be treated as a future debt, alternatively it is non-provable (such that rule 14.44 is inapplicable), alternatively the liability for interest on any future debt until it would have fallen due should also be admitted.[14]

31. GP1 is leaving the arguments on this issue to Deutsche Bank.[15]

32. These are construction and insolvency issues of English law.

C LEGAL PRINCIPLES APPLICABLE TO CONSTRUCTION

C.1 Applicable principles on the interpretation of contracts

33. Moving on to the LBHI2 Application, all the relevant agreements contain English law clauses.

34. The basic principles are familiar and do not need repeating. Reference may be made generally to *Investors Compensation Scheme Ltd v West Bromwich Building Society (No. 1)*[16], *Arnold v Britton*[17] and *Wood v Capita Insurance Services Ltd*[18]. In the exercise of interpretation, the following specific matters are relevant to the overall approach to be adopted.

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[13] LBHI/SLP3 Position Paper [46]-[47] [A/5/87-90] and Reply Position Paper [67]-[71] [A/10/211-215].
[14] Deutsche Bank Position Paper [53]-[66] [A/8/146-153].
[15] GP1 Position Paper [6.4] [A/9/157].
[16] [1998] 1 WLR 896 at pp 912-3.
[17] [2015] UKSC 36, [2015] AC 1619, at [14]-[23].
[18] [2017] UKSC 24, [2017] AC 1173, at [9]-[14].

35. First, every contract is to be construed holistically by reference to the agreement as a whole: *Strachey v Ramage*[19]; *Re Sigma Finance Corp*[20]. One of the facets of this approach is that (whilst this may not be possible in every case) the normal expectation and presumption is of consistency of approach, such that similar words may be expected to bear similar meanings within the same document: *Shell UK v Total UK*[21]; *Interactive Investor Trading Co v City Index*[22]; *Barnardo's v Buckinghamshire*[23].

36. Second, the unitary exercise of interpretation may involve giving greater or lesser weight to any of the particular words used, the contractual context, the wider factual matrix and the overall commercial sense. Specifically, in the case of formal contracts, especially ones drafted by lawyers, correspondingly greater weight is properly accorded to the words used and the overall contractual context: *Lukoil Asia Pacific v Ocean Tankers*[24]. The court may interpret an agreement "*principally by textual analysis*" because of its sophistication and complexity and because it has been "*negotiated and prepared with the assistance of skilled professionals*": *Wood v Capita*, at [13].

37. Third, the approach to contractual interpretation is an objective one. Hence, as per Leggatt J in *Tartsinis v Navona Management Co*[25], "*What the parties to the contract actually meant, or whether they had any pertinent subjective intention at all, is irrelevant to the task of interpretation. Rather, the court identifies the meaning of the language used by assuming that the parties were reasonable people using the language of the contract to express a common intention."* Amongst other things, this means that references to the contractual "*purpose*" of a document are also

[19] [2008] EWCA Civ 384, [2008] 2 P & CR 8, at [29].
[20] [2009] UKSC 2, [2010] 1 All ER 571, at [12].
[21] [2010] EWCA Civ 180, [2010] 1 CLC 343, at [16].
[22] [2011] EWCA Civ 837 at [29].
[23] [2018] UKSC 55, [2019] 2 All ER 175, at [23].
[24] [2018] EWHC 163 (Comm), [2018] 1 Lloyd's Rep 654.
[25] [2015] EWHC 57 (Comm) at [9].

objective: i.e. what reasonable persons would have had in mind in the situation of the parties: *Reardon Smith Line v Hansen Tangen*[26].

38. Fourth, any suggestion that there was a mistake in the language would (outside the claim to rectification, which is considered separately below) have to satisfy the rigorous test set out by Lord Hoffmann in *Chartbrook Ltd v Persimmon Homes Ltd*[27]: it requires a "*strong case*" to persuade a court that "*something has gone wrong with the language*" in order to justify a meaning which departs from the words actually used. And not only must it be clear that something has gone wrong with the language, it must also be clear "*what a reasonable person would have understood the parties to have meant.*" The test that must be satisfied to justify such a result is "*strict*": *Hayfin Opal Luxco 3 SARL v Windermere VII CMBS plc*[28].

39. Fifth, declarations of subjective intent and pre-contractual negotiations are inadmissible (*ICS v West Bromwich*, at 913; *Chartbrook*, at [33]-[42]). Further, the scope for "*factual matrix*" evidence generally is severely constrained in the case of tradeable instruments (and see further below at paragraph 45).

40. Sixth, as regards the interpretation of the 2008 Amendments to the LBHI2 Sub-Notes, the same rules of interpretation apply. The general principle is that each amendment falls to be interpreted as at its date and against the (admissible) circumstances prevailing at that date. The meaning of the amendment must be ascertained by examining the contract as at the date of the amendment: *Stena Line Ltd v Merchant Navy Ratings Pension Fund Trustees Ltd*[29].

C.2 Factual matrix

41. SLP3's Position Papers appear to be premised on the assumption that there is a broad scope for the investigation of the factual matrix around the drafting of the

[26] [1976] 1 WLR 989 at pp 995-996.
[27] [2009] UKHL 38, [2009] 1 AC 1101, at [15].
[28] [2016] EWHC 782 (Ch) at [68].
[29] [2011] EWCA Civ 543, [2011] Pens LR 223, at [30] and [32].

LBHI2 instruments (and indeed that the outcome of such investigation favours its position).

42. It remains to be seen how SLP3 puts its case on both the admissibility of factual matrix evidence and its alleged significance. Outside the context of the rectification claim, and beyond the Statement of Agreed Facts, SLP3 has identified little admissible or relevant material. Deutsche Bank advances a separate argument by reference to the evidence and the "dividend stopper". PLC does not comment on that argument, save to note that, if established, it further supports the conclusions PLC invites the court to reach on the Application.

43. The LBHI2 Sub-Debt Agreements replicated mandatory FSA standard forms. The scope for applicable factual matrix in their interpretation is therefore inherently attenuated. See generally *AIB Group (UK) Ltd v Martin*[30].

44. The Terms and Conditions of the LBHI2 Sub-Notes were contained in the LBHI2 Sub-Notes OC dated 26 April 2007, as amended by the 2008 Amendments pursuant to a resolution dated 3 September 2008. The LBHI2 Sub-Notes OC is a formal, complex and sophisticated document, in respect of a debt obligation of over $6 billion. It was drafted by A&O and sets out the detailed legal terms governing the LBHI2 Sub-Notes issue. It is at the most sophisticated end of the scale of contractual documents, such that a textual analysis is likely to carry overwhelming weight in the interpretation exercise. This is no different in respect of the 2008 Amendments. These, too, were drafted by A&O, and were considered by senior professionals within Lehman.

45. As all of the relevant LBHI2 instruments were used for the purpose of regulatory capital, the regulatory regimes in place between 2006 and 2008 provide potentially relevant context. A&O's letter to LBHI2 dated 1 May 2007 [F4/2243] confirming that the LBHI2 Sub-Notes complied with GENPRU is also potentially relevant factual matrix. Further, the LBHI2 Sub-Debt Agreements provide relevant factual matrix for

[30] [2002] 1 WLR 94 at [7] *per* Lord Millett.

the interpretation of the (later) LBHI2 Sub-Notes. Beyond that, as it appears to PLC, the evidence adduced in the witness statements provides little, if any, admissible or relevant factual matrix which is able to assist on the interpretation issues before the court. In contrast, the determining importance of the words used is underlined by the nature of the instruments to be interpreted and the legal and other professional input into their drafting.

46. The background to the regulatory regime was set out in detail by David Richards J at first instance in *Waterfall I*[31]. In very brief summary, and so far as material:

46.1. Basel I (concerned mainly with credit risk) allowed for two tiers of regulatory capital, including (in tier 2) subordinated debt of fixed term maturity over five years. However, it was recognised (at [23] [J1/1/6]) that such debt instruments had deficiencies as capital because of their "*inability to absorb losses except in a liquidation.*"

46.2. Basel I was implemented in respect of credit institutions by Council Directive 89/299/EEC of 17 April 1989 [J1/3]. Subordinated debt agreements of over 5 years duration were permitted as "*own funds*" under article 4(3) "*if binding agreements exist under which, in the event of the bankruptcy or liquidation of the credit institution, they rank after the claims of all other creditors and are not to be repaid until all other debts outstanding at the time have been settled.*"

46.3. Council Directive 93/6/EEC of 15 March 1993 [J1/4] introduced capital adequacy requirements for investment firms and credit institutions in relation to market risk. Whilst the same definition of 'own funds' was applied, there was also provision, at Annex V [J1/4/91-92], for subordinated debt of at least two years duration.

[31] *Re Lehman Brothers International (Europe) (in administration)* [2014] EWHC 704 (Ch), [2015] Ch 1, at [35-47].

46.4. LBIE was a regulated investment firm and the UK Lehman Group was subject to consolidated supervision by the FSA[32]. The applicable rules prior to 1 January 2007 were IPRU(INV). Pursuant to Rule 10-63(2) [J2/10/517], subordinated loans were required to be drawn up by using FSA standard documentation[33].

46.5. Basel II was published in June 2006. This noted, at [49(xii)] [J1/2/56], the same deficiencies of subordinated debt instruments as capital. It also envisaged the inclusion of a third tier of capital, comprising short term subordinated debt covering market risk.

46.6. Effect was given to Basel II by Council Directives 2006/48/EC [J1/6] and 2006/49/EC [J1/7], both of 14 June 2006, which recast the earlier Directives. The requirement that subordinated debt rank after the claims of all other creditors in the event of bankruptcy or liquidation was repeated at article 64(3) [J1/6/181].

46.7. On 31 December 2006, the FSA introduced GENPRU, which set out the capital adequacy rules applicable thereafter until the Lehman administrations. A description of the three tiers of capital, and their characteristics, is given at *Waterfall I* at first instance [43-47]. Pursuant to the GENPRU rules:

(a) A requirement of Tier 1 capital is that "*it ranks for repayment upon winding up, administration or any other similar process no higher than a share of a company incorporated under the Companies Act 1985…(whether or not it is such a share)"* (GENPRU 2.2.64R [J2/11/828]).

(b) In respect of Tier 2 capital, "*the claims of the creditors must rank behind those of all unsubordinated creditors."* (GENPRU 2.2.159R [J2/11/844]).

47. Of further significance is the fact that the LBHI2 Sub-Notes were created as tradeable instruments, for which a very narrow factual matrix is in principle

[32] Hutcherson WS at [39] [C/6/76-77].
[33] Hutcherson WS at [16] [C/6/72].

admissible in any event, because such contracts are to be interpreted by the reasonable person on the basis that third parties might be expected to become bound by the terms on their face and without knowledge of any internal arrangements between the original parties, and therefore (whether or not in fact traded) the terms must be construed without reference to such arrangements: *Chitty on Contracts*[34] at [13-051]; *Cherry Tree Investments v Landmain*[35]*; Re Sigma Finance Corp* at [37]; *Napier Park European Credit Opportunities Fund Ltd v Harbourmaster Pro-rata CLO 2 BV*[36].

48. As is clear on the evidence (including on the face of the LBHI2 Sub-Notes OC), the LBHI2 Sub-Notes were deliberately created not as bilateral loan agreements but rather as negotiable notes listed on the Channel Islands Stock Exchange which were, as is usual for such notes, listed on a register of noteholders and inherently transferable according to their terms (see especially clause 2 of the LBHI2 Sub-Notes).

49. SLP3 seeks to make something[37] of the fact that, as it appears, the parties to the LBHI2 Sub-Notes had at the time no plan to trade the LBHI2 Sub-Notes out of the Lehman Group, and that they were created as negotiable instruments and listed on a recognised public stock exchange in order to achieve withholding tax advantages[38]. However, none of this broadens out the admissible factual matrix. The ambit of available material, and indeed the correct interpretation of the LBHI2 Sub-Notes, cannot change depending on the parties' subjective intentions (which could themselves change) as to whether and if so how they intended to deploy the negotiability of the instruments. There can only be a single interpretation of the LBHI2 Sub-Notes, undertaken objectively, as at the date of the issue of the Notes, and by reference to their terms. This is underscored by the fact that it was their very negotiability which secured the tax benefit which drove the structure. And in any

[34] 33rd edn (Sweet & Maxwell, 2018).
[35] [2012] EWCA Civ 736, [2013] Ch 305, at [124] and [130].
[36] [2014] EWCA Civ 984 at [33].
[37] LBHI/SLP3 Reply Position Paper [13(4)] and [32] [A/10/179 and 190-191].
[38] Dolby WS at [37]-[38] [C/3/37]

event the Notes were in fact transferred numerous times, between Lehman entities.

50. Another feature is that the LBHI2 Sub-Debt Agreements were executed and the LBHI2 Sub-Notes were issued within a domestic and international regulatory and fiscal context. They were intended to be relied upon by regulators and by tax authorities, as instruments designed to achieve particular advantages within that context. For the purpose of the exercise of interpretation, the "*relevant audience*"[39] included such third parties, whether or not the instruments were intended to be traded elsewhere.

51. More generally, the court should be wary of any invitation to engage in a broad and undisciplined enquiry into intentions derived from the factual matrix as if they are of equal weight with the words used by the parties when construing a sophisticated, professionally drafted commercial banking contract. They are not.

52. Indeed, there are profound difficulties in the sort of exercise that appears to be contemplated by SLP3, even if it were admissible and relevant. A pressing reality is that the instruments in question were drafted and produced in the context of a complex multinational corporate structure, responding to multiple drivers at the time. Each step that was taken was the subject of detailed advice by lawyers and accountants. It is not now possible to recreate all the factors in play at any one time nor all the considerations leading to the decisions taken or to the drafting of documents. This is all the more problematic in circumstances in which the companies have been in administration for 11 years and where none of the office-holders have first-hand knowledge of any of the relevant facts. Hence, even aside from issues of admissibility, great care would need to be taken in the construction of an evidential narrative, especially if the intended conclusion is that such narrative should disapply the otherwise apparent meaning of the words used.

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[39] As the term is used by Briggs J in *LB Re Finance No 3 Ltd v Excalibur Funding No. 1 plc* [2011] EWHC 2111 at [42-43].

D THE LBHI2 SUBORDINATED LOANS

D.1 Introduction to the LBHI2 Sub-Debt

53. PLC entered into three sub-debt facility agreements with LBHI2 on 1 November 2006:

    53.1. a long term (10 year) agreement for $4.5 billion [E/1];

    53.2. a long-term (10 year) agreement for €3 billion [E/2]; and

    53.3. a short-term (5 year) agreement for $8 billion [E/3].

D.2 The terms of the LBHI2 Sub-Debt

54. Each Sub-Debt Agreement [E/1 to E/3] comprised: Section A, a one page agreement; Section B, the Variable Terms (i.e. terms specific to this loan), in Schedule 1; and Section C, the Standard Terms, in Schedule 2.

55. The loans were revolving credit facilities (cl 7 of the Variable Terms), carrying interest at the provided rate (cl 8 of the Variable Terms and cl 3 of the Standard Terms).

56. Section A recorded on its face in the only preamble paragraph LBHI2's desire that the loan qualify as Financial Resources to satisfy its Financial Resources Requirement under the then applicable IPRU(INV) rule 10-200 of the FSA Handbook[40], and "*has fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective Subordination of the Loan*". This was therefore a disclosed purpose informing each Agreement and some of the terms in it, including the subordination clause.

[40] As specified in the definitions of Financial Resources, Financial Resources Requirement and Financial Rules in the Standard Terms of the LBHI2 Sub-Debt Agreements.

57. The reference to IPRU(INV) makes clear that the instrument was on an FSA standard form, as was mandatory at the time. There was no published guidance or case law of which PLC is aware explaining what was to happen if two competing creditors were claiming under standard form instruments which both contained the same cross-referential subordination wording, or how that wording was to operate.

D.3 Introduction to the LBHI2 Sub-Notes

58. The LBHI2 Sub-Notes were floating rate notes issued under the LBHI2 Sub-Notes OC dated 26 April 2007 [E/4], as amended pursuant to a resolution dated 3 September 2008 [E/5]. The initial issue size was $6.139bn. The proceeds were used to discharge some of the existing LBHI2 Sub-Debt (with, as it seems, the remaining balance of the LBHI2 Sub-Debt reflecting funding derived from ECAPS).

D.4 The terms of the LBHI2 Sub-Notes

59. The LBHI2 Sub-Notes were redeemable after 10 years (condition 5) with monthly interest payable at a rate of one-month US dollar LIBOR plus 0.32% (condition 4 and the definition of 'Margin' in condition 1).

60. As with the LBHI2 Sub-Debt Agreements, the regulatory capital purpose of the LBHI2 Sub-Notes was evident from the instrument itself. Page 14 of the LBHI2 Sub-Notes OC stated that the purpose of the issue was to "*strengthen the regulatory capital base of the group of companies in which it operates, to pay off existing loans and for general corporate purposes*" [E/4/63].

61. The applicable FSA rules at the time of the issue of the LBHI2 Sub-Notes were no longer IPRU(INV) but were instead GENPRU, which did not mandate a standard form[41]. The wording used in the LBHI2 Sub-Notes was therefore the choice of the drafters, albeit it had to be compliant with GENPRU (and its compliance was confirmed by A&O). GENPRU 2.2.159(1) required that to qualify as tier 2 capital "*the*

[41] GENPRU 2.2.164 [J2/11/845].

claims of the creditors must rank behind those of all unsubordinated creditors" [J2/11/844]. GENPRU said nothing about priority between subordinated debts. Hence, whilst there was no obligation to layer subordinated debt, there was equally no regulatory prohibition against it. This was entirely a matter of contractual choice and the regulatory position was neutral either way. If a borrower wished to preclude the layering of its subordinated debt, it would have been easy enough to include an express term in relevant instruments to that effect.

62. It is recorded in the LBHI2 Sub-Notes OC that the LBHI2 Sub-Notes were initially purchased by PLC (see page 18 [E/4/67]). PLC was, of course, also the holder of the LBHI2 Sub-Debt.

63. The LBHI2 Sub-Notes were subsequently amended by agreement between LBHI2 and SLP3 (the then holder of 100% of the LBHI2 Sub-Notes), as recorded in an LBHI2 written resolution dated 3 September 2008 [E/5], with the consent of the FSA.

64. In *Waterfall I*[42], Lewison LJ in the Court of Appeal explained the different ways in which subordination agreements may be drawn. Both the LBHI2 Sub-Debts and the LBHI2 Sub-Notes employ the second form identified, that of imposing conditions of solvency on payment under the subordinated instruments.

E THE PRIORITY DISPUTE

65. The subordination clauses are summarised in the following table, excluding the additional wording added by the 2008 Amendments to the LBHI2 Sub-Notes, which is discussed separately below. It is convenient to consider first the legal position under and by reference to the original version of the LBHI2 Sub-Notes.

Clause	LBHI2 Sub-Debt [E/1] dated 1 November 2006	LBHI2 Sub-Notes [E/4] dated 26 April 2007
subordination	"*the rights of the Lender*	"*The rights of the Noteholders*

[42] *Re Lehman Brothers International (Europe) (in administration) 'Waterfall I'* [2015] EWCA Civ 485, [2016] Ch 50, at [38].

clause	*in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities…"*	*against the Issuer in respect of the Notes are subordinated in right of payment to the Senior Creditors (as defined below)"*
definition of 'Senior Liabilities'/'Senior Creditors'	"*all Liabilities except the Subordinated Liabilities and Excluded Liabilities*"	*"creditors of the Issuer… (ii) who are subordinated creditors of the Issuer other than those with whose claims the claims of the Noteholders are expressed to rank* pari passu *and those whose claims rank, or are expressed to rank,* pari passu *with, or junior to, the claims of the Noteholders"*
definition of 'Excluded Liabilities'	"*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*"	
definition of 'Subordinated Liabilities'	*"all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon"*	

66. PLC agrees with SLP3[43] that the three LBHI2 Sub-Debt Agreements rank *pari passu* among themselves. However, this is a matter of contractual interpretation.

66.1. Each Sub-Debt Agreement purports to provide exclusively for its own contractual ranking, as against other debt. All other debt must fall into one of

[43] LBHI/SLP3 Reply Position Paper [35] [A/10/192].

three categories: Senior Liabilities, Subordinated Liabilities and Excluded Liabilities. The definition of Subordinated Liabilities, on its face, is restricted to the liabilities under the Sub-Debt Agreement in question. Yet, given both identical wording and identical timing, the other Sub-Debt Agreements can be neither Senior Liabilities nor Excluded Liabilities, or else there would be impossible circularity which would result in none of the tranches ever being paid.

66.2. Given such an impossible circularity, the interpretation of the LBHI2 Sub-Debt Agreements must yield to business common sense (*Antaios Cia Naviera SA v Salen Rederierna AB*[44]). Although it does not especially matter for present purposes how this is achieved (as there is no dispute as between the Sub-Debt Agreements), the most likely interpretation is that, for, the purpose of ranking, the other Sub-Debt Agreements executed in the same form on the same date are to be treated as "*Subordinated Liabilities"* and that, by way of implied term, the three identical agreements carry a *pari passu* ranking *inter se*. Such an implication would satisfy the stringent test for the implication of terms (*Marks & Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd*[45]), as the minimum necessary to make these agreements work.

67. Contrary to SLP3's suggestion[46], the fact that the three LBHI2 Sub-Debt Agreements can only be *pari passu inter se* is of no particular interest or relevance to the priority dispute as between the LBHI2 Sub-Debt and the LBHI2 Sub-Notes, where the same conditions do not arise, both because the draftsmen of the LBHI2 Sub-Notes employed materially different language and because the instruments were sequential not simultaneous. Instead, the process of interpretation, as explained below, results in no impossible circularity but a definite hierarchy between the subordinated debts. For the avoidance of doubt, SLP3's rationale for the *pari passu*

[44] [1985] AC 191 at p 201.
[45] [2015] UKSC 72, [2016] AC 742.
[46] LBHI/SLP3 Reply Position Paper [36], [39(2)] and [41(3)i] [A/10/192-195].

ranking of the LBHI2 Sub-Debt Agreements[47], that simply by being subordinated to the same other liabilities (Senior Liabilities) they must rank *pari passu* by reason of the statutory insolvency scheme, is rejected for the reasons set out below.

68. SLP3 contends[48] that the LBHI2 Sub-Debt ranks *pari passu* with the LBHI2 Sub-Notes, although it does not explain how this is said to work linguistically. PLC's position is as follows.

E.1 The proper construction in this case, prior to the 2008 Amendments

69. The drafting technique in both the LBHI2 Sub-Debt Agreements and the LBHI2 Sub-Notes is similar, in that they each employ a referential structure. Whilst there is a broad subordination to unsubordinated debt (necessary for regulatory purposes), each instrument (as a primary instrument) allows for the possibility of layering: that another instrument (as a referred instrument) may express itself to be more deeply subordinated and that there be tiers of subordinated debt.[49] Whether any referred instrument does in fact do so is a matter of construction of both the primary instrument (as to what amounts to '*expressed to'*) and the referred instrument (as to what it '*expresses*').

70. It is correct, as SLP3 points out[50], that the subordination wording in both the LBHI2 Sub-Debt Agreements and the LBHI2 Sub-Notes goes beyond references to what ranking might be "*expressed*" in other instruments, albeit in different ways. The definition of Excluded Liabilities in the LBHI2 Sub-Debt Agreements is 'Liabilities' which are expressed to be "*and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior…"* The corresponding definition of Senior Creditors in the LBHI2 Sub-Notes includes subordinated creditors other than those with whose claims the claims of Noteholders are expressed to rank *pari passu* "*and those whose*

[47] LBHI/SLP3 Position Paper [14(5)-(7)] [A/5/61-63] and LBHI/SLP3 Reply Position Paper [36(1)] [A/10/192].
[48] LBHI/SLP3 Position Paper [24]-[25] [A/5/71-73].
[49] Or, as the wording of the LBHI2 Sub-Notes but not the LBHI2 Sub-Debt provides, *pari passu*.
[50] LBHI/SLP3 Reply Position Paper [38]-[39] [A/10/192].

claims rank, or are expressed to rank, pari passu *with, or junior to…"* the claims of Noteholders.

71. This difference in wording makes it difficult to see how this aspect is intended to assist in the present exercise. More substantively, there is in fact no operation of law which supersedes the contractual agreements between the parties. There is no law, for example, that all subordinated debt must be *pari passu*, no matter what the contracts say. Equally, the general *pari passu* principle under the insolvency scheme in respect of debts proved at the same time is subject to and does not trump the parties' actual agreements as to priority (otherwise all subordinated debt would rank equally both *inter se* and with unsubordinated debt). As Arden LJ noted in *Lehman Brothers International (Europe) v CRC Credit Fund Ltd,*[51] the *pari passu* maxim is not of universal applicability; "*It always yields to a contrary intention, express or inferred…"* And in *Waterfall I*,[52] per Lord Neuberger: "*I can see no objection to giving effect to a contractual agreement that, in the event of an insolvency, a contracting creditor's claim will rank lower than it would otherwise do in the 'waterfall'".*

72. This is also the reason why it is the terms of the agreements rather than the insolvency scheme which lead to *pari passu* between the LBHI2 Sub-Debt Agreements: where the agreements provide exhaustively for ranking against other debts, it is necessary to engage in the exercise of interpretation in order to resolve that ranking question. To seek to find the answer instead in the insolvency scheme is to circumvent the parties' actual agreements. PLC submits that the answer to the priority dispute as between the LBHI2 Sub-Debt and the LBHI2 Sub-Notes is to be found in the corresponding terms of the contracts and that, in short, the LBHI2 Sub-Notes are expressed to rank junior to the LBHI2 Sub-Debt. There is therefore no relevance (even if it were linguistically possible when applying both sets of

[51] [2011] Bus LR 277, at [76], quoting from *Cox v Bankside Members Agency Ltd* [1995] 2 Lloyd's Rep 437, at p 463 per Peter Gibson LJ.
[52] *Re Lehman Brothers International (Europe) (No. 4)* [2017] UKSC 38, [2018] AC 465, at [66].

agreements) to an enquiry into where an instrument ranks in the abstract beyond the crucial enquiry into where it is expressed to rank.

73. The principal determinant which resolves the priority issue, leaving aside for the moment the 2008 Amendments, is the differing wording of the instruments. A proper analysis of the wording leads to the ranking of the LBHI2 Sub-Debt ahead of the LBHI2 Sub-Notes from the outset. This conclusion is also supported and confirmed by the timeline, in which the LBHI2 Sub-Debt agreements preceded the LBHI2 Sub-Notes by six months yet were not mentioned in the later instruments by way of exception to the stated subordination.

74. Starting first with the wording of the LBHI2 Sub-Debt.[53] The technique, as above, is of a general subordination to other debt, save for liabilities "*expressed to*" rank junior in any Insolvency. This therefore envisages a clear expression of subordination in the referred instrument.

75. Reverting to the LBHI2 Sub-Notes, the LBHI2 Sub-Notes OC provides important detail around the LBHI2 Sub-Notes' own general subordination that is not contained in the FSA standard form employed in the LBHI2 Sub-Debt agreements. The LBHI2 Sub-Notes are subordinated to Senior Creditors, who comprise (a) all unsubordinated creditors; and (b) subordinated creditors save those "*whose claims rank, or are expressed to rank,* pari passu *with, or junior to, the claims of the Noteholders."* The inclusion of this latter category represents a qualified express statement of subordination (as anticipated by the LBHI2 Sub-Debt): it is an expression of subordination to all other subordinated debt subject only to the qualification or exception of debt which is expressed to rank (or which ranks) *pari passu* with or junior to the LBHI2 Sub-Notes.

76. Pausing therefore at this stage, the LBHI2 Sub-Notes *do* contain an expression of subordination to other subordinated debt because that is what the words say. The only further question is whether this creates an actual subordination to the LBHI2

[53] As the first in time, although ultimately it does not matter which instrument one starts with.

Sub-Debt. As to this, the answer is 'No' if the LBHI2 Sub-Debt falls within the qualification, and 'Yes' if it does not.

77. So it is necessary to go on to construe and apply the qualification in the LBHI2 Sub-Notes. This also uses the words *"expressed to*", which words may be taken to bear the same meaning as in the LBHI2 Sub-Debt Agreements. However, in this case, the LBHI2 Sub-Debt Agreements (as the referred instrument) make no clear or express reference to their position vis-à-vis any other subordinated debt.

78. In the absence of any reference to its position vis-à-vis other subordinated debt (as is found in the LBHI2 Sub-Notes), the LBHI2 Sub-Debt does not carry the necessary expression required to satisfy the qualification in the LBHI2 Sub-Notes. The subordination to '*all Liabilities'* is general in nature and hence not sufficient, especially when contrasted with the wording in the LBHI2 Sub-Notes, and by it the LBHI2 Sub-Debt is not "*expressed to*" rank junior to the LBHI2 Sub-Notes. So, as the qualification in the LBHI2 Sub-Notes is not engaged, the result is that the LBHI2 Sub-Notes do indeed contain an actual expression of subordination to the LBHI2 Sub-Debt.

79. Ultimately, the answer as a matter of language turns on the difference of wording between the two sets of Instruments. The LBHI2 Sub-Notes overtly provide, as a default, for their subordination to other subordinated debt, unless this position is expressly reversed in the referred instrument. The LBHI2 Sub-Debt Agreements make no express provision for their position as against other subordinated debt; hence they do not expressly reverse the subordination created in the LBHI2 Sub-Notes. That means, in turn, that the LBHI2 Sub-Notes are Excluded Liabilities under the LBHI2 Sub-Debt Agreements. There is no circularity, and no need for an implied term, and nor does the insolvency scheme intrude on the contractual ranking between these instruments.

80. Further, the pre-condition of solvency in clause 3(a) the LBHI2 Sub-Notes precludes any payment of the Sub-Notes unless LBHI2 is able to pay "*its debts*" as they fall due

(the first of the cumulative tests in the definition of 'solvent' in clause 3(b)(i)).[54] 'Debts' includes LBHI2's liabilities under the LBHI2 Sub-Debt, which are now due but cannot be paid in full by LBHI2. Accordingly, the LBHI2 Sub-Notes are not payable until after the LBHI2 Sub-Debt.[55]

81. Against this textual analysis, the timeline provides clarificatory context which confirms this construction:

81.1. As at the date of the LBHI2 Sub-Debt Agreements, the LBHI2 Sub-Notes did not exist. Nor is there believed to have been any other subordinated debt owed by LBHI2. Hence the wording in the LBHI2 Sub-Debt ("*expressed to*") was not a reference to existing debt but could only have been a reference to possible future debt. The parties were allowing for the possibility that, in the future, new subordinated debt might be created which might be subject to deeper subordination. Without such wording, this would not be possible (or at least would be difficult and probably uncertain). As David Richards J observed in *Waterfall I*[56] of an identical clause in relation to the LBIE subordinated debt:

"It seems to me that the obvious purpose of the exclusion of such Liabilities is to cater for the situation in which a Borrower issues further debt on terms that it is expressed to rank junior to the subordinated liabilities created by these subordinated debt agreements. It is, and was at the date of these agreements, a real possibility that a Borrower might wish to issue such debt and the purpose of this provision is simply to ensure that such junior subordination is effective."

81.2. By the time of the LBHI2 Sub-Notes, in contrast, the LBHI2 Sub-Debt was already in existence (and indeed the LBHI2 Sub-Notes were issued to PLC, the holder of the LBHI2 Sub-Debt, and the proceeds paid off part of that LBHI2 Sub-Debt). Hence, the subordination provisions in the LBHI2 Sub-Notes were directed to the existing subordinated debt as well as to any future debts. The

[54] The solvency condition in the LBHI2 Sub-Debt does not contain these words or have this effect.
[55] SLP3 has so far not advanced any reason to disregard the clear words of this part of the solvency condition: SLP3 Reply Position Paper [42(2)-(3)] [A/10/196].
[56] At [75].

existing LBHI2 Sub-Debt forms part of the factual matrix relevant to the interpretation of the LBHI2 Sub–Notes.

81.3. In that context, and given the drafting technique in the LBHI2 Sub-Notes (ie "*subordinated…to…subordinated creditors of the Issuer other than…*") the reasonable inference is that the drafting of the LBHI2 Sub-Notes reflected an acknowledgment of subordination to the existing LBHI2 Sub-Debt (LBHI2's only other subordinated debt). Had the draftsmen of the LBHI2 Sub-Notes wished to provide that the LBHI2 Sub-Debt fell within the qualification to the subordination provisions, then they could easily have said so, identifying the LBHI2 Sub-Debt by name and date. Given in particular the lack of any contrary express statement in the LBHI2 Sub-Debt, the conclusion is that the LBHI2 Sub-Notes were indeed intended to be junior to the extant subordinated debt.

81.4. SLP3 seeks to contend that it is unhelpful to ask what a draftsman could have said to make the position '*yet clearer*'.[57] But this is simply wrong. It is a common and appropriate judicial construction technique to consider the likelihood that if the parties had meant a certain thing they would have said so explicitly.[58] Where the parties to the LBHI2 Sub-Notes (LBHI2 and PLC) are expressly providing an exclusive code for the ranking of subordinated claims, where they adopt a default position that the LBHI2 Sub-Notes be subordinated to all other subordinated claims, where there is in existence only one other subordinated claim, which is between the very same parties, but they choose not to mention it as an exception to the default position, then there is a natural inference that they did not intend that it should displace that default position.[59]

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[57] LBHI/SLP3 Reply Position Paper [41(3)ii] [A/10/195].

[58] See e.g. *First National Trustco (UK) Ltd v Page* [2019] EWHC 1187 (Ch) per Joanna Smith QC at [193(ii)]; *Liberty Investing Ltd v Sydow* [2015] EWHC 608 (Comm) per Leggatt J at [11].

[59] The dictum relied upon by SLP3 in its Reply Position Paper [41(3)(ii)] [A/10/195], *Charrington & Co v Wooder* [1914] AC 71 per Lord Dunedin at 82, concerns an ambiguous term the parties had used without a

81.5. SLP3 seeks rather desperately to answer this point by arguing that the relevant A&O draftsmen of the LBHI2 Sub-Notes did not know that any of the LBHI2 Sub-Debt would remain.[60] Even if this is correct, there are two complete answers to it (i) absent a case for rectification (not advanced in relation to these words), it is legally irrelevant to enquire into the actual states of mind of any party to the LBHI2 Sub-Notes; the exercise of interpretation is purely objective; and (ii) even if it were otherwise, the knowledge of A&O would be irrelevant in any event, and it is not suggested that the LBHI2/PLC decision makers were unaware of the remaining LBHI2 Sub-Debt (note in fact that the continuation of existing LBHI2 Sub-Debt was reflected consistently in the contemporaneous documentation, including in Ms Hutcherson's letter to the FSA dated 12 April 2007 [F4/2044-2048], PwC's letter of advice dated 31 May 2007 [F5/2391-2492] and Ms Dolby's restructuring memorandum dated May 2007 [F4/2096-2098]).

82. PLC will respond to SLP3's case as formulated at the hearing, but for present purposes makes the following further points by reference to SLP3's Position Papers:

82.1. SLP3 seeks to rely on the statutory *pari passu* distribution for debts other than preferential debts which are proved at the same time[61], but this tells us nothing about the answer to the question in issue, which is the order in which PLC and SLP3 are entitled to prove, i.e. the contractual priority. If the agreements had not provided for their ranking against other debt, then the insolvency scheme might have given the answer. But where each agreement contains an exhaustive code for its ranking against other debt, the scheme must implement, not determine, the contractually agreed priority.

82.2. Similarly, SLP3 seems to suggest that *pari passu* ranking results from the mere fact that LBHI2 Sub-Notes (though not the LBHI2 Sub-Debts) allow for other

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gloss. That does not mean that the deliberate choice not to refer to something of which the parties must have been aware does not have significance for construction.

[60] LBHI/SLP3 Reply Position Paper [41(3)iii] [A/10/195].

[61] LBHI/SLP3 Position Paper [24(3)-(4)] [A/5/71].

debts to rank *pari passu*[62], but there is a vacuum of reasoning here. The fact that *pari passu* ranking is a theoretically available outcome under the LBHI2 Sub-Notes does not mean that it is the contractual outcome in this case. SLP3 fails to explain how, why and when the LBHI2 Sub-Debt should be determined to rank *pari passu* with the LBHI2 Sub-Notes.

82.3. SLP3 contends that the wording in the two instruments is "*materially the same*".[63] This is not correct, for reasons already explained. The drafting technique is the same but the wording is materially different. And that wording needs to be considered also by reference to the difference in timing of the instruments.

82.4. SLP3 seeks to place weight on the fact that the LBHI2 Sub-Notes post-dated the LBHI2 Sub-Debt but did not expressly refer to them.[64] As above, proper appreciation of the wording of the LBHI2 Sub-Notes takes this point in the other direction: given the express default subordination to other subordinated debt, the absence of reference to the existing LBHI2 Sub-Debt by way of qualification demonstrates that, contrary to SLP3's contention, the LBHI2 Sub-Notes did evince an objective intention to rank junior to the existing LBHI2 Sub-Debt.

82.5. SLP3 has indicated that it will pray in aid the factual matrix. Subject to the *caveats* mentioned above, which mean that the admissible factual matrix is narrowed to vanishing point:

(a) The contention that Lehman's objective was to refinance the LBHI2 Sub-Debt for tax and GAAP purposes[65] and that there was no regulatory need for subordinated instruments to rank differently from each other,[66] says nothing about the priority issue. The obverse is that there

[62] LBHI/SLP3 Position Paper [24(4)-(5)] [A/5/71-72], LBHI/SLP3 Reply Position Paper [41(2)] [A/10/194-195].
[63] LBHI/SLP3 Position Paper [24(2)], and [24(3)] [A/5/71] is also based on this premise.
[64] LBHI/SLP3 Position Paper [24(1)] [A/5/71].
[65] LBHI/SLP3 Position Paper [24(6)i] [A/5/72].
[66] LBHI/SLP3 Position Paper [24(6)ii] [A/5/72].

was no regulatory requirement that subordinated instruments should rank at the same level.

(b) The further though notably vague contention that the refinancing was intended to be on "*materially the same terms*"[67] is either (i) an assertion of inadmissible subjective intent; or (ii) a mischaracterisation of the objective materials before the court: there is nothing from which contractual purpose as to ranking can be drawn other than the words in fact used.

(c) SLP3 also contends[68] that no Lehman decision-maker gave consideration to how the subordination provisions would operate as between the Instruments. That may or may not be so but it is irrelevant as well as inadmissible. Contracts are not construed by reference to what the parties did or did not have in their mind, even if this could be established in the evidence, let alone what they might have had in mind had they thought about it at the time.

(d) SLP3 has previously indicated[69] that it intended to contend that "*ordinary market practice*" was for dated subordinated debts to rank *pari passu*. As no permission has been sought for expert evidence to this effect, it is assumed that this point is not pursued, but it suffers from inherent implausibility, not least because the wording of the LBHI2 Sub-Notes expressly contemplated tiers of subordinated debt and does not provide that all subordinated debts should rank *pari passu*.

82.6. Finally, SLP3 reverts to the ubiquitous submission that there is "*no commercial rationale*" in ranking the LBHI2 Sub-Debt above the LBHI2 Sub-Notes. At its heart SLP3's argument appears to come down to being unable to identify a positive commercial rationale for the priority on insolvency that the terms of

[67] LBHI/SLP3 Position Paper [24(6)i] [A/5/72].
[68] LBHI/SLP3 Position Paper [21(8)] [A/5/69].
[69] LBHI/SLP3 Position Paper [24(6)] [A/5/72].

the subordination provisions entail.[70] Deutsche Bank advances specific rationales for such a priority, but even if one cannot be identified, that should not be a matter of surprise twelve years after the event. At its lowest, neither outcome serves an intrinsically better commercial purpose than the other and SLP3 certainly cannot say that the ranking of the LBHI2 Sub-Debt above the LBHI2 Sub-Notes is commercially absurd. Again, the answer is to be found in the terms of the Instruments, not in self-interested pleas about rationale.

E.2 The proper construction in the light of the 2008 Amendments

83. In fact, the LBHI2 Sub-Notes OC terms were amended by the 2008 Amendments and it is only this amended version (which can be found at [E/5], or with the changes showing in tracks at [F5/2847-2856]) that must be construed, although the above points in relation to the pre-amendment version continue to apply and provide the background when construing the impact of the 2008 Amendments. The following section considers the proper construction of the amendments to the LBHI2 Sub-Notes OC, disregarding evidence of subjective intent or pre-contractual negotiations which, while admissible when considering rectification (see below), are inadmissible in construction.

84. The language of the 2008 Amendments must be considered within the structure of the original LBHI2 Sub-Notes OC terms [E/4 at 53 onwards]. That structure provided, at clause 3, for provisions dealing with "Status and Subordination" and, at clause 4, for "Interest". Within that structure, the principal amendments address two separate issues:

84.1. By the addition of an entirely new clause 4(f), this amendment both allows the issuer to defer payment of interest which was otherwise due, and regulates the accrual and subsequent payment of that interest. None of that affects priorities with other creditors. But it is significant that clause 4(f) contains a comprehensive code for the deferral, accrual and payment of interest. Subject

[70] LBHI/SLP3 Position Paper [24(7)] [A/5/72].

to immediately consequential minor amendments to acknowledge the potential for arrears (e.g. at clause 5(a) and 5(c)), nothing more needed to be added to the Terms in order to regulate the operation of the new regime for interest payment deferral.

84.2. Yet, separately, there are extensive amendments to clause 3(a). Such amendments do not regulate the deferral of interest. On any reasonable objective interpretation, they regulate status and subordination (i.e. priority). Hence, they have a different subject matter (and indeed, purpose, to the extent that can be discerned) to the clause 4(f) amendments. As submitted below, the 2008 Amendments plainly rank the LBHI2 Sub-Notes below the LBHI2 Sub-Debt. Accordingly (and save on the issue of rectification), nothing turns on whether this was a reinforcement of the pre-existing position or a change.

85. Under the heading, and by reference to, "Status and Subordination", clause 3(a) was amended as follows:

85.1. The amendments to the first paragraph of clause 3(a) are directed to the solvency condition under the LBHI2 Sub-Notes. The effect is to remove the condition of solvency, "*where an order is made by a competent court, or a resolution passed, for the winding up or dissolution of the Issuer*".

85.2. There is then an entirely new paragraph (beginning "*If any time*…"). The purport and effect of this critical paragraph is as follows:

(a) It is triggered upon winding up or dissolution (this following the same wording as in the amendments to the first paragraph).

(b) In that event, the payable amount on the LBHI2 Sub-Notes is deemed to be the amount which would have been payable if the Noteholder had been the holder of preference shares with a preferential right to return over (i) other shareholders; and (ii) other creditors with rights equivalent to notional or unissued shares.

85.3. The import of the new paragraph is that:

(a) It is concerned directly with the status and subordination rights of Noteholders in the event of such a claim. Indeed, this is clear from its function as a replacement for the solvency condition, which itself had been included to subordinate those rights: see paragraph 64 above.

(b) It is a deeming provision, to the effect that the claims of Noteholders are to be treated, not at the priority level of debt claims, but at the priority level of claims by preference shareholders satisfying the definition given.

(c) Of necessity, this provision affects priorities because creditors and shareholders stand in a different place in the applicable waterfall. By deeming the Noteholder claims to be equivalent to those of preference shareholders, and making payable only such amount as "*would have been payable*" if they had preference shares within the definition, the amendment relegates Noteholder claims behind all other creditors, including all other subordinated creditors.[71] It accordingly expresses the desired ranking of the LBHI2 Sub-Notes.

(d) This is confirmed also by the final assumption at the end of the paragraph that such preference share "*was entitled to receive, on a return of assets in such winding up"* amounts of principal plus interest. All other debt payments, including under the LBHI2 Sub-Debt, fall due

[71] SLP3 has previously argued that the reference to the preferential shares having a right to return over Notional Holders (as well as shareholders) indicates that the LBHI2 Sub-Notes were to rank above some other debt, because (SLP3 contends) Notional Holders must be holders of debt because they are described as "creditors": LBHI/SLP3 Reply Position Paper [50(2)-(3)] [A/10/200-201]. This is a bad point which ignores the definition of 'Notional Holder' as "*any creditor of the Issuer whose claims against the Issuer on a winding-up are quantified as though they held a Notional Share*" (which is in turn defined as an unissued share with a preferential right over other classes of issued shares). Notional Holders are a special type of 'creditor' being one that is also pegged by a deeming provision ("*as though they held a Notional Share*") to the level of preferential shares. In any event, so far as PLC is aware, LBHI2 has no creditor which fits this description.

before, and hence in priority to, any "*return of assets*" to shareholders or deemed shareholders.

(e) The fact that ranking at preference share level involves a demotion below other debt is plain and indeed was a technique utilised in other related Lehman documents. For example, the summary of the ECAPS OC dated 29 March 2005 [E/10/154] stipulated that PLC's subordinated guarantee ranked "pari passu *with the non-cumulative perpetual preferred securities or preference shares of the Guarantor (whether or not in issue)"*, with the result that claims (on the subordinated guarantee) ranked senior to ordinary shares but junior to claims of creditors of the guarantor.

85.4. This outcome is confirmed by the final, new paragraph of clause 3(a), which is declaratory in its effect, namely that the Noteholders are to have a right to a return of assets in the winding up in priority over (and, so only over) shareholders for regulatory capital purposes qualifying as Upper Tier 2 or Tier 1.[72] As dated instruments, the LBHI2 Sub-Debt could only qualify either as Lower Tier 2 Capital or as Tier 3 Capital[73]. Had there been any intention to rank the LBHI2 Sub-Notes claims *pari passu* with the LBHI2 Sub-Debt, this could easily and may be expected to have been made clear in this paragraph.

85.5. On this basis, and whatever the position in 2007, at least as from the date of the 2008 Amendments, and therefore for present purposes, the LBHI2 Sub-Notes are "*expressed to*" rank junior to the LBHI2 Sub-Debt and so are Excluded Liabilities within the meaning of the LBHI2 Sub-Debt.

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[72] SLP3 has previously argued that the final paragraph, with its reference to the LBHI2 Sub-Notes ranking above "*holders of any securities*", does not mean what PLC says it does because "*securities*" means shares and debt, not shares alone: LBHI/SLP3 Reply Position Paper [50(4)] [A/10/201]. This is simply wrong as a matter of ordinary language, and GENPRU 2.2.176G [J2/11/846] referred to by SLP3 does not say that securities includes debt, rather it confirms that some debt may be eligible Upper Tier 2 regulatory capital. SLP3 fails to mention that '*securities*' is in fact defined in the Handbook containing GENPRU to include shares, debentures, warrants etc, i.e. in the ordinary way not including debt [J2/12].

[73] GENPRU 2.2.11G [J2/11/818], 2.2.12G [J2/11/812], 2.2.157G [J2/11/843], 2.2.159R [J2/11/844], 2.2.177R [J2/11/847], 2.2.194R [J2/11/849].

86. SLP3 contends[74] that the amendment evinces a clear intention that the LBHI2 Sub-Notes rank above shareholders but no intention that they rank below debt (in other words, by setting a floor to their priority status and not a ceiling). But this is an impossible interpretation as it is not what the amendment says. The deemed status as preference shareholders carries both a floor and a ceiling. It is this conscious and overt deeming provision which confirms or establishes the subordination of the LBHI2 Sub-Notes to the LBHI2 Sub-Debt.

87. Further:

87.1. SLP3 itself,[75] and its witnesses, seem to accept the concept of fixing ranking of debt at the level of preference shareholders[76], i.e. with a floor (higher than non-preference share equity) and ceiling (lower than debt).

87.2. Lest the contrary be alleged, there is nothing uncommercial about ranking subordinated debt such as the LBHI2 Sub-Notes at the level of preference shares. This is clear from the willingness of LBIE to convert large amounts of subordinated debt into actual preference shares, as Ms Dolby explains in relation to replacement of $2bn of subordinated debt with the same amount of non-cumulative preference shares in 2006,[77] and then a further $5.1bn in May 2007.[78]

88. PLC addresses the meaning of the references to winding up or dissolution below. Subject thereto, these provisions taken as a whole are clear as to the resultant priority level of the LBHI2 Sub-Notes. As they are to sit at the level of preference shares, and whilst they are superior to ordinary shares (and "*Notional Holders*", if there are any), they are necessarily inferior to all other debt. The language is not capable of supporting any other meaning.

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[74] LBHI/SLP3 Position Paper [29] [A/5/75-76].
[75] LBHI/SLP3 Position Paper [43(7)] [A/5/87].
[76] Miller WS [19]-[20] [C/1/5]. Also Grant WS [42]-[43] [C/2/24].
[77] Dolby WS [20(a)] [C/3/34]. Also Hutcherson WS [62] and [75]-[76] [C/6/82 and 85].
[78] Dolby WS [43] [C/3/38]. Also Hutcherson WS [81] [C/6/86]. See also eg Ms Hutcherson's letter to the FSA dated 12 April 2007 [F4/2044-2048], PwC's letter of advice dated 31 May 2007 [F5/2391-2492] and Ms Dolby's restructuring memorandum dated May 2007 [F4/2096-2098]).

89. On the correct approach set out above, the court may have regard to the purpose of the amendment, construed objectively by reference to the terms of the LBHI2 Sub-Notes themselves. But this is ultimately a circular exercise. On the face of clause 3(a), the purpose of the amendment was to confirm or affect the status and subordination of the LBHI2 Sub-Notes, and the detailed language sets out the manner in which this was achieved. Hence the objective purpose is consistent with the correct interpretation of the words used, as described above.

90. Consistently with the submissions made above, there is little scope for factual matrix evidence in interpreting the 2008 Amendments. PLC remains cautious as to the admissibility of a wider examination of the particular discussions or arrangements within Lehman which led to the conclusion of the amendment. If SLP3 persists in seeking to establish factual matrix through evidence, it will remain important to distinguish pre-contractual negotiations and subjective intent, which are inadmissible outside the context of rectification, and more general commercial purpose evident from the factual matrix. PLC will address such evidence as is found admissible and relevant during and in the closing of the hearing, and merely confines itself to observing that in addition to the deferral of interest, there was plainly an intention to affect priority, which intention can be derived from the clear terms used.

E.3 The meaning of the words "*winding-up or dissolution*"

91. The amendment to the first paragraph of clause 3(a) removes the solvency condition included in the original version and allows for the possibility of payment to be made "*where an order is made by a competent court, or a resolution passed, for the winding-up or dissolution of the Issuer (except for the purposes of a reconstruction, amalgamation, reorganisation, merger or consolidation on terms previously approved in writing by an Extraordinary Resolution of the Noteholders)*". The second paragraph, in turn, repeats the same wording for the same purpose. Otherwise, the pre-condition of solvency precludes any payment unless LBHI2 is

able to pay "*its debts*" as they fall due. These include its subordinated debts and so the condition remains incapable of being satisfied.

92. The question arises as to whether the insolvency events specified in these two paragraphs include the circumstances now obtaining in respect of LBHI2, namely a distributing administration. For these purposes, the competing interpretations may be described as:

    92.1. the '*broader definition'*, to the effect that the words include (at least) a distributing administration; or

    92.2. the '*narrower definition'*, i.e. that the words mean only a winding up or dissolution in accordance with the Insolvency Act (and, possibly, the equivalent in another jurisdiction, although the boundaries of SLP3's case are unclear).

93. PLC considers that the broader definition is the correct one for the reasons set out below. If it is, then the priority of the LBHI2 Sub-Notes is manifest for the reasons set out above: the LBHI2 Sub-Notes rank below other subordinated debts and level with preference shares in accordance with the definition.

94. Because of the adverse consequences of the broader definition, SLP3 is forced to advance the narrower definition.[79] However, that definition also leads to the priority of the LBHI2 Sub-Debt over the LBHI2 Sub-Notes, although for different reasons. So the outcome is the same, whatever the definition.

95. Considering first the narrower definition, there are two reasons why this is also fatal to SLP3's case. The first is by reference to the remaining terms of the LBHI2 Sub-Notes. Very simply: on the narrower definition, if the insolvency events specified in clause 3(a) do not include a distributing administration, then the default position obtains, namely the solvency condition operates. As is clear on the wording of

[79] LBHI/SLP3 Position Paper [27-8] [A/5/75] and LBHI/SLP3 Reply Position Paper [43] [A/10/197].

clause 3(a), this precludes any payment falling due on the LBHI2 Sub-Notes because LBHI2 is unable to satisfy that condition.

96. This point as to the preclusion of payment on the LBHI2 Sub-Notes is reinforced by reference also to clause 8, which provides for the only enforcement remedies available to the Noteholders. These remedies are as follows:

96.1. By clause 8(a), upon default, the Noteholders may institute proceedings "*for the Insolvency of the Issuer*". 'Insolvency' is defined in clause 1 to mean and include a "*liquidation, winding up, bankruptcy, sequestration, administration, rehabilitation and dissolution…".*

96.2. By clause 8(b), if an order is made or resolution passed for winding up or dissolution (the same wording as is used in the clause 3(a) amendment, which SLP3 says does not cover a distributing administration because of the narrower definition), the LBHI2 Sub-Notes may become immediately due and payable.

96.3. However, and by clause 8(c) "*no remedy… against the Issuer other than as specifically provided by Conditions 8(a) and 8(b) or submitting a claim in the winding-up of the Issuer will be available to the Noteholders.*"

97. The origin of this clause (which appears to have been a rehashed version of clause 9 in the PLC Sub-Notes [E/9/134-135]) is obscure on the evidence but the different wording in each of these sub-clauses is itself strongly indicative of the applicability of the broader definition. It would follow from the narrower definition that, because the wording is not exactly the same, each sub-clause engages different insolvency processes. That would be an incoherent interpretation.

98. Be that as it may, the narrower definition advanced by SLP3 would also lead to the conclusion that the reference to "*winding-up of the Issuer*" in clause 8(c) is a reference only to an Insolvency Act winding up. If that were right, then the Noteholders would be without any claim for payment in a distributing

administration, thereby ceding priority to the LBHI2 Sub-Debt for this reason also. So the narrower definition is fatal to SLP3 on any sensible view.

99. SLP3, whilst clinging to the narrower definition, seeks to avoid the unpalatable consequences under clause 8 by two unconvincing arguments:[80]

99.1. It contends that as clause 8(a) permits the institution of insolvency proceedings, that clause must also entitle SLP3 to prove its debt. Had clause 8(a) stood on its own, PLC accepts that an implied term to this effect would follow. But this is to ignore clause 8(c), which expressly provides for the process of proof. The implied term cannot be read into clause 8(a) when the subject matter is already dealt with in clause 8(c)[81].

99.2. It contends in the alternative that the reference in clause 8(c) to a "*winding-up*" includes a distributing administration, although (on its case - the narrower definition) the words "*winding-up or dissolution*" in clauses 3(a), 4(f) and 8(b) do not. This is as hopeless as it sounds.

100. The second reason why the narrower definition does not avail SLP3 arises out of the terms of the LBHI2 Sub-Debt. As will be recalled, Excluded Liabilities are those which are expressed to be (and do) rank junior "*in any Insolvency*" of LBHI2. The definition of "*Insolvency*" is very wide and includes "*liquidation, winding up, bankruptcy, sequestration, administration"* and other processes. Even if, pursuant to the narrower definition, clause 3(a) is expressly engaged only on an Insolvency Act winding up, the LBHI2 Sub-Notes are thereby expressed to rank junior "*in any Insolvency*", namely in such a winding up. Hence they are for this reason and in any event Excluded Liabilities under the LBHI2 Sub-Debt agreements.

101. Whilst the narrower definition would accordingly also lead to the priority of the LBHI2 Sub-Debt, the broader definition is much more realistic. And this conclusion is

[80] LBHI/SLP3 Reply Position Paper [45(2)] [A/10/198-199].
[81] K Lewison, *The Interpretation of Contracts,* 6th edn (Sweet & Maxwell, 2017) at [6.11], *Broome v Pardess Co-operative Society of Orange Growers Ltd* [1940] 1 All ER 603.

inescapable if, contrary to the above, the alternative (narrower) definition allowed for anything to be paid on the LBHI2 Sub-Notes. In summary:

101.1. The amendment has to be seen in its regulatory context. The solvency condition in the original form of the LBHI2 Sub-Notes was the mechanism by which subordination was achieved, this being essential if the Sub-Notes were to qualify as regulatory capital.[82] The second paragraph of clause 3(a) was accordingly necessary to effect subordination, notwithstanding the removal of the solvency condition. To comply with GENPRU, such subordination had to apply in every circumstance in which an insolvent firm's assets were being distributed to creditors. The broader definition is accordingly the only interpretation consistent with the regulatory context.

101.2. The premise of the argument that SLP3 has to make, as understood, is that, on the assumption that the amendments to clause 3(a) otherwise have the effect of demoting the Sub-Notes to the level of preference shares and hence below all other debt, the parties agreed that this should be the result only if there was a distribution in an Insolvency Act winding up and that it should not be the result if there was a distribution in an administration. So, on SLP3's case, priority in respect of billions of dollars of regulatory capital would not be fixed, could never be predicted, and would be subject to massive change depending on the particular insolvency process engaged and on the progress of that process. It would also mean that, in administration, any claim in respect of the debt under the LBHI2 Sub-Notes would be subject to the solvency condition, even though a condition for entering administration was that the company was or was likely to become insolvent. This is, with respect, commercially and legally absurd, unprincipled and dangerous.

101.3. The words "*winding up or dissolution"* must be read in the context of what is being sought to be achieved (both in clause 3(a) and in clause 8(c)), on the correct assumption of consistency of language. These provisions allow for

[82] See paragraph 46 above.

circumstances in which, by way of carve out, the solvency condition does not apply and Noteholders may enforce a remedy in an insolvency process. It would be nonsensical to remove the solvency condition where there is a winding up but retain it where there is a distributing administration.

101.4. The wording does not refer to the Insolvency Act as such and does not specify that the processes referred to should bear a narrow definition. The words "*winding up*" are capable of bearing a wider meaning and do in fact do so, as the scheme of clause 8 makes clear (see paragraph 97 above).

101.5. There is no reason to construe these words narrowly. The correct context for their construction is the broad definition of 'Insolvency' in clause 1, with the result that the Noteholders are entitled to payment (at the appropriate priority level) in the event that a distribution is made out of any of the processes so identified. Accordingly, and at a minimum, the words embrace a distributing administration which is functionally the same as a distribution through an Insolvency Act winding up.

101.6. Specifically, so far as outcome and structure are concerned, there is in practical terms, no substantive difference between the payment processes in an Insolvency Act winding up and those in an Insolvency Act distributing administration. The aim of each is to distribute the remaining assets of the insolvent estate to the creditors.

101.7. See eg *Waterfall I* in the Supreme Court[83]: "*In a distributing administration, as in a liquidation, the duty of the office holder, whether administrator or liquidator, is to gather in and realise the assets of the company and to use them to pay off the company's liabilities…"*

101.8. See also *Re Kaupthing Singer & Friedlander Ltd*[84]. At [2] Blair J observed that the administrator receives proofs of debt, adjudicates such proofs and makes

[83] At [16].
[84] [2010] EWHC 316 (Ch).

a distribution to creditors "*in much the same way*" as in a liquidation, and the machinery for making distributions is "*modelled on the equivalent rules applicable to liquidations*". And at [24] he accepted the submission that the administration distribution under paragraph 65(3) of Schedule B1 was "*in substance equivalent to a distribution made by a liquidator in the course of a winding up.*"[85] Indeed, the Judge in that case held (at [24]) that the term "*winding up*" within the Terms and Conditions of certain Bonds extended not only to compulsory or voluntary liquidation but also to administration where a notice of proposed distribution to creditors had been given in accordance with rule 2.95.

101.9. Particularly as the concept of a distributing administration is a relatively new one (the changes in the Enterprise Act becoming effective on 15 September 2003), it is unsurprising that it is not expressly referred to in what appears to be a standard form of words used.

101.10. There is no reason to distinguish the two processes of an Insolvency Act winding up and distributing administration in this context. And, indeed, it would be perverse to arrive at a construction whereby the entitlement of the Noteholders to payment depended entirely on the specific distributing insolvency regime that happened to eventuate. It would also produce an arbitrary outcome, which could not have been the intention of commercial parties to the LBHI2 Sub-Notes, and would not be in accordance with commercial common sense. There is no sensible purpose in an outcome which provides Noteholders with a remedy if there is an insolvency distribution through a winding up but with no remedy if the distribution comes through an administration.

[85] At [16], Blair J also quoted from G Lightman and others, *Lightman & Moss on The Law of Administrators and Receivers of Companies* (Sweet & Maxwell, 2007) at [15-011], where the distributing administration was described as "*as surrogate mechanism for the distribution rules applicable in liquidation, thereby rendering entry into liquidation unnecessary.*"

102. Further, and lest the contrary be advanced, nor is there any particular significance in the words "*an order is made by a competent court, or a resolution passed…"*. Certainly, there is no significance which lends support to the narrower definition. Administration may also be by order (and a distributing administration must be). But in any event, these words are not used consistently throughout the amendments: clause 4(f) refers to "*the commencement of the winding up or dissolution of the Issuer (except for the purposes of a reconstruction, amalgamation, reorganisation, merger or consolidation on terms previously approved in writing by an Extraordinary Resolution of the Noteholders)*", indicating that the focus is on the substance not the procedure.

103. Finally, PLC agrees with SLP3 Reply Position Paper [45(1)] [A/10/197-198] that the amendments must also be seen in their regulatory context. See above. However, SLP3 attempts artificially to force a meaning into the words used in Clause 3(a) by reference to what it suggests Clause 8(b) must mean in the light of GENPRU. As to this:

    103.1. The theory that the meaning of clause 3(a) must be driven by the meaning of clause 8(b) is unsound in principle. The process of interpretation is unitary not linear.

    103.2. As for clause 8(b) itself, it is further unsound to derive a narrow meaning of the words used in the Sub-Notes by deploying a narrow meaning of the words used in GENPRU.

    103.3. There is nothing to suggest that GENPRU (or indeed the Directives which it implemented)[86] actively focused on granular distinctions between insolvency processes, let alone on distinctions between a winding up and a distributing administration. The language is entirely general, and addresses the function (ie the liquidation of assets) rather than the particular legal process by which this is achieved. And, reverting to Basel I and Basel II, the role of subordinated

[86] Blair J in *Kaupthing* noted at [12] that the 2000 Directive did not define the term "*liquidation*" but that its intent was clear.

debt as regulatory capital was to provide loss adjustment in a "*liquidation*". It is not conceivable that any distinction should be drawn between different processes in which an insolvent company's assets are liquidated.

103.4. Whilst GENPRU does make reference variously to "*winding up*", "*liquidation*" and "*administration*", these are interchangeable or composite terms, rather than words with narrow and disjunctive meaning. For example, conditions for eligibility for a Tier 1 instrument include at GENPRU 2.2.64(3)(a) that it "*cannot be redeemed at all or can only be redeemed on a winding up of the firm"* [J2/11/828]. Yet at GENPRU 2.2.64(9) a further condition is that it "*ranks for repayment upon winding up, administration or any other similar process no higher than a share of a company"* [J2/11/828]. The earlier reference cannot sensibly bear a narrow meaning.

103.5. The same can be seen from the rule relied on by SLP3, GENPRU 2.2.159 [J2/11/844]. At 2.2.159(3), it is provided that the remedies available (in respect of a Tier 2 instrument) in the event of non-payment or other breach must be "*limited to petitioning for the winding up of the firm or proving for the debt in the liquidation or administration"* [J2/11/844]. As to this:

(a) The use of the words 'winding up', 'liquidation' and 'administration' are indicative of a broad rather than narrow approach to definitions.

(b) There would be no coherent reason why the subordinated creditor should be permitted to petition for an Insolvency Act winding up and to prove in a liquidation (whatever that is meant to be) and an administration, yet not to institute an administration, if able to do so.

(c) The proper context of GENPRU further supports the broader interpretation of these words. At GENPRU 2.2.116(2)(b), one of the further requirements of a Tier 1 instrument is that the holder "*is not able to petition for the winding up or administration of the firm or for a similar procedure…."* [J2/11/837]. So there is a clear contrast between the position under Tier 1 and Tier 2. The natural reading of 2.2.159(3) in

that context is that the Tier 2 creditor is able to do that which the Tier 1 holder is not. Yet, if SLP3's narrow approach were to be adopted, it would mean that, because the Tier 2 creditor may petition only for a "*winding up*" it is otherwise subject to the same (but silently imposed) restrictions as apply (expressly) to the Tier 1 holder.

103.6. It is equally unrealistic to try to read the LBHI2 Sub-Notes as if they are a map reflecting the (allegedly) narrow interpretation of GENPRU. On the contrary, to the extent that such an exercise reveals anything, it is that the draftsmen, and A&O, intended to reflect a much broader view of GENPRU:

(a) Reverting to GENPRU 2.2.159(3), as above, the remedies available to the creditor are limited to "*petitioning for the winding up"* [J2/11/844].

(b) By clause 8(a) of the LBHI2 Sub-Notes, and upon default, the Noteholders are granted the power to "*enforce payment by instituting proceedings for the Insolvency of the Issuer…"* The definition of "*Insolvency*" is much wider than an Insolvency Act winding up. So the power is much wider.

(c) In their letter dated 1 May 2007 [F4/2243-2245], in which A&O confirmed that the LBHI2 Sub-Notes satisfied the GENPRU requirements, they expressly stated that clause 8 complied with GENPRU 2.2.159(3).

(d) Accordingly, and on any view, the LBHI2 Sub-Notes applied a broader meaning to the condition in GENPRU 2.2.159(3) than that contended for by SLP3. PLC submits that this was entirely correct.

(e) A similar conclusion can be reached by reference to clause 8(c) of the Sub-Notes. This permits (only) the submitting of a claim in a "*winding up*". Consistently with GENPRU 2.2.159(3), this means both a winding up and an administration (as indeed SLP3 contends in one of its

contortions[87]). This was confirmed also in the A&O opinion letter dated 1 May 2007, which stated that the condition in GENPRU 2.2.159R was "*explicitly provided for in Condition 8*" [F4/2243-2245]. It was, but only if the broad definition applied.

104. The above analysis provides further support for the broad interpretation of the Sub-Notes (and, if necessary, GENPRU). But, at its lowest, it demonstrates that the attempt to impose a narrow interpretation on the Sub-Notes upon the assumption that they must reflect a narrow interpretation of GENPRU is misconceived.

105. Further and in any event, the suggestion[88] that GENPRU 2.2.159 permits acceleration only in a winding up because acceleration would otherwise defeat the stated purpose of an administration is an example of a submission which does not take into account the special circumstances of a distributing administration, as a functional equivalent of a winding up[89]. This is a further example of a suggested outcome which is arbitrary and makes no sense: there is no reason at all why the position of a creditor seeking to prove for its debt should be so fundamentally different depending on the insolvency process adopted. At all events, there is nothing to suggest that this was a distinction expressly made under GENPRU.

106. Ultimately, as above, the relevance of GENPRU, Basel and the Directives is their focus on the need for subordination to unsubordinated debt rather than distinctions over particular legal processes. Of further particular significance is the functional equivalence of the two regimes by which the assets of an insolvent company may be liquidated and distributed and the absurdity of the SLP3 construction. SLP3 has never provided any possible reason for the otherwise bizarre conclusion that the LBHI2 Sub-Notes should provide a radically different outcome

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[87] LBHI/SLP3 Reply Position Paper [45(2)] [A/10/198-199]. This is in the context of SLP3's argument referred to above at paragraph 99.2.

[88] LBHI/SLP3 Reply Position Paper [45(1)(i)] [A/10/197-198].

[89] In *Kaupthing*, the Bonds provided for acceleration on "*winding up*", but Blair J noted (at [7]) that the same meaning had to be given to the same term in the subordination clause also. The effect of the decision was, accordingly, that the acceleration provision was engaged on a distributing administration. Amongst other things, SLP3's case is therefore directly inconsistent with this Judgment and it has to contend that Blair J was wrong.

for Noteholders depending on whether the issuer has its assets distributed through a winding up or a distributing administration.

F SLP3'S RECTIFICATION CASE

107. In its initial Position Paper dated 11 January 2019, SLP3 first intimated a claim for rectification of the 2008 Amendments. This previously unheralded claim appears to have emerged after SLP3 had given more careful consideration to its chances of success on construction. This has led to an expansion of the evidential scope of the applications. Given the rules on admissibility, and indeed the recently revived element of subjectivity in rectification cases, there needs to be a clear dividing line between the issues of construction and the issues which arise on this alternative claim. The necessary premise of the rectification claim is that SLP3 has failed on construction, such that the LBHI2 Sub-Notes are, pursuant to the terms of the instruments, subordinated to the LBHI2 Sub-Debt.

G THE LAW OF RECTIFICATION

108. This is addressed below under the following heads:

(i) The basic requirements.

(ii) The subjective test.

(iii) The evidential standard.

(iv) The substantive elements.

(v) Discretion.

G.1 The basic requirements

109. The basic requirements for rectification of a contract for common mistake were set out by Peter Gibson LJ in *Swainland Builders Ltd v Freehold Properties Ltd*[90] and quoted with approval by Lord Hoffmann in *Chartbrook Ltd v Persimmon Homes Ltd*[91], by Leggatt LJ in *FSHC Group Holdings Ltd v GLAS Trust Corporation Ltd*[92] and on many other occasions:

> *"The party seeking rectification must show that:*
>
> *(1) the parties had a common continuing intention, whether or not amounting to an agreement, in respect of a particular matter in the instrument to be rectified;*
>
> *(2) there was an outward expression of accord;*
>
> *(3) the intention continued at the time of the execution of the instrument sought to be rectified;*
>
> *(4) by mistake the instrument did not reflect that common intention."*

G.2 The subjective test

110. In *FSHC*, the law was clarified by the Court of Appeal which, in particular, confirmed that common mistake rectification was based on subjective not objective mistake. In summary, at [176]:

> *"…it is necessary to show… that, when they executed the document, the parties had a common intention in respect of a particular matter which, by mistake, the document did not accurately record. In the latter case it is necessary to show not only that each party to the contract had the same actual intention with regard to the relevant matter, but also that there was an "outward expression of accord" – meaning that, as a result of communication between them, the parties understood each other to share that intention."*

111. As was further explained:

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[90] [2002] EWCA Civ 560 at [33].
[91] [2009] 1 AC 1101 at [48].
[92] [2019] EWCA Civ 1361 at [100-1].

111.1. where rectification is based on a concluded binding antecedent contract as to what would be in the executed document, then the antecedent agreement to be enforced must be construed objectively [141];

111.2. where it is based on a non-binding antecedent common intention, rectification is made pursuant to the equitable principle of good faith and conscience [142], [146] and [152] (which is the same principle that grounds rectification for unilateral mistake [147]).

112. The Court of Appeal in *FSHC* expressly rejected the objective analysis set down *obiter* by a unanimous House of Lords in *Chartbrook*[93]. This was on the basis that: (i) the *Britoil plc v Hunt Overseas Oil Inc*[94] decision in the Court of Appeal was binding and required a subjective approach (*FSHC* at [160-3], [176], also [88-97]); (ii) the dictum in *Chartbrook* was based on an erroneous reading of three cases (*FSHC* at [155-9]); (iii) the application of the objective approach in *Daventry District Council v Daventry & District Housing Ltd*[95] was not the subject of argument but rather assumed to be correct by both parties (*FSHC* at [134-8]). It was recognised that the subjective test is a more demanding test than the objective test [173-4].

G.3 The evidential standard

113. The burden is on the party seeking rectification. Whilst the standard of proof remains the normal civil standard, it is well recognised that the evidential burden is

[93] Both prior to and after *Chartbrook* there was a lively academic and extra-judicial debate about the true essence of, and hence test for, rectification. See eg M Smith, '*Rectification of contracts for common mistake, Jocelyne v Nissen and subjective states of mind*' [2007] LQR 116; Sir Nicholas Patten, *Does the law need to be rectified? Chartbrook revisited*' 2013 Chancery Bar Annual Lecture; Sir Terence Etherton, '*Contract Formation and the Fog of Rectification* (2015) 68 Current Legal Problems 367; D McLauchlan, '*Refining Rectification*' [2014] LQR 83; Lord Hoffmann, '*Rectification and other Mistakes*' 2015 COMBAR Lecture; P Davies, *Rectification versus interpretation: the nature and scope of the equitable jurisdiction* [2016] CLJ 62. It seems that the decision of the Court of Appeal has put much of this debate to rest, at least for now.

[94] [1994] CLC 561.

[95] [2011] EWCA Civ 1153, [2012] 1 WLR 1333.

an onerous one. As Mustill J explained in *Etablissements Georges et Paul Levy v Adderley Navigation Co Panama SA (The Olympic Pride)*[96]*:*

> *"The Court requires the mistake to be proved with a high degree of conviction before granting relief. There are sound policy reasons for this. The Court is reluctant to allow a party of full capacity who has signed a document with opportunity of inspection, to say afterwards that it is not what he meant. Otherwise, certainty and ready enforceability would be hindered by constant attempts to cloud the issue by reference to pre-contractual negotiations. These considerations apply with particular force in the field of commerce, where certainty is so important. Various expressions have been employed in the reported cases to describe the standard of proof required of the person who seeks rectification. Counsel in the present case were agreed that the standard can adequately be stated by saying that the Court must be "sure" of the mistake, and of the existence of a prior agreement or common intention before granting the remedy."*

114. Earlier cases referred to the need for "*irrefragable"* evidence. On the more modern formulation, there must be "*convincing proof*".[97] Just as in fraud cases the party alleging fraud must overcome its inherent improbability, so in a rectification case the party alleging it "*must counteract the cogent evidence of the parties' intention displayed by the instrument itself*"[98], i.e. the inherent probability creating a presumption that the parties did intend what they said.[99] The jurisdiction is one which must be "*cautiously watched and jealously exercised".*[100]

115. The satisfaction of the burden of proof will depend upon the facts of a particular case. But the burden is likely to be harder to discharge where the mistake was not as to the words used but as to their meaning, or where professional advice was received during the drafting, or where the document was carefully and well-drafted.[101]

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[96] [1980] 2 Lloyd's Rep 67 at 72.
[97] *Swainland Builders Ltd* at [34]; *T&N Ltd v RSA plc* [2003] EWHC 1016 at [135].
[98] *Thomas Bates and Son Ltd v Wyndham's (Lingerie) Ltd* [1981] 1 WLR 505 at 521.
[99] *Tartsinis v Navona Management Co* [2015] EWHC 57 at [85]; *FSHC* at [186].
[100] *Whiteside v Whiteside* [1950] Ch 65 at p 71 per Evershed MR.
[101] D Hodge, *Rectification*, 2nd edn (Sweet & Maxwell, 2015) at [10-08] and [10-09 to 18]. *Britoil* at 572.

116. In order to satisfy the heavy burden by establishing a sufficient common intention, it may be expected that the court will require evidence from the individuals concerned (namely, in the case of a corporate party, the individuals whose intention is to be attributed to that party: see below). At a time when the *Chartbrook* objective test prevailed, it was said by Mann J that such a test "*probably makes it easier to maintain a rectification case without calling witnesses*"[102]; this emphasises the corresponding importance of witness evidence on the return to the subjective approach. In *FSHC,* there was sufficient evidence from all the relevant persons to establish the convincing proof required. Leggatt LJ noted:

> *"The action was tried over five days. All the main individuals involved in the relevant events (whose names we have mentioned) were called as witnesses and cross-examined. This is therefore a claim for rectification in which – in the words of Kekewich J in Bonhote v Henderson [1895] 1 Ch D 742 , 749 – the court took "the proper course of having the evidence thrashed out in the witness box"."*

117. In some cases, it may be appropriate to draw an adverse inference from the absence of an available witness, if the obviously relevant witnesses are available to be called but are not called[103]. But whether there is an adverse inference or not, the absence of such evidence may itself be fatal. If a party seeking rectification for common mistake does not adduce evidence from the individuals who are supposed to have laboured under such a mistake, then there will be an obvious gap in the narrative, unless the "*convincing proof*" can be derived from some other source.

118. Even where a relevant witness does give evidence as to an earlier subjective intention, such evidence must be treated with care and, as appropriate, caution. This will be especially so in cases where (a) there is no direct documentary support; and (b) there is a significant time lapse between the event and the evidence. Memory is itself notoriously unreliable and witnesses can (innocently) convince themselves of things that favour their position.[104] This is particularly the case where the witnesses are solicitors because "*in rectification claims of this nature… the Court*

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[102] *Murray Holdings Ltd v Oscatello Investments Ltd* [2018] EWHC 162 (Ch) at [192].
[103] *Wisniewski v CMHA* [1998] PIQR 324 at 340.
[104] See e.g. *FSHC Group Holdings Ltd v Barclays Bank plc* [2018] EWHC 1558 at [116].

should look astutely at the evidence [of solicitors], since such evidence, even though honestly given, is capable of being warped by a subconscious wish to avoid liability for professional negligence".[105] There is a danger in rectification cases that witnesses who are responsible for a mistake and risk embarrassment may have convinced themselves that they had intentions that they did not.[106]

G.4 The substantive elements

119. The following substantive elements need to be considered:

    (i) The need for actual common intention.

    (ii) Outward expression of accord.

    (iii) The nature of the relevant mistake.

G.5 The need for actual common intention

120. As per *Chitty* [3-089]:

> *"The burden of proof is on the party seeking rectification. He must produce "convincing proof" not only that the document to be rectified was not in accordance with the parties' true intentions at the time of its execution, but also that the document in its proposed form does accord with their intentions."*

121. As set out in this passage, there are two distinct but related requirements. The first is that the document does not accord with the parties' true intentions at the time. This is a reference to their true actual intentions in fact. As described by Leggatt LJ in *FSHC,* at [147], "*It is fundamental to the doctrine… that an actual mistake was made by one or more real people in believing that the written contract gave effect to what either was or was understood by one party to be the parties' actual common intention."* The test will not therefore be satisfied unless the parties had a relevant intention which was not reflected in the document. So the remedy will be

[105] *Konica Minolta Business Solutions (UK) Ltd v Applegate* [2013] EWHC 2536 at [38].
[106] *Lansing Linde Ltd v Alber* per Rimer J at para 128.

unavailable if the parties had overlooked the point or it had simply not been the subject of any discussion or consideration. Nor is it enough to speculate on what the parties might or might not have thought had they been directed to such a point, if they were not labouring under an actual mistake at the time. See *Chitty* [3-058]:

> *"Rectification will not be ordered… if a written agreement fails to mention a matter because the parties simply overlooked it, having no intention on the point at all, or if they decided deliberately to omit the issue. In such cases the written agreement must be construed as it stands. It is an essential element of the doctrine that there has been a mistake."*

122. It follows also that the relevant intention must be a positive intention which conflicts with the document. This may include a positive intention not to take some step or to effect some change. But it is not to be confused with the absence of an intention, which is never sufficient. See e.g. *CH Pearce & Sons Ltd v Stonechester Ltd*[107] per Oliver LJ:

> *"… it is important, I think, at the outset of the argument to appreciate what a plaintiff has to prove in an action for rectification. He has to demonstrate that the parties have formed a common intention, which can be formulated with certainty, about what was to go into the written document. He has to demonstrate that that common intention, once formed, continued as a common intention up to the preparation of the document; and he has to show that the document, as produced, does not accurately reflect that intention and what it was that the document should have said if it was to reflect that intention. It is not enough for him to seek to demonstrate that, although there may not have been any common intention about what the document was to contain, it was not intended to contain what it in fact did contain."*

123. It is not, therefore, enough, merely to point to the absence of a conscious intent to agree a particular term or effect a particular change. If it were otherwise (and, it seems, if the law were as SLP3 wishes to contend), any document would be open to rectification on its being shown that the parties did not give specific thought to the

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[107] Unreported 15 November 1983 (CA) transcript p 8. See also *Crane v Hegeman Harris Co Inc* [1939] 1 All ER 662 at p 664 per Simonds J: "*For let it be clear that it is not sufficient to show that the written instrument does not represent their common intention unless positively also one can show what their common intention was."* See also *Whiteside v Whiteside*.

inclusion of every single term and its legal effects. But that is obviously not a basis for rectification[108]. The document must (to the requisite degree of proof) be inconsistent with an actual, formed, mutually understood or agreed intention.

124. So, for example, in *Lloyd v Stanbury*[109], there was no rectification of a contract for the sale of land because the purchaser had not been interested in the precise boundaries, was content to leave their exact definition to his legal advisers and so had "*no positive intention"* that a disputed parcel of land (plot 1428) should be excluded from the sale. See the test as described by Brightman J[110]*:*

> *"… I must be satisfied that it was not the intention [of either party] that 1428 should be included in the contract. It is not sufficient that there should be convincing proof that the written contract did not represent the true intention of the parties. I must also be satisfied that there was a common intention, and I emphasise a common intention, of [the parties] that 1428 should be excluded."*

125. Leggatt LJ in *FSHC* at [74] identified *Lloyd* as an illustration of how a claim for rectification can fail at the first hurdle "*for want of proof that the written contract was contrary to the actual intentions of the parties".* He went on at [84] to distinguish this requirement from the test for implied terms, citing from a decision of the High Court of Australia: "*The difference is that with rectification the term which has been omitted and should have been included was actually agreed upon; with implication the term is one which it is presumed the parties would have agreed upon had they turned their minds to it – it is not a term that they have actually agreed upon."*

126. Similarly, in *Olympia Sauna Shipping Co v Shinwa Kaiun Kaisha Ltd (The "Ypatia Halcoussi")*[111], a settlement agreement was not rectified so as to include the deduction of an overlooked balance in favour of the defendants because "*The defendants themselves, having unhappily forgotten all about the $74,000 balance,*

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[108] See eg *FSHC* at [149].
[109] [1971] 1 WLR 535 at 544.
[110] At p 543.
[111] [1985] 2 Lloyd's Rep 364 at 370.

had no intention in regard to it at any relevant time before the compromise agreement."

127. A further example is the decision of Rimer J in *Lansing Linde Ltd v Alber*[112]. Changes were made to a pension deed to bring the retirement age for women to 65, the same as men, and to permit early retirement on reduced pension between 60 and 65. The changes had the effect, amongst other things, of granting benefits to those who had retired before 60 or 65 (so called "*deferreds*"). The claim for rectification was refused. The Judge found (at [135]) that, at the relevant trustees' meeting there had been no discussion or consideration of the position of the deferreds and (at [147]) that the trustees "*never positively resolved, and never positively intended, to change the position of the deferreds."* Yet, the amending deed (running to 160 pages) had included many amendments on which they had not had specific intentions. The Judge held (at [149]) that "*their intention was no more complicated than to sign a deed in the form produced to them, whatever it in fact provided, and knowing that in material respects it had gone beyond the limits of what had been resolved…"*

128. It also follows from the above, amongst other things, that it would not be enough merely to establish (if it could be established) that a solicitor had made an error in the drafting of a document. Rectification is not a safety net for error or negligence. An example of this is *Racal Group Services v Ashmore*[113]. A company intended to make charitable payments but these would carry fiscal benefits only if covenanted for more than 3 years. The solicitor miscalculated the dates. Rectification was sought of the covenant by substituting different, compliant dates but this was refused. As explained by Peter Gibson J[114], "*I am left in real doubt as to whether that was [the relevant individual's] specific intention. It seems to me probable that no thought was given to the precise dates of payment in each year."*

[112] [2000] Pens LR 15.
[113] [1995] STC 1151.
[114] At 1160.

129. The second element indicated in the passage from *Chitty* is that the court must be satisfied that the document in its rectified form would in fact accord with the parties' intentions. Rectification is not a licence to improve a document, it is the correction of a document to reflect a prior proven consensus. Accordingly, as per Bingham J in *The Ypatia Halcoussi*[115], "*it must be shown that the instrument, if rectified as claimed, would accurately represent the true agreement of the parties at that time.*"

130. Hence, as Denning LJ expressed it in *Frederick E Rose (London) Ltd v William H Pim Ltd*[116] (quoted with approval by Lord Hoffmann in *Chartbrook* at [60]): "*If you can predicate with certainty what their contract was, and that it is, by a common mistake, wrongly expressed in the document, then you can rectify the document; but nothing less will suffice.*" So, the common intention must be "*on terms which the Court can ascertain*".[117] In other words, "*it must be shown that the instrument, if rectified as claimed, would accurately represent the true agreement of the parties at that time*".[118] Even if a common intention mistake is shown, if it is not proven that the proposed replacement text was intended then rectification will not be granted.[119]

131. Indeed, in *Pearce v Stonechester*, it was found that the fact that a party advanced alternative and contradictory formulations of the common intention was itself fatal to a rectification claim, as it demonstrated that there was no real prospect of showing the necessary single clear and certain intention. This may be contrasted with the position in *Swainland*, where alternative versions of the rectification sought were seen as merely differing formulations to give effect to the same common intention. Nevertheless, the court must be satisfied that there is a common intention and that the document as rectified does reflect it.

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[115] At 370.
[116] [1953] 2 QB 450 at 461.
[117] *The Olympic Pride* at 73.
[118] Per Slade LJ in *Agip SpA v Navigazione Alta Italia SpA (The Nai Genova)* [1984] 1 Lloyd's Rep 353 at 359.
[119] E.g. *Allnutt v Wilding* [2007] EWCA Civ 412 per Carnwath LJ at [26].

G.6 Outward expression of accord

132. As one of the basic requirements set out in *Swainland*, there must be an outward expression of the relevant actual mutual intention. In *FSHC*, this was confirmed as an independent requirement, operating alongside but in addition to the subjective test. This is because, per Leggatt LJ in *FSHC* at [73]:

> *"it is not sufficient for rectification to prove that each party privately and independently had the same intention as the other with regard to a particular provision of their contract. There can be no common intention of a kind with which the written contract can justifiably be made to conform if the relevant intentions remained "locked separately in the breast of each party" without being communicated by each party to the other".*

133. As Leggatt LJ further explained (at [77]), the establishment of new contractual rights and obligations could only be justified if founded on mutual agreement. Hence, it was fundamental that contractual rights and obligations should be based on "*mutual assent which the parties have manifested to each other and not on uncommunicated intentions which happen, without the parties knowing it, to coincide*". The position is to be contrasted with pensions cases, which are not contracts and depend upon consent of one party to the exercise of a power by the other party and not upon agreement ([76] and [78-9]). Importantly, Leggatt LJ expressly rejected the contention that the outward expression of accord was only evidential [75-77]. A mere co-incidence of intention is not the same as a mutuality of intention sufficient to establish a claim to rectification.

134. The requirement of an outward expression of accord also aids the achievement of certainty. Were there no requirement of an outward expression of accord, "*there could be no certainty in all business transactions if a party who had entered into a firm contract could afterwards turn round and claim to have it rectified on the ground that the parties intended something different*".[120]

[120] *Rose v Pim* at 462; *T&N Ltd v RSA plc* at [134].

135. Arden LJ explained this in *Ahmad v Secret Garden (Cheshire) Ltd*[121]:

> *"The evidence must meet the requirement for the outward expression of accord. This stems from the law's concern that parties should not be able to disassociate themselves from their agreement simply because it has become commercially undesirable. They have to show clear evidence of a consensus on some issue which the executed and unrectified agreement does not reflect. The agreement has to be objectively ascertained by reference to what they both did and said, and not to what each of them may privately have thought."*

136. The requirement of an outward expression of accord does not mean that, in every case, there has to be express communication of the relevant intention. Leggatt LJ in *FSHC* at [87] approved the observation in *Chitty* at [5-117] that an accord "*may include understandings that are so obvious as to go without saying, or that were reached without being spelled out in so many words."* But this was with the *caveat* that the court is concerned with "*what the parties actually communicated to each other, and not with identifying their presumed intentions by means of an officious bystander test*".

137. Ultimately, the satisfaction of this requirement is a matter of degree. Especially when dealing with amendments, there may be cases where the fact that a particular change is not included in discussions can be regarded as an outward expression of a mutually and actually held intention not to make that change. But, as against the powerful evidence of the written document, the court would need to be clearly satisfied that the failure to discuss a matter constituted an outward expression, not of an absence of relevant intention (which would be insufficient), but of the presence of a positive intention not to make the change. It is only in the clearest and most obvious of cases that such a case could be established.

138. The decision in *FSHC* deserves consideration in this respect. There the parties intended that a company ('the Parent') provide as security to Barclays the benefit of a shareholder loan, which security should have been provided under an obligation in an intercreditor agreement four years previously (see [4]) but had been missed. It

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[121] [2013] EWCA Civ 1005 at [43].

was decided that the best way to provide the security was by accession deeds to IRSAs [23], existing agreements by which companies assigned the benefits under various obligations to Barclays as security [17]. The deeds were signed by a director of the Parent [28]. As well as assigning the rights by way of security, which was all the Parent needed to do [33], the deeds also had the consequence of making the Parent liable under various additional obligations which had never been intended for it and which it would never knowingly have assumed. The additional obligations were, from the perspective of the Parent, commercially absurd [35] and involved giving as security the Santander assets, which was something the parties had expressly considered and not agreed [35].[122] The inclusion of these obligations had not been noticed by anyone [3] including the three lawyers involved [40] to [41]. None of them had reviewed the additional obligations [40] and [182].

139. The Judge found that, on the facts of the case, the parties did have the actual intention to "*do no more*" "or *less*" than provide the third party security [42] to [44], [177]. This was a finding on the evidence, having heard from all of the main witnesses involved, and there being specific discussed commercial reasons why the additional security was not intended. He also found that the relevant individuals at Barclays had derived their understanding from communications on behalf of the Parent [177]. There was therefore a sufficient outward evidence of accord to satisfy the requirement of mutual common intention, and so the claim in rectification was upheld on the basis of the (correct) subjective test. Leggatt LJ then went on to consider the objective test also applied by the Judge and concluded that the findings were supportable on this basis. This was because there was a specific single and only purpose to the accession deeds- filling the previously identified missing piece in the security [187]-[189], because the additional obligations were absurd [35] and [190], and because had additional obligations been intended there would have been discussion of them and the silence on that '*spoke louder than words'* [191]-[192]. Leggatt LJ observed that these factors also strongly supported the Judge's conclusions as to what the parties actually intended and understood each

[122] And this is made clearer in Carr J's judgment at first instance [2018] EWHC 1558 (Ch) at [172].

other to intend [183]. It will accordingly be seen that the facts in *FSHC* were extreme and that the answer (once the evidence had been thrashed out) was clear and obvious.

G.7 The nature of the relevant mistake

140. As per *Chitty* [3-059]:

> *"Rectification may be ordered where the document did not record correctly what the parties had agreed, or where the legal effect of the words used was not what the parties had agreed on: for example, if the document states that £x is to be paid "free of tax" when what was meant was that the payment would be of such sum that after deduction of tax would amount to £x. In contrast, rectification is not possible if the parties were merely mistaken over the consequences of their agreement, for example for tax purposes, any more than it is when the mistake is not over the terms the parties had agreed but the factual circumstances."*

141. The most obvious type of relevant mistake is a mistake as to words, either where particular words used in the contract were not intended to be included, or where intended words were omitted. [123] More complex, though still potentially relevant, is a mistake as to meaning or legal effect: where the parties specifically intend to contract on the terms which are contained in the document but are mistaken as to what those terms (objectively) mean or do.[124]

142. However, rectification is not available in cases of a mistake as to the commercial consequences of or advantages to be gained by the words used.[125] That is not a mistake as to the meaning of the document. Nor is it available where the mistake is as to the reasons for agreeing the words used.[126] This is because rectification "*does not empower the court to change the substance of that transaction or to correct an error in the transaction itself*"[127] as "*Rectification does not mend bargains; it mends*

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[123] Hodge at [4-62].
[124] Hodge at [4-62].
[125] Hodge at [4-68 to 70], *AMP (UK) plc v Barker* [2001] Pens LR 77 at [70], *FSHC* at [179] to [182].
[126] *FSHC* at [179].
[127] *Ashcroft v Barnsdale* [2010] EWHC 1948 (Ch) at [15].

the expression of bargains"[128]. Rectification can put right a mistake as to the document recording a transaction but not a mistake as to the transaction.[129]

143. This distinction can be seen in the cases:

(a) In *Allnutt v Wilding*[130] a discretionary settlement failed to achieve an exemption status that would have reduced inheritance tax in respect of a transfer of funds. Rectification was sought to turn the settlement into an interest in possession settlement, so as to achieve the tax benefit. Mummery LJ (with whom the rest of the Court of Appeal agreed) held that the mistake made was in believing that the trusts declared meant that a subsequent transfer would qualify for the exemption and so result in tax savings, i.e. a mistake (induced by wrong and apparently negligent advice) as to the fiscal consequences of the trust.[131] There was no mistake in recording the settlor's intentions, only in the consequences that the settlement would have.[132] Rectification was refused. At [6], Mummery LJ cited a passage from the judgment of Millett J in *Gibbon v Mitchell*[133] (in respect of voluntary settlements):

"It will be set aside for mistake whether the mistake is a mistake of law or of fact, so long as the mistake is as to the effect of the transaction itself and not merely as to its consequences or the advantages to be gained by entering into it."

(b) In *Oun v Ahmad*[134], per Morgan J: "*… the court can order rectification where the relevant mistake is as to the meaning or effect of the words used in the instrument and, indeed, as to the legal effect of the instrument as a whole"* (at [48])*. "But rectification is not available when*

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[128] *Cherry Tree Investments Ltd v Landmain Ltd* per Lewison LJ at [134].
[129] *The Olympic Pride* at 72.
[130] [2007] EWCA Civ 412.
[131] At [19] to [20].
[132] At [19].
[133] [1990] 1 WLR 1304 at 1309. As Millett J confirmed at 1307, this was not in fact a case of rectification but of mistake. Nevertheless, it is clear that the reference to mistake as to "*effect*" means a mistake as to legal effect: see 1310. See also *Wolff v Wolff* [2004] EWHC 2110 (Ch) at [26].
[134] [2008] EWHC 545 (Ch).

the parties have executed the document they intended to execute and the mistake is as to the legal consequences of that document" at [51]).

(c) *Pitt v Holt*[135]*, per* Lord Walker: *"Rectification is a closely guarded remedy, strictly limited to some clearly-established disparity between the words of a legal document, and the intentions of the parties to it. It is not concerned with consequences."*

(d) In *AMP (UK) plc v Barker*[136], Lawrence Collins J described a policy of keeping equitable relief within reasonable bounds, by ensuring that rectification is not used "*simply when parties are mistaken about the commercial effect of their transactions or have second thoughts about them*." The cases established "*that relief may be available if there is a mistake as to law or the legal consequences of an agreement or settlement…"*

(e) In *FSHC,* the mistake was as to the legal effect of the accession deed (namely the assumption of the additional liabilities) rather than as to their commercial consequences (at [182]).

G.8 Attribution

144. Where, as in the present case, the parties to the document are corporate entities, care must be taken to identify the human agents whose knowledge and intention are for these purposes to be attributed to those entities.

145. In *Murray Holdings Ltd v Oscatello Investments Ltd*[137]*,* Mann J summarised the principles applicable in the rectification context as follows at [198]:

"(a) One is looking for the person who in reality is the decision maker in the transaction in order to find intentions in relation to rectification.

[135] [2013] 2 AC 108 at [131].
[136] [2001] Pens LR 77 at [70].
[137] [2018] EWHC 162 (Ch).

(b) In the case of the company that person will usually be the person with authority to bind the company.

(c) Someone who is not a person with power to bind can nonetheless be treated as the decision maker if that is the reality on the facts.

(d) The intention of a "mere negotiator" may be relevant if it is shared with the actual decision maker; but, as it seems to me, that is because the intention has become that of the actual decision maker.

(e) Where a person who would normally be expected to be the decision maker (such as the board of a company) leaves it to a negotiator to negotiate a deal and produce a contract by instructing solicitors, on the understanding that the decision maker would do a deal on those terms, then the negotiator's intention is the relevant one, either because that person is the decision maker, or, if that description is not apt, because the technical decision maker has simply adopted the intentions of the negotiator…"

146. Accepting, therefore, that the search is for the actual or real decision maker, the first step is to identify the persons with authority to bind the company. These will normally constitute the decision makers and the sole question is as to their intentions (which may of course have been informed by others). The only contrary example given by Mann J arises where the person with authority in effect delegates that authority to another by an arrangement or understanding that he will approve whatever is arranged. In that event, the relevant intention is that of the arranger or negotiator (either by a form of implicit adoption or because he is in reality the decision maker).

147. These questions are by their nature highly fact sensitive and would need to be established on the evidence. For example, as Peter Gibson LJ observed in *Wimpey UK Ltd v VI Construction Ltd*[138], "*The fact that the contract has been negotiated by a person who is not the decision-taker and has made an error is irrelevant unless it can be shown that the decision-taker shares the intention of the negotiator; but that requires evidence*".

[138] [2005] EWCA Civ 77 at [48].

148. The dividing line between negotiators and decision makers was explored in *Murray*. On one side of the transaction were the trustees of the Tchenguiz Discretionary Trust and its corporate vehicle, Oscatello. It was alleged that that the real decision maker was Mr Brown, who negotiated the transaction. Mann J found that Mr Brown was "*certainly a driving force*" and that "*it was always likely that his recommendations would be accepted*" [216]. That was because it was his job to "*come up with commercial arrangements*" [216]. However, this did not mean "*that the trustees… were not the real decision makers*" [216]. On the contrary, the trustee officer "*was not effectively committed to doing what Mr Brown negotiated, even though it was always likely she would*." Accordingly, Mr Brown's mistake was not attributed to the trustees (although, as the trustee officer had the relevant intention herself, this did not adversely affect the rectification case).

149. The threshold for attribution to one who is not the formal decision maker is therefore high. This was satisfied on the other side of the transaction in *Murray*. Isis had directors provided by a corporate services provider [67]. They took no part in the conduct of the actual business of Isis [67], were not consulted before or during the negotiation and did not consider the desirability of the contract, nor did they have the expertise to do so [203]. Their role was a "*compliance*" role [203] "*to check the technical correctness of documents that were put before her and make sure there was nothing obviously wrong about them*" [190] and [202(d)]. For Isis, Mr Gunnarsson the negotiator was the "*real decision maker"* even though he lacked technical authority.

150. This echoed the findings in *Hawksford Trustees Jersey Ltd v Stella Global UK Ltd*[139] (which was considered in *Murray*). There a Jersey professional corporate trustee entered into an SPA negotiated by the principal trust beneficiary, Mr Begg. As Patten LJ (with whom the rest of the Court of Appeal agreed) held,

> *"In a corporation with a defined and well-understood decision-making structure the division of responsibility should be readily apparent at least if prescribed*

[139] [2012] EWCA Civ 55 at [41].

procedures are followed. But this is not a case of this kind. Although the trustee alone by its officers had the power to enter into the SPA and Amended SPA, it is clear from the judge's findings of fact that this decision was largely a formality provided that the terms of the sale were acceptable to Mr Begg."

151. Thus there were factual findings in *Hawksford* that the trustees gave no thought to the relevant definitions and were not privy to what the provisions were intended to achieve, and "*In practice this meant (as the judge records in paragraph 122) that Hawksford would follow Mr Begg's recommendations if he was happy to enter into the SPA on the terms he had negotiated*" [42]. Accordingly, even if Mr Begg was not the decision maker, his mistaken assumption was "*shared*" with Hawksford [43][140].

152. The facts in *Hawksford* were exceptional and the trustees' role was an entirely passive one. This would not be replicated in a properly run commercial organisation, where the directors would be required to comply with their own duties to the company in making relevant decisions. *Hawksford* may be contrasted by those in *Mayor and Burgesses of Barnet v Barnet Football Club Holdings Ltd*[141], where the intention of the negotiator was held to be immaterial, absent any suggestion that it had been actively shared with the actual decision makers, and in *Wimpey*, where, again, the negotiator was not the decision maker. In these cases, the decision makers did not take a passive role.

153. In these cases, the court also highlighted the difficulties in advancing an attribution case without sufficient evidence from those who had the authority to bind the company. As for *Barnet* ([at 48]):

"… there the negotiator for the Borough made an error in the drafting of the contract, but he was not the decision taker; those who took the decision for the Borough were not called to give evidence and it could not be inferred that they intended the Borough to contract other than in the form of the contract which the Borough executed."

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[140] Note that the trial Judge ([2011] EWHC 503 (Ch)) received evidence from Mr Begg to the effect (at [38]) that "*everyone understood that he was the decision maker*" and from Mr Robinson, a director of the trust company, (at [42]) that Mr Begg "*was the effective decision maker for the Trustee in agreeing the terms of the SPA and the amended SPA."*

[141] [2004] EWCA Civ 1191.

And, equally, in respect of *Wimpey* (at [49-50]):

> *"There is no evidence of what the decision takers themselves, the members of the board, thought. There are no minutes of any board meeting nor any instructions to the signatory of the contract, Mr Hewitt, who gave no evidence… Without further evidence I do not see how one can escape the conclusion that the board, which was supplied with the draft contract… , intended to approve the contract in the form in which it was put to the board and in which it was executed" (see also Blackburne J at [82-4]).*

154. Further questions may arise in claims for rectification of agreements made within corporate groups, where there is not in any substantive sense a "*negotiator",* rather one (or more) instigators within a centralised management structure. Where such an instigator prepares a transaction for presentation to and approval by separate companies within the group, could it ever realistically be said that the instigator is the decision maker? This would seem unlikely, at least if the group is properly run, because it would be for each company to make its own decision in its own interests. Such decisions could only be taken by the separate directors.

G.9 Discretion

155. As a species of equitable relief, the remedy of rectification lies ultimately in the discretion of the court[142].

H THE FACTS OF THE PRESENT CASE

156. The facts relevant to rectification are addressed under the following headings:

    (i) The case advanced by SLP3.

    (ii) The central facts and evidence.

    (iii) Analysis.

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[142] *Chitty* [3-093]. See also e.g. *Daventry* at [223], *Ahmad v Secret Garden* at [32].

(iv) Discretionary factors.

H.1 The case advanced by SLP3

157. Given the stringency of the requirements for rectification, as well as the evident importance of precision, it is regrettable that the court is being presented with a claim for rectification by way of position paper/skeleton argument rather than through the discipline of a pleading. The result is a case which is intrinsically vague. But this should not be permitted to facilitate a case which vacillates.

158. SLP3's claim is for rectification on the grounds of mutual mistake. The claim is made in the alternative, and only in the event that SLP3's case on interpretation fails. The premise is that (i) in their unamended form the LBHI2 Sub-Notes ranked *pari passu* with the LBHI2 Sub-Debt; but (ii) the consequence of the amendments is to rank the LBHI2 Sub-Notes behind the LBHI2 Sub-Debt.

159. The rectification which SLP3 claims gives effect to the parties' mutual intention involves the blanket deletion of every part of the amendments to clause 3(a) of the LBHI2 Sub-Notes, other than the words "*and interest (including Arrears of Interest as defined below)"* in the 5th line. This is the deletion of around 30 lines of text, a significant substantive change.

160. In SLP3's initial Position Paper, the case for rectification is as follows:

160.1. There was a common and continuing intention that the amendments "*should do no more and no less*" than enable LBHI2 to defer interest and so, if they changed priority, this was a mistake [30(1)] [A/5/77].

160.2. The "*relevant centralised decision makers*" did not discuss changing the ranking of the LBHI2 Sub-Notes. It was not the parties' common intention for the amendments to have such legal effect [30(2)] [A/5/77].

160.3. A&O were not instructed to alter ranking and did not intend to do so [30(3)] [A/5/77].

161. In its Reply Position Paper, SLP3 elaborates on its case in the following respects, so far as material:

161.1. It intends to rely on evidence from A&O (albeit, as understood, for the purpose of demonstrating the scope of the instructions given to A&O) [56] [A/10/204].

161.2. It was the common intention of SLP3 and LBHI2 that the amendments "*would do no more*" than permit the deferral of interest [57] [A/10/204-206].

161.3. SLP3's intention is said to be that of Ms Dolby and/or Ms McMorrow, as the relevant decision makers, alternatively the Board of LBDI, which in approving the amendments "*gave effect to the intentions of Ms Dolby and/or Ms McMorrow"* [57(1)] [A/10/204-205].

161.4. LBHI2's intention is also said to be that of Ms Dolby and/or Ms McMorrow, as the relevant decision makers. Alternatively, the Board of LBHI2, which in approving the amendments "*gave effect to the intentions of Ms Dolby and/or Ms McMorrow"* [57(2)] [A/10/205].

161.5. No consideration was given to making the LBHI2 Sub-Debt senior to the LBHI2 Sub-Notes [57(3)] [A/10/205-206].

161.6. There was an outward expression of accord by emails dated 10 June 2008 commenting on the first draft of the amendments [57(4)] [A/10/206].

161.7. Alternatively, and by analogy with pensions cases, there need be no outward expression of accord as the same intention converged [57(5)] [A/10/206]. This submission must be rejected after *FSHC* and is not considered further here.

H.2 The central facts and evidence

162. The evidence before the court comprises the available documentary record (from within Lehman and A&O) together with some witness evidence. The only live witnesses who deal directly with the amendments are Ms Dolby and Mr Grant. The

hearsay notices served by SLP3 cover the interviews of a number of Lehman officers, including Mr Rush, one of the directors of LBHI2, but (other than the interview of Ms Dolby in April 2019) none of these is concerned with the 2008 Amendments.

163. The narrative of events, as revealed in the documentary record and the written witness evidence, may be shortly stated:

163.1. The trigger for the 2008 Amendments was a perceived tax benefit to be achieved by the deferral of interest payments on the LBHI2 Sub-Notes[143].

163.2. As Head of European Corporate Tax and Planning, Ms Dolby co-ordinated the project, with assistance from Ms McMorrow, Ms Dave and Mr Bowen[144].

163.3. On 2 June 2008, Ms McMorrow asked Mr Fletcher of A&O whether it would be possible just to sign a waiver letter without making any amendments [F5/2575]. Whatever the answer to this question (presumably in the negative) A&O were then instructed by Ms McMorrow to amend the LBHI2 Sub-Notes (albeit that there is no document of instruction as such)[145].

163.4. On 5 June 2008, Mr Grant sent a first draft set of amendments to Ms McMorrow [F5/2607-2619]. These were of a limited nature, principally the introduction of a new clause 4(f). Mr Grant indicated that he would have the amendments "*blessed*" by Mr Dehal of A&O. He also sent a form of certificate [F5/2618-2619].

163.5. On 10 June 2008, Ms McMorrow told Mr Grant that Lehman had no comments on the draft, other than a point about the relevant party on the certificate [F5/2676].

163.6. On 12 June 2008 (and apparently following internal discussions within A&O), Mr Grant sent a second draft set of amendments to Ms Dolby, Ms Dave, Ms

[143] Dolby WS at [56] [C/3/40].
[144] Dolby WS at [60] [C/3/41].
[145] Dolby WS at [61] [C/3].

McMorrow and others [F5/2839-2877]. These comprised wider amendments, including substantial additions to cl 3(a) under the heading "Status and Subordination". Mr Grant stated in his covering email:

"Deferral provisions introduce tax sensitivities. The amendments are designed to ensure these sensitivities are met."

In a separate email [F5/2819-2831], he also sent draft board minutes.

163.7. Ms Dolby replied on the same date [F5/2967] , "*we will discuss internally and come back to you."*

163.8. There was then a period of delay, during which consent was sought and obtained from the FSA.

163.9. As part of this process, on 23 June 2008 [F6/3060] Ms Dolby sent the amendments and related documents to Claire Edwards, the former lead supervisor at the FSA on the team that looked after Lehman and who had become a compliance officer[146]. Ms Edwards replied on 10 July 2008 [F6/3117] that she had "*gone through*" the documents and was satisfied that GENPRU was being complied with "*as long as we have the confirmation that the deferral of the payment of interest does not effect [sic] the eligibility of the notes to be included in Lower Tier 2."*

163.10. Once the FSA had consented, Mr Grant raised a further query about the accounting treatment of the LBHI2 Sub-Notes, specifically whether there was a risk that they might be equity accounted. This was examined within Lehman by Claire Homer, who reported on 28 August 2008 [F6/3344] that the Sub-Notes were debt. In this email, sent to Ms Dolby and others, she expressly noted the subordination provisions in the amendments: "*The Notes are intended to have a right to a return of assets in the winding up or dissolution of the Issuer in priority to the rights of the holders of any securities of the*

[146] Hutcherson transcript [C/19/259-60].

Issuer which qualify as Upper Tier 2 Capital or Tier 1 Capital. The Notes are only junior to Senior Creditors."

163.11. The amendments were effected on 3 September 2008 through the following documents:

(a) Written Resolution of LBHI2 to amend the LBHI2 Sub-Notes and assented to by SLP3 [E/5]. The Resolution was signed by Ms Upton on behalf of SLP3 and countersigned by Mr Rush on behalf of LBHI2.

(b) Minutes of a meeting of the Board of LBHI2, attended by Mr Rush and Mr Jameson and signed by Mr Rush, resolving to approve the Written Resolution [F6/3325-3337].

(c) Certificate of LBHI2 signed by Mr Rush [F6/3499].

(d) Electronic consent of the Board of LBDI, as sole general partner of SLP2, which in turn was the sole general partner of SLP3, resolving to approve the Written Resolution. This consent was signed by Mr Triolo [F6/3503].

163.12. The final version of the LBHI2 Sub-Notes, as amended, was in substantially the same form as the second draft sent on 12 June 2008, though with an additional amendment (at clause 12(b)) dispensing with the need for FSA consent to further amendments [E/5/10].

163.13. On 3 September 2008, the amended terms and conditions were provided to the Channel Islands Stock Exchange, on which the LBHI2 Sub-Notes were listed [F6/3487-3502].

H.3 Analysis

164. Given both the absence of a pleading and the sensitivity of any rectification claim to the oral evidence of relevant witnesses (if any), the analysis at this stage is necessarily truncated. However, as it appears to PLC, the following considerations are likely to frame the consideration of this claim.

165. The amendments comprised alterations to a $6bn Sub-Note instrument. They were the subject of careful drafting by an expert firm of solicitors and of review, both within the firm and by experienced bank officers at Lehman. This is therefore a case where the presumption that the parties' intentions are properly reflected in the agreement to which they assented is especially strong.

166. Furthermore, it is relevant at the outset to have regard to the nature and scale of the rectification which is sought. SLP3 is correct to say[147] that there is no *theoretical* limit to the scope of the remedy of rectification. Nevertheless, the scale of the remedy reflects the ambition of the claim. SLP3's case is (or at least has to be) that virtually the entirety of the amendments to Clause 3 was a mistake and indeed was contrary to the parties' intentions. If correct, that is not a matter that could have been easily overlooked. Instead, it would be a damning indictment of both A&O and Lehman, as drafting and/or approving 30 lines of amendment in a $6bn Note without realising that everything in them was directly inconsistent with (in the case of Lehman) their allegedly shared common intention and (in the case of A&O) the ambit of their instructions. Such a proposition is so inherently improbable that it would require a particularly convincing case to sustain it. Yet the evidence lends no support to such an extreme outcome.

167. To consider the claim to rectification, it is first necessary to identify the person or persons whose intentions are to be attributed to the relevant corporate entities, LBHI2 and SLP3. As to this, the obvious decision makers for LBHI2 were Mr Rush and Mr Jameson as the directors of the company, who approved the Written Resolution. The decision makers for SLP3 were either the Board of LBDI who approved the Electronic Consent or Ms Upton, who signed the Written Resolution on SLP3's behalf.

168. It is not suggested by SLP3 that these individuals did not properly exercise their duties owed to their respective companies or played a passive role. Mr Rush, in particular, was the Head of International Tax in the UK and Ms Dolby's superior,

[147] LBHI/SLP3 Reply Position Paper [53(1)] [A/10/202].

who was told of and discussed the tax objectives behind the transactions that he approved[148]. There is no evidence that the decision making structure had collapsed or that, as in *Hawksford*, it was simply an unthinking formality. That would amount to a further serious criticism of the conduct of the directors, and, properly, no such criticism is made. In fact, the corporate governance process is explained by Ms Dolby[149] in terms which confirm the integrity of that process. These were not passive decision makers who abdicated responsibility.

169. There is therefore an immediate, and it would appear insuperable, difficulty with the claim for rectification in that none of the decision makers is giving oral evidence and so the court will be deprived of any understanding of their actual subjective intent, in circumstances in which it is their intent (and theirs alone) that is determinative. There is, as mentioned above, a hearsay notice in respect of a prior interview of Mr Rush [C/12 and C/15], but he was not asked about the amendments. There is accordingly nothing by way of primary evidence (let alone convincing proof) to displace the presumption. Nor is there any outward expression of accord between the decision makers (save for the terms of the amendment itself).

170. In short, the court is being asked to make an order for rectification in the absence of every single one of the obviously critical witnesses who made the operative decisions. In such circumstances, adverse inferences are appropriate. But even without such inferences, the evidential gaps cannot be filled. This is unsurprising in a belated claim for rectification of an instrument 11 years after its execution. One of several likely obstacles to such an endeavour, as here, is the paucity of evidence in support of the claim. The court's role in such a case is not to guess at what the evidence might have been. Nor is it to try to fill the gaps by examining and then transposing the intentions of some other person, just because they happen to be giving evidence. If sufficient relevant evidence from the actual decision makers is not before the court, the claim for rectification must fail.

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[148] Dolby WS at [14] and [71]-[72] [C/3/43 and 43].
[149] Dolby WS at [69-72] [C/3/43-44].

171. Because it does not have the evidence from the authorised decision makers, SLP3 contended in its Position Papers that the true decision makers were Ms Dolby and Ms McMorrow. If this is still pursued, it is itself a problematic position, given that there is no evidence from Ms McMorrow either (she worked in Lehman's legal department and was accordingly the key point of contact with A&O on the amendment[150]). So SLP3 would be seeking rectification without any evidence from (on its case) one of the only two decision makers. Even if it were right, such a case would therefore be evidentially deficient.

172. It may well be, however, that such a case is no longer pursued:

172.1. As above, it is not contended (and there would be no evidence to support the contention) that the authorised decision makers played a passive role. SLP3 cannot simply assert that someone else should be treated as the decision maker, without evidence to explain why this should be so.

172.2. Furthermore, such a case would be directly contrary to the evidence, including the evidence which SLP3 is itself adducing. In her 2 July 2013 interview p 39/7-9 [C/14/171], Ms Dolby describes her role as a member of "*back office*" staff. Whilst her expertise was in tax, proposals would also have to be considered by other officers from the regulatory, compliance, legal and treasury departments. Further, when she was specifically asked at interview on 9 April 2019 whether she was a decision maker, her answer was unambiguous (see p24/23-25 [C/21/287]):

"No, I wouldn't make the ultimate decisions. If I had a project that I was working on that involved Lehman entities, I'd present it to management and they would make the ultimate decision."

(and at p 26/23-26 [C/21/289]):

"Q Moving on to the 2008 amendments, now…did you make any decisions for or on behalf of LBHI2, SLP3 or Delaware to enter into the 2008 amendments?

[150] Dolby WS at [39] and [60]-[61] [C/3/37 and 41].

A No."

173. Given the absence of evidence from Ms McMorrow (or any of the authorised decision makers) and the clarity of contrary evidence from Ms Dolby, PLC assumes that SLP3 will no longer pursue the case contended for in its Positions Papers that these were the decision makers. If, however, it does, that case is hopeless.

174. The alternative formulation by SLP3 in its Position Papers is that, assuming that the Boards were the decision makers, it is enough that they "*gave effect to the intentions*" of Ms Dolby and Ms McMorrow. This would appear to be an attempt to bring the present facts within the analysis in *Hawksford*, at least by the use of the same words. However, as explained above, the facts in *Hawksford* were exceptional, in that the court found, having heard the evidence of both a trust company director and the beneficiary, that the trustee simply implemented the terms negotiated by the beneficiary. If SLP3 intends to contend that there is a general principle that, for the purpose of a claim in rectification, a corporate entity "*gives effect*" to the intentions of an appointed negotiator, then that is legally unsound. If, on the other hand, the submission is that the facts of this case are sufficiently exceptional to merit such a conclusion, then this fails because there are no facts which can support it.

175. Even if, contrary to the above, the intentions of Ms Dolby and Ms McMorrow were on some basis considered relevant to the claim for rectification, this would be of no obvious assistance to SLP3 in any event. The submission[151] that there was a common intention that the amendments "*should do no more and no less than enable LBHI2 to defer interest on the LBHI2 Sub-Notes"* is linguistically equivocal and inadequate to support the claim in rectification on the facts:

    175.1. It is accepted, as above, that the trigger for the amendments was to achieve a tax benefit by facilitating the deferral of interest.

[151] For example at LBHI/SLP3 Position Paper [30(1)] [A/5/77].

175.2. The first draft of the amendments supplied by Mr Grant on 5/6/08 responded to this trigger by enabling the deferral of interest through the addition of a new clause 4(f) [F5/2607-2617].

175.3. The second draft supplied by Mr Grant on 12/6/08 contained a raft of separate amendments to clause 3 which were unconnected with the deferral of interest [F5/2839-2877]. These amendments addressed two different issues: (a) the removal of the solvency condition on a winding up in order to solve a tax problem arising on the original form of the Sub-Notes identified by Mr Grant's colleague, Mr Dehal; and (b) the insertion of detailed wording regulating the ranking of the Sub-Notes for the purpose of ensuring that, notwithstanding the removal of the solvency condition, the Sub-Notes were subordinated and hence continued to qualify as Lower Tier 2 regulatory capital. These amendments were said by A&O to be necessary to address "*tax sensitivities"* [F5/2839].

175.4. Ms Dolby's evidence is that it is likely that she would have reviewed the amendments at the time and would have approved them[152]. As above, the amendments were also reviewed by (at least) Ms Edwards and Ms Homer[153], both of whom reported back to Ms Dolby. None of them raised any queries about A&O's drafting, or about the fact that the clause 3 amendments went beyond the deferral of interest. The proper conclusion is that (to the extent that Ms Dolby was a decision maker or her intention is otherwise relevant) her intention was to approve all of the amendments drafted by A&O, including all amendments drafted to meet the "*tax sensitivities*" which Mr Grant mentioned, provided of course the Sub-Notes remained GENPRU compliant[154].

175.5. In such circumstances, it will be seen why the bald statement that the intention was to defer interest "*and no more"* is both ambiguous and,

[152] Dolby WS at [64] [C/3/42].
[153] It would also have been looked at by Lehman legal: Dolby WS [65] [C/3/42].
[154] See also Dolby WS at [65] [C/3/42].

ultimately, irrelevant. It is ambiguous because it may well be the case that the deferral of interest was the only change that Ms Dolby consciously desired. But that does not mean that she intended that the amendments should do nothing but defer the interest. She was prepared to accept all of the changes that A&O proposed, including those changes which did more than defer interest. This is why the submission is also irrelevant. It will often (and perhaps always) be the case that a client has no active desire or indeed understanding as to every clause in a contract drafted by its lawyers. But the mere fact that, as with Ms Dolby, the client is content not to second guess the drafting cannot be a basis for rectification.

176. Relevant also in this respect is SLP3's first position paper[155] where it is contended that: "*The 2008 Amendments evince a clear intention that the LBHI2 Sub-Notes rank above the 'Notional Holders' (namely UT2 creditors), preference shares and the ordinary shares making up Tier 1 capital. The ranking of the LBHI2 Sub-Notes is thus described from the 'bottom up'".* PLC does not accept the characterisation of the amendments as '*bottom up*', if that is thought relevant, but what is important is that it is therefore SLP3's <u>own case</u> that there was an intention, indeed a "*clear*" intention, that the amendments should do more than merely enable the deferral of interest but should affect ranking. SLP3's case is accordingly internally inconsistent, with contradictory arguments advanced to suit different parts of its case.

177. And the further suggestion[156] that it was not the common intention of the parties that the amendments should have the legal effect of changing priority is both wrong and tellingly misconceived:

    177.1. It is wrong because, as above, the intention was that the document should effect such changes as had been drafted, including as to status and subordination.

[155] LBHI/SLP3 Position Paper [29(4)] [A/5/76].
[156] LBHI/SLP3 Position Paper [30(2)] [A/5/77].

177.2. It is misconceived because, as explained above, while rectification may be available where there is a common intention which is inconsistent with the executed document, it is not available merely because there was no common intention to achieve a particular outcome. It is the evidence of Ms Dolby and others that questions of priority between layers of subordinated debt on insolvency were never considered within Lehman[157]. As such, neither Ms Dolby nor anyone else could have had an actual formed intention that the amendments should not change the ranking between LBHI2 Sub-Debt and LBHI2 Sub-Notes in the event of insolvency.

177.3. The statement at SLP3's reply Position Paper[158] is accordingly revealingly incomplete. The rather contorted sentence, "*At no stage… was there any consideration by LBHI2, SLP3 and/or the relevant decision makers… as to making the LBHI2 Sub-Debt senior to the LBHI2 Sub-Notes…"* should more naturally read: "*At no stage did the relevant decision makers give any thought to the ranking of the Sub-Debt or Sub-Notes."* That is, in and of itself, fatal to the claim.

177.4. Given that the matter was not discussed or considered, the fact that A&O were not expressly instructed to change priority is inevitable but irrelevant. Equally, nothing is to be gained by an examination of what Ms Dolby or anyone else might or might not have assumed to be the position had it been raised with her. Speculation is not the province of rectification.

178. A still further difficulty is the absence of any outward expression of accord as regards any supposed intention. Even if that expression may be tacit, there must be something, and indeed something clear, upon which it is based. And this is not a case, such as *FSHC*, where a change in priority would have been "*commercially absurd*", such that, unless they said otherwise, it was blindingly obvious that the parties intended not to do it. On the contrary, Ms Dolby's evidence is that it is

[157] see e.g. Dolby WS at [66-68] [C/3/42-43] and 9 April 2019 interview pp 15/12-22 [C/21/278], 30/1-6 [C/21/293], 37/2-7 [C/21/300].
[158] LBHI/SLP3 Reply Position Paper [57(3)] [A/10/205-206].

"*difficult to say*" what she would have thought had she been told that the amendments affected the ranking on insolvency[159]. Indeed, the fact that (in 2006 and on exactly the same date as the issue of the LBHI2 Sub-Notes on 1 May 2007) Lehman was prepared to convert portions of LBIE sub-debt into preference shares (with a consequential effect on ranking) shows that there was no internal imperative that all subordinated capital should remain *pari passu*.

179. Nor can SLP3's case on this aspect be taken in isolation. It must be stitched together with the rest of its case. On the one hand its case is (or must be) that the supposed intention of all parties not to make any change to ranking was so obvious that it went without saying. Yet, on the other, it seeks to contend that A&O nevertheless drafted 30 lines of amendment on "status and subordination" without itself realising that, or any of a number of senior officers at Lehman even enquiring as to whether, such amendments might not match their mutual and continued and supposedly obvious intention.

180. In this respect also, it will be remembered that the only outward expression of accord identified by SLP3 is contained in exchanges on 10 June 2008[160]. This was in respect of the first draft, and so SLP3 points to nothing at all in respect of the second or indeed final draft (which contains all of the amendments that they seek to delete by rectification). That cannot amount to an outward expression of accord not to agree the changes made in those subsequent drafts.

181. Moving down the hierarchy one further notch, it is not suggested in the Position Papers that the intentions of A&O associate Mr Grant should, by some (unexplained) process, be attributed to the relevant decision makers, and rightly so. He was plainly not a decision maker himself, or even a negotiator, merely a draftsman. The only element of his own intentions that was shared with Ms Dolby and others was his comment that deferral provisions introduced tax sensitivities.

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[159] Dolby WS at [68] [C/3/42-43].
[160] LBHI/SLP3 Reply Position Paper [57(4)] [A/10/206].

And it follows that his evidence of what he and others at A&O were seeking to achieve is irrelevant.

182. However, even if Mr Grant's intentions could on some extenuated basis be so attributed to the Lehman decision makers, this would not improve the position on rectification. On the basis of what he has said so far, it is clear that (i) his "*bespoke solution*"[161] to what he says was a tax problem mentioned by Mr Dehal was intended to affect the ranking of the LBHI2 Sub-Notes; there could have been no other conceivable reason for it. Instead, the purpose of the amendments was to insert a different/replacement form of subordination provision, upon removal of the solvency condition; (ii) although not necessary for the analysis, it seems probable that Mr Grant consciously intended to place the subordination of the LBHI2 Sub-Notes below all other (non-Upper Tier 2) debt, as that is what his solution undoubtedly achieved; (iii) if not, his mistake, if that is the right term, arose from his apparent failure to appreciate (or to find out) that LBHI2 already had other subordinated debt (i.e. the LBHI2 Sub-Debt), which would therefore take priority over the new ranking given to the LBHI2 Sub-Notes. This was not a mistake as to the meaning of the amendments or their legal effect. The amendments accurately set the ranking of the LBHI2 Sub-Debt at the preference share level which was exactly what he intended. His was a mistake, at best, as to the factual consequences of his bespoke solution, because he had not taken the trouble to find out what those factual consequences were. That is not a basis for rectification, on any view. And nor in any event was it a mistake shared with or that could in some way be attributed to Ms Dolby (at least) who was well aware of the existence of the LBHI2 Sub-Debt.

183. Finally, reference has already been made to the scale of the rectification being sought. And as explained above, the court must be satisfied both as to the mutual mistake to support the claim and as to the efficacy of the rectified document to give proper effect to the true intentions of the parties. Even leaving aside all of the

[161] Grant WS [44] and [49] [C/2/24 and 26].

above submissions, and whatever view may properly be taken of the evidence, SLP3's case fails also at this final hurdle. Its claim to rectify clause 3 carries the submission that there was no purpose at all in the 30 lines that A&O drafted and the parties approved, and indeed that the whole extract conflicted with the parties' true and obvious though surprisingly unstated intentions. Such an extreme position cannot be supported and, indeed, it is inconsistent with SLP3's own case[162] that there was a clear intention to clarify that the LBHI2 Sub-Notes ranked above upper tier 2 creditors.

184. In conclusion, and far from presenting convincing proof, this claim for rectification evidences only wishful thinking. It must be rejected.

H.4 Discretionary factors

185. This is on any view an unusual claim for equitable relief. It was made for the first time in SLP3's first position paper, served on 11 January 2019. This was nearly 12 years after the LBHI2 Sub-Notes had been issued and 10 ½ years after both the amendments and the collapse of Lehman. No prior indication of such a claim had been intimated, even at the directions hearing before Mann J in July 2018.

186. It is accepted that delay, in and of itself, is not a ground to refuse equitable relief that is otherwise appropriate. In this case, the very long period of delay until the supposed mistake was identified serves more to underscore the reality that the ranking of subordinated debt was never an issue of relevance between the parties and not a matter on which there was any actual intention sufficient to support a case in rectification. And if and insofar as the length of time has led to a thinning of available evidence then that is, and is properly, a matter which enures to the detriment of SLP3.

187. Beyond that, PLC has a broader objection. The subordinated debt funding within Lehman was sophisticated and complex, involving high value commercial

[162] LBHI/SLP3 Position Paper [29(4)] [A/5/76].

instruments being used for carefully defined purposes for specific tax, accounting and regulatory advantages. There was a relevant audience, including regulators and tax authorities in the United Kingdom and abroad, who were intended to rely the documents in their executed form. That was the structure within which the amendments were made. Because of the Lehman collapse, the particular advantages which were intended did not materialise. The court is not now in a position to understand all of the specific purposes or advantages, in the UK and US, which were intended to be achieved, nor the delicate calibrations involved. It is unattractive for a party to come to court 11 years later and to seek to rip up a set of amendments simply because it does not like one of their consequences, when the full effect of the amendments and of the proposed rectification cannot sensibly be recreated. It may be that this is a further specific objection to the particular and broad rectification sought. Alternatively, it is a relevant factor in the court's discretion.

188. In addition, the LBHI2 Sub-Notes were deliberately made to be quoted Eurobonds listed on the Channel Islands Stock Exchange, a public stock exchange, in order to secure a tax benefit[163]. That exchange held a copy of the LBHI2 Sub-Notes and required a copy of the amendment[164]. Whatever the initial plan not to trade the LBHI2 Sub-Notes outside the Lehman group, that listing indicates an intention and acceptance that the LBHI2 Sub-Notes were publicly tradeable, and accordingly they might in the future be traded to and relied upon by third parties ignorant of any subjective mistake. SLP3 should not be allowed to now profess that the public listing was a fiction. SLP3 should not, years later, be granted rectification altering that wording.

ADRIAN BELTRAMI QC

ADAM KRAMER

3 Verulam Buildings

31 October 2019

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[163] Dolby WS at [37]-[38] [C/3/37].
[164] Grant WS at [67]-[69] [C/2/29-30].

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