Claim Nos CR–2008–000026 / CR-2009-000052

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
COMPANIES COURT (ChD)

IN THE MATTER OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)
AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN

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

Applicant

and

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

Respondents

IN THE MATTER OF LEHMAN BROTHERS HOLDINGS PLC (IN ADMINISTRATION)
AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN

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

Applicant

and

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

Respondents

SKELETON ARGUMENT ON BEHALF OF THE JOINT ADMINISTRATORS OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)
FOR THE TRIAL COMMENCING 11 NOVEMBER 2019 (READING DAYS: 7-8 NOVEMBER 2019)

Time estimate: pre-reading 2 days; hearing as per the draft trial timetable which has been largely agreed (subject to a small number of minor points) between the parties – it is thought that the minor points in dispute can be clarified/agreed as the hearing progress.

References to the trial bundles are in the form **[vol/tab/page]**.

The Court will find an agreed Statement of Facts, List of Definitions and Chronology at Section 3 of Bundle C. An agreed List of Persons is attached to this Skeleton Argument.

This Skeleton Argument adopts defined terms from the parties' agreed List of Definitions and position papers, unless otherwise stated.

Suggested pre-reading:

(a) Agreed Statement of Facts **[C/23/302-7]**, List of Definitions **[C/24/308-10]**, List of Persons (attached to this Skeleton Argument) and Chronology **[C/25/311-12]**
(b) The two application notices **[A/1-13]** and **[A/3/21-23]**
(c) Howell 2 **[A/2/4-20]** and Bruce 3 **[A/4/24-55]**
(d) The parties' skeleton arguments **[B]**
(e) The parties' position papers **[A/S-9/S6- 90]** and reply position paper of LBHI/SLP3 **[A/10]**
(f) The Order of Mann J dated 24th July 2018 **[A/11/216-225]**
(g) The Order of Hildyard J dated 31st July 2019 **[A/12/226-229]**
(h) The witness statements in Section 1 of Bundle C without exhibits
(i) LBHI2 anticipates that LBHI/SLP3 and Deutsche Bank may wish to rely on and/or draw the Court's attention to certain parts of the transcripts of interviews conducted with various Lehman personnel (in Section 2 of Bundle C; Hearsay Notice in respect of the transcripts is at **[C/12/145-7]**). LBHI2 suggests that any such passages identified in those parties' pre-reading lists should be pre-read but does not make any independent pre-reading suggestions in relation to the transcripts.
(j) Examples of core transactional documents:

NB: specific clauses within these documents on which the parties rely are identified in their position papers

1) One of the facility agreements dated 30 July 2004 which forms part of the PLC Sub-Debt **[E/6/81-93]**
2) The Offering Circular and Prospectus in relation to one series of the PLC Sub-Notes (dated 20 February 2006) at **[E/14/341-64]** and **[E/1S/36S-4S6]**
3) One of the facility agreements dated 1 November 2006 which forms part of the LBHI2 Sub-Debt **[E/1/1-1S]**

4) The LBHI2 Sub-Notes (original Offering Circular dated 26 April 2007 [E/4/50-69] and as amended by resolution on 3 September 2008 **[E/5/70-80]**)

5) Settlement Agreement – main provisions **[E/16/457-512]**

A. INTRODUCTION

1. Listed for hearing before the Court is the trial of two applications for directions by officeholders arising out of the insolvency of the Lehman Brothers group, the first made by the LBHI2 Administrators and the second made by the PLC Administrators.

2. By the Applications, both of which were issued on 16th March 2018, the LBHI2 Administrators and the PLC Administrators seek the resolution of priority issues which have arisen as between the subordinated creditors in each estate. There is a substantial overlap between the relevant background facts and the issues which arise in the two applications and in July 2018 Mann J ordered them to be case managed and tried together **[A/11/216-225]**.

3. The respondents to the PLC Application are:

   (a) LBHI (which is owed around US$1.9 billion pursuant to the PLC Sub-Debt);[1]

   (b) GP1 (which is owed, as general partner in the Partnerships, around US$790 million pursuant to the PLC Sub-Notes);[2]

   (c) Deutsche Bank which is a holder of ECAPS issued by the Partnerships and held on behalf of and cleared through the systems operated by Euroclear and Clearstream. The Partnerships used the proceeds of the ECAPS to subscribe for the PLC Sub-Notes and PLC in turn used the proceeds of the PLC Sub-Notes (and the PLC Sub-Debt) to make subordinated loans to LBHI2 through the LBHI2 Sub-Debt. The extent to which Deutsche Bank (and other ECAPS holders) will be repaid depends on (1) what, if anything, is paid by LBHI2 to PLC under the LBHI2 Sub-Debt and (2) what, if anything, is paid by PLC to the Partnerships under the PLC Sub-Notes).[3]

4. The respondents to the LBHI2 Application are:[4]

   (a) SLP3 (which is owed around US$6.139 billion pursuant to the LBHI2 Sub-Notes);

   (b) PLC (which is owed around US$2.2 billion or more[5] pursuant to the LBHI2 Sub-Debt); and

[1] Bruce 3 para 46 **[A/4/32]**. The PLC Sub-Debt has now, by various assignments and other transactions, vested in LBHI – Bruce 3 para 59 **[A/4/35]**.
[2] Bruce 3 para 46 **[A/4/32]**
[3] Bruce 3 paras 40, 64-69 and 72 **[A/4/31, 37-38]**
[4] Howell 2 para 12 **[A/2/7]**
[5] Recent investigations within the PLC administration have indicated that a sum of US$961 million previously thought to be a balance outstanding between LBHI2 and PLC in respect of preference shares issued by LBHI2 to PLC may represent a further balance of LBHI2 Sub-Debt, rather than an investment in preference shares. Accordingly, the quantum of the LBHI2 Sub-Debt may exceed the value previously thought (US$2.2 billion). The parties are agreed that this quantum issue does not affect the determination of the

(c) Deutsche Bank (which was joined to the proceedings in July 2018 by Mann J, but has only an indirect interest in the estate of LBHI2, as set out above).

5. The LBHI2 Administrators adopt a neutral position on the issues arising in their Application. Their interest is in ensuring that the substantial funds held by them are distributed on the correct basis, and in accordance with the agreements and other documents entered into by LBHI2, to the parties entitled to them. It is nevertheless right to point out that LBHI2 does have an economic interest in the outcome. It is a feature of the Lehman Brothers insolvency that much of the remaining debt comprises inter-company debt and that, because of the way in which that debt is held, there is a complex circuity relating to cash-flows between Lehman Brothers companies. An example of this arises in this case. LBHI2 is an unsubordinated unsecured creditor of Lehman Brothers Ltd ("LBL") which in turn is an unsubordinated unsecured creditor of PLC. It is thus in LBHI2's interests to maximise recoveries in the PLC estate because it will thereby benefit from enhanced distributions from that estate to LBL and in turn to LBHI2.[6]

6. The PLC Administrators adopt a neutral position on the issues arising in their Application but are advancing a positive case in relation to the issues arising in the LBHI2 Application. The LBHI2 Administrators do not advance any positive case on the issues arising in the PLC Application. Although LBHI2 has an economic interest in the PLC estate, that interest is at levels which have priority to the subordinated claims against PLC of LBHI and GP1 (and Deutsche Bank which is at one stage removed) and is therefore unaffected by the disputes between the holders of subordinated unsecured debt. It is the case, however, that the dispute concerning the proper construction of the Settlement Agreement may well be of wider relevance to the administration of the estates of other Lehman Brothers companies, including PLC, LBL and LBHI2, for the reasons identified in Geraghty 2 **[C/7/90-106]**.[7]

7. The economic interest of each party to each of the Applications is shown in a summary diagram annexed to the Statement of Agreed Facts **[C/23/302-7]**.

8. LBHI and SLP3 are represented by the same legal team and have filed a joint position paper and witness evidence.

9. The remainder of this Skeleton Argument is divided into the following sections:

issues in the two Applications before the Court. See the letters from Hogan Lovells LLP dated 30 September 2019 [H/299-300] and Dentons UK and Middle East LLP dated 3 October 2019 [H/306-307]

[6] Bruce 3 paras 24-25 **[A/4/28]**

[7] Further, one of the LBHI2 Administrators, Mr Howell, played a key role in the negotiations which led to the Settlement Agreement, as can also be seen from Geraghty 2 paras 40 and 67 **[C/7/98, 103]**.

(a) Section B: The background to and context in which the Applications come to be made;

(b) Section C: A summary of the regulatory background to the relevant instruments;

(c) Section D: A short summary of the legal principles relating to two of the principal issues arising on the LBHI2 Application (and on the priority issues in the PLC Application), namely:

(1) The principles of construction; and

(2) The principles of rectification

(d) Section E: A breakdown and analysis of the issues raised by the position papers, and a summary of the opposing arguments.

(e) Section F: Conclusion.

B. BACKGROUND TO THE APPLICATIONS

10. LBHI2 is the immediate parent of Lehman Brothers International (Europe) ("LBIE"), now holding the entirety of its issued and allotted share capital, comprising various classes of preferential shares and ordinary shares.[8] Immediately prior to the collapse of the Lehman group in September 2008, LBIE was the principal trading company of the Lehman group in Europe. LBIE went into administration on 15th September 2008, accompanied or followed by other members of the Lehman group, including LBHI2, PLC and LBL.

11. LBHI2 was also a substantial creditor of LBIE as at the date that LBIE went into administration holding (a) an ordinary unsecured senior (ie unsubordinated) claim of about £38 million, and more significantly, (b) a subordinated claim of about £1.24 billion (the "LBIE Sub-Debt") in respect of advances made by LBHI2 to LBIE under three subordinated loan agreements made in November 2006 (the "LBIE Sub-Debt Agreements"), in both cases excluding interest. Subsequent to the commencement of LBIE's administration, LBHI2, as part of a joint venture with certain funds, assigned its senior debt and the LBIE Sub-Debt to special purpose vehicles pursuant to a set of complex pooling agreements with various funds under which LBHI2 received

[8] LBL formerly held one ordinary share: Howell 2 para 4 **[A/2/5]**. That share was transferred to LBHI2 pursuant to arrangements sanctioned by Hildyard J in July 2017 following the settlement of the Waterfall III proceedings which were tried in part in early 2017 but overtaken by the judgment of the Supreme Court in the Waterfall I proceedings.

a substantial up-front payment and retained substantial participation rights in recoveries made in respect of the assigned debts.[9]

12. At the time that LBIE went into administration and for a period thereafter, it was not thought that LBIE would be able to discharge in full the principal amount of its ordinary unsecured senior liabilities; still less, its subordinated liabilities. However, from a point in 2013 it was clear that the principal amount of the senior liabilities would be paid in full. By four dividends paid between November 2012 and April 2014, the principal amounts of admitted unsubordinated claims were paid in full, leaving a substantial surplus running to many billions of pounds ("the LBIE Surplus").

13. The emergence of the LBIE Surplus resulted in a series of applications (collectively, the "Waterfall Proceedings") which were intended to determine issues relating to (i) the nature, extent and ranking of the claims of different classes of creditors to the LBIE Surplus and (ii) the nature and extent of the liability of LBHI2 and LBL, as members of LBIE (an unlimited liability company) and as contributories, to contribute to any shortfall in the payment of the claims of creditors. Substantially simplified and so far as they are material to the Applications, the outcomes of the Waterfall Proceedings were as follows:

    (a) In the Waterfall I proceedings, which culminated in the decision of the Supreme Court given in May 2017 ([2018] AC 465), (a) that the LBIE Subordinated Debt was subordinated both to interest payable on creditors' claims pursuant to the predecessor provision of what is now IR 2016 r. 14.3 (IR 1986 r. 2.88) and IA 1986 s. 189 ("Statutory Interest") and to non-provable claims, but (b) that creditors with claims expressed in a foreign currency had no claim (provable or otherwise) in respect of foreign currency losses suffered as a result of the statutory currency conversion under the predecessor of what is now IR 2016 r. 14.21 (IR 1986 r. 2.86), and (c) that LBIE could not prove in LBHI2's administration in respect of LBHI2's contributory liability unless and until LBIE went into liquidation;

    (b) In the Waterfall IIA proceedings, that the rule in *Bower v Marris* did not apply so as to require dividends paid in an administration to be notionally appropriated in discharge of interest before principal: judgment of the Court of Appeal given in October 2017, [2018] Bus LR 508; and

    (c) In the Waterfall IIC proceedings, that for the purpose of calculating Statutory Interest where a claim was made in excess of the statutory rate (8% pa) based on the provisions of the ISDA Master Agreements, the cost of funding upon which the default rate is based in the agreements does not include cost of equity funding: judgment of Hildyard J given in October 2016, [2017] Bus LR 1475.

14. Those outcomes have now been crystallised and reflected in the terms of a scheme of arrangement proposed by the LBIE Administrators (the "LBIE Surplus Scheme") for the settlement of outstanding litigation relating to and the distribution of the LBIE Surplus. The LBIE Surplus Scheme was sanctioned by Hildyard J by an order made on 15th June 2018: [2019] Bus LR 1012.

15. The outcomes identified above were beneficial to LBHI2. Having regard to the size of the LBIE Surplus, the consequences have been that:

    (a) The prospect of a claim being made against LBHI2 as a contributory in respect of a shortfall in LBIE has for all intents and purposes been reduced to nil;

    (b) After payment of Statutory Interest to LBIE's creditors, there will be a substantial surplus in the LBIE administration amounting to about £2.4 billion which will be available for the payment of dividends in respect of the LBIE Sub-Debt in which, as explained above, LBHI2 has participation rights; and

    (c) The Court granted permission to the LBHI2 Administrators for LBHI2 to become a distributing administration on 15 June 2017. The LBHI2 Administrators have been able to make distributions to LBHI2's unsubordinated creditors amounting to payment in full of the principal amounts of admitted claims together with post-administration Statutory Interest.

16. In commercial terms, the consequences for LBHI2 and its estate are that there is a substantial surplus (the "LBHI2 Surplus") available for the payment of dividends in respect of its subordinated debt.[10] The LBHI2 Administrators have been able to distribute a total of £204.7 million of the LBHI2 Surplus to PLC on account of the LBHI2 Sub-Debt to date, SLP3 having agreed to waive any entitlement to share in such distributions. SLP3 has, however, reserved its rights to receive a catch-up dividend at a later stage, to the extent that LBHI2 has sufficient funds. The size of the remaining LBHI2 Surplus will depend on several factors, including the eventual outcome in the LBIE estate, the outcome of various legal proceedings (including the present Applications - see paragraph 5 above), and the costs and expenses of the

[9] This is the Wentworth transaction referred to in Howell 2 para 6 **[A/2/5]**

[10] Howell 2 para 11 **[A/2/6-7]**; LBHI2 Administrators' most recent progress report dated 12 August 2019 for the period 14 January to 13 July 2019 **[F/567/5725-5746]**

administration. As at the date of their most recent progress report for the period 14 January to 13 July 2019, the LBHI2 Administrators estimated that future returns to subordinated creditors may be in the range of £300 million to £900 million, although these figures remain subject to material uncertainty.

17. As briefly set out above, LBHI2 has two subordinated creditors with claims in aggregate amounting to US$8.3 billion:[11]

    (a) PLC, in respect of sums advanced by PLC to LBHI2 under the three LBHI2 Sub-Debt Agreements in November 2006. The amount of the LBHI2 Sub-Debt (ie the claim under all three agreements, excluding accrued interest) has been estimated at around US$2.2 billion;[12] and

    (b) SLP3, under floating rate notes issued in April 2007 pursuant to the terms of an offering circular dated 26th April 2007, as amended in early September 2008. LBHI2's liabilities under the LBHI2 5ub-Notes are about US$6.1 billion.

18. In the light of these figures, the LBHI2 Surplus is plainly insufficient to discharge the claims of LBHI2's subordinated creditors in full, and it is in this context that the dispute has arisen between PLC and SLP3. PLC contends that the LBHI2 Sub-Debt ranks in priority to the LBHI2 Sub-Notes; SLP3, on the other hand, now contends that the LBHI2 Sub-Notes and the LBHI2 Sub-Debt rank *pari passu* (it had formerly contended in correspondence that the LBHI2 Sub-Notes ranked in priority to the LBHI2 Sub-Debt, but this is no longer pursued).

19. In economic terms, if PLC is successful in the LBHI2 Application, then there arises in the administration of the PLC estate an issue as to the respective ranking of the claims of its various subordinated creditors. That possibility arises in the following circumstances:[13]

    (a) As at the date on which the Applications were issued (March 2018):[14]

        (1) PLC had paid three dividends to its unsubordinated creditors amounting in aggregate to £705 million or slightly over 69% of the principal amount of admitted claims.

        (2) The amount required to pay the balance of the principal amount of admitted unsubordinated claims was about £317 million, and the amount required to pay statutory interest was about £750 million.

    (b) The LBHI2 Administrators understand from the Progress Report of the PLC Administrators dated 10 October 2019 for the period 14 March to 14 September 2019 that the current position is that PLC has paid five interim dividends to its unsubordinated creditors totalling 100p in the pound and a sum of around £27.2 million towards creditors' entitlement to post-administration Statutory Interest.

    (c) The future returns to unsubordinated and subordinated creditors of PLC remains materially uncertain (ranging from no further significant distributions to either category of creditor to the payment of statutory interest in full to unsubordinated creditors and around £600 million being paid to subordinated creditors). The outcome depends, amongst other factors, on whether SLP3's position in the LBHI2 Application is successful.

20. PLC's liabilities to its subordinated creditors fall into three categories:[15]

    (a) A liability of about $1.9 billion in respect of the PLC Sub-Debt, ie sums advanced under three subordinated loan agreements, two of which were made on 30th July 2004 and the third on 31st October 2005. The PLC Sub-Debt has now, by various assignments and other transactions, vested in LBHI.

    (b) Liabilities of about $790 million arising under the PLC Sub-Notes, ie fixed rate notes issued pursuant to four offering circulars dated 29th March 2005, 19th September 2005, 26th October 2005 and 20th February 2006. The notes were issued to different limited partnerships (LP1, LP2 and LP3), but those Partnerships have a common general partner, GP1, now in liquidation and it claims against PLC's estate in respect of these liabilities.

    (c) A potential guarantee liability under the PLC Guarantees, ie guarantees given by PLC to investors to whom each of the Partnerships issued securities.

21. The issues and the respective positions adopted by the parties have been set out in the parties' position papers filed and served as follows:

    (a) Joint position paper of SLP3 and LBHI on 11th January 2019 **[A/5]**;

    (b) Position papers of each of LBHI2, PLC, GP1 and Deutsche Bank on 22nd February 2019 **[A/6-9]**;

[11] Howell 2 para 12 **[A/2/7]**
[12] But may be increased by $961m depending upon the outcome of the investigations identified at footnote 5 above.
[13] Bruce 3 paras 18 to 22, 42 to 45 **[A/4/27, 31-32]**
[14] Bruce 3 para 21 **[A/4/27]**
[15] Bruce 3 paras 46, 48 to 88 **[A/4/32-43]**

(c) Joint reply position paper of SLP3 and LBHI on 22nd March 2019 **[A/10]**.

22. Those position papers contained detailed argument and it is not proposed to repeat them here, but a summary is given to show the Court the shape of the two Applications and to seek to identify in a logical order the specific issues which the Court will need to determine.

23. As a preliminary point, the position papers reveal that there is a dispute over the order in which the Applications ought to be addressed or determined.

(a) SLP3/LBHI contends that the priority or ranking issues raised by the PLC Application should be addressed or determined first because the PLC Sub-Debt and the PLC Sub-Notes pre-date the LBHI2 Sub-Debt and the LBHI2 Sub-Notes and therefore form part of the context in which the priority or ranking issues raised by the LBHI2 Application fall to be considered.[16]

(b) By contrast, Deutsche Bank and GP1 contend that the LBHI2 Application should be determined first because it is only if PLC/Deutsche Bank are successful in arguing that the LBHI2 Sub-Debt ranks ahead of the LBHI2 Sub-Notes that the issues on the PLC Application will in fact be of any practical importance. Without securing that priority in the LBHI2 Application, PLC will be unable to make any distribution to its subordinated creditors.[17]

24. It is not known whether the competing parties will address the Court on this point at the outset, but LBHI2 considers that, on the basis (a) that the Applications have been directed to be tried together, and (b) that evidence has been adduced in relation to all issues on both Applications, an approach which deals with the priority or ranking issues chronologically is correct as a matter of analysis. The economic argument deployed against it was relevant at the point when the Court had to determine how the Applications should be managed and tried, but appears now to be of little weight when the issue is to how the issues should be dealt with at a single hearing where both Applications are to be tried.

25. Some general points are worth making at the outset:

(a) The parties all agree that the priority issues in the PLC Application involve the proper construction of the PLC Sub-Debt Agreements and the terms and conditions applicable to

[16] SLP3/LBHI's PP para 7 **[A/5/57-58]**

[17] Deutsche Bank's PP para 5**[A/8/125]**; GP1's PP paras 2-4 **[A/9/156]**; see Bruce 3 para 124 **[A/4/49]** for evidence as to the reasons why this is the case.

the PLC Sub-Notes.[18] In this context, it should be noted that (a) the terms of the PLC Sub-Debt Agreements are in substantially the same form as the LBHI2 Sub-Debt Agreements,[19] but (b) the terms and conditions applicable to the PLC Sub-Notes are different from those applicable to the LBHI2 Sub-Notes.

(b) The parties all agree that the priority issues in the LBHI2 Application involve the proper construction of the LBHI2 Sub-Debt Agreements and the LBHI2 Sub-Notes.[20] The LBHI2 Sub-Debt Agreements and their subordination provisions are in substantially the same form as those considered in the Waterfall I proceedings; all are based on the standard FSA form printed in the Interim Prudential Sourcebook dealing with capital adequacy rules. That said, the context in which those provisions fall to be considered in this case is different. In the Waterfall I proceedings, it was an argument between senior and subordinated creditors as to the depth of the subordination; here, it is an argument between subordinated creditors as to which, if any, has priority over the other.[21]

(c) The background to the LBHI2 Sub-Debt Agreements and the PLC Sub-Debt Agreements, and to the issue of the LBHI2 Sub-Notes and of the PLC Sub-Notes, and the context in which those agreements were made and the notes were issued, will or may be material to the process by which the various sets of terms and conditions are construed. At least a part of that background and context will be the same or substantially overlapping for all of the agreements and notes. However:

(1) The extent of the relevant factual matrix against which the construction issue is to be determined is not agreed by the parties advancing competing positive cases in the Applications, and there is a substantial dispute as to the admissibility of certain matters asserted by those parties and said to be relevant to issues of construction: SLP3 and LBHI's approach is summarised in its position paper at paras 31(1)-(4) and 31(6)-(7) (general principles) **[A/5/78-79]**, para 13 (PLC Application) **[A/5/59-61]** and paras 21 and 25 (LBHI2 Application) **[A/5/67-69, 72-73]** and in its reply position paper at paras 31-34 (LBHI2 Application) **[A/10/190-192]** and para 62 (PLC Application) **[A/10/207-209]**. It relies on

[18] LBHI/SLP3's PP para 13 **[A/5/59]**; GP1's PP para 44 **[A/9/168]**; Deutsche Bank's PP paras 47-48 **[A/8/144-145]**

[19] Bruce 3 para 48 **[A/4/33]**

[20] It appears all parties are agreed that it is a matter of construction: LBHI/SLP3's PP paras 21, 24, 29 and 30 **[A/5/67-77]** for the arguments and para 31 **[A/5/77]** for relevant principles; LBHI2's PP para 5 **[A/6/92]**; PLC's PP paras 6-9 **[A/7/96]** for summary of position and paras 10-17 **[A/7/96-98]** for relevant principles.

[21] Howell 2 paras 7 and 14 **[A/2/5-8]**

specific aspects of the factual matrix, in particular the fact that the various instruments were all executed/issued as part of transactions devised and implemented by centralised decision-makers within the Lehman Group and aspects of the regulatory background to the transactions.

(2) PLC's approach in relation to the LBHI2 Application is summarised at para 19 of its position paper **[A/7/99-100]**. In broad terms, PLC contends for a narrow factual matrix.

(3) Deutsche Bank's additional points on the factual matrix are set out at paras 21-22 (LBHI2 Application) and paras 51-52 (PLC Application) of its position paper **[A/8/130-132, 145-146]**. It too contends for a narrow factual matrix, but to the extent the Court considers a wider factual matrix is appropriate to the construction process, Deutsche Bank relies on the regulatory background to the transactions and certain alleged commercial and tax drivers within the Lehman Group underlying the transactions in support of its case on construction.

(4) GP1's approach is summarised at paras 9-13 of its position paper **[A/9/158-159]**. GP1 criticises LBHI/SLP3 for seeking to adduce evidence of the parties' subjective intentions.

(d) The question of whether rectification of the LBHI2 Sub-Notes should be ordered (to strike through certain parts of condition 3(a) added to the terms and conditions of the LBHI2 Sub-Notes in September 2008) only arises if the Court would have held that the LBHI2 Sub-Notes rank before the LBHI2 Sub-Debt in a distributing administration of LBHI2 but in fact holds that the LBHI2 Sub-Notes rank behind the LBHI2 Sub-Debt in such a distributing administration because the 2008 amendments to the LBHI2 Sub-Notes terms and conditions ("the 2008 Amendments") have that effect.[22]

26. In addition to the priority issues as between PLC's subordinated creditors, the PLC Application raises two further matters. In summary, and expressed in fairly general terms, these additional matters (which have various sub-issues within them) are:

(a) Whether LBHI's claims under the PLC Sub-Debt have been (a) fully released under the 2011 Settlement Agreement governed by New York law or (b) partially released/discharged/diminished by LBHI's liability as guarantor of PLC's obligations under the PLC Sub-Debt;

(b) Whether PLC's liability under the PLC Sub-Notes falls to be discounted as a future liability under IR 2016 14.44 or some other method.

27. A question of whether the PLC Guarantee Liabilities had terminated was also raised in LBHI/SLP3's initial position paper and responded to by Deutsche Bank in its position paper.[23] However, all relevant parties agree[24] that, if enforceable, the PLC Guarantee Liabilities rank after the PLC Sub-Debt and the PLC Sub-Notes and, accordingly, on the PLC Application no party is asking the Court to decide whether those PLC Guarantee Liabilities have terminated or not.

C. REGULATORY BACKGROUND

28. It is common ground that the facility agreements and notes that comprise the PLC and LBHI2 Sub-Debts and Sub-Notes fall to be considered in the context of the regulatory background in which Lehman Brothers operated. In this section of the Skeleton Argument, there is a description of the regulatory structure as it existed at the relevant times.

29. In broad terms, under the capital adequacy rules made by national regulators, banks and other financial institutions are required to hold capital of a certain amount, which depends in broad terms on the extent of their business and their risk exposures. The purpose of capital adequacy rules is so far as possible to ensure that firms provide financial resources to protect their customers and other stakeholders against failure and enable them to withstand some level of loss.

30. LBIE was the main trading entity of the Lehman group in the UK and it was regulated by the Financial Services Authority (later the Prudential Regulation Authority). All the subordinated instruments involved in these proceedings formed part of LBIE's regulatory capital.

31. In July 1988, the Basel Committee on Banking Supervision, comprising representatives of the central banks and supervisory authorities of the Group of Ten (G10) countries, published the first Basel Accord, entitled International Convergence of Capital Measurement and Capital Standards (Basel I) **[J/1]**. It was agreed by all its members and endorsed by the central bank

[22] SLP3 argues that the LBHI2 Sub-Notes should be so rectified if the amendments made in 2008 have the effect of causing the LBHI2 Sub-Notes to rank behind the LBHI2 Sub-Debt (PP para 30 **[A/5/76-77]**; Reply PP paras 52-58 **[A/10/202-206]**). PLC and Deutsche Bank argue that they should not be rectified and that the amendments made in 2008 simply confirm that the LBHI2 Sub-Debt ranks ahead of the LBHI2 Sub-Notes (PLC PP paras 68-80 **[A/7/120-123]**; Deutsche Bank PP paras 19-20 **[A/8/129]**).

[23] LBHI argues that they have (PP paras 42 and 43(1) **[A/5/84-85]**). Deutsche Bank argues that they have not (PP para 68 **[A/8/153]**).

[24] See LBHI/SLP3's PP paras 42 and 43(2)-(7) **[A/5/84-87]**, LBHI/SLP3's Reply PP paras 65-6 **[A/10/211]**, Deutsche Bank's PP's paras 68 and 71 **[A/8/153-154]** and GP1's PP para 6.3 **[A/9/156]**. Relevant evidence: Bruce 3, paras 78-88 **[A/4/40-43]**.

governors of the G10 countries. It set out the details of the agreed framework for measuring capital adequacy and the minimum standard to be achieved which the national supervisory authorities represented on the Committee intended to implement in their respective countries.

32. Basel I addressed subordinated term debt in paragraph 23:

> *"The Committee is agreed that subordinated term debt instruments have significant deficiencies as constituents of capital in view of their fixed maturity and inability to absorb losses except in a liquidation. These deficiencies justify an additional restriction on the amount of such debt capital which is eligible for inclusion within the capital base."*

33. Effect was given to Basel I within the European Community by the Council Directive of 17 April 1989 on the own funds of credit institutions (89/299/EEC) **[J/3]**. Article 2.1 provided that the unconsolidated own funds of credit institutions could consist of a number of items, including equity share capital and *"fixed-term cumulative preferential shares and subordinated loan capital as referred to in article 4(3)."* Article 4(3) provided that member states could include fixed-term cumulative preferential shares and subordinated loan capital in own funds, *"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."* Article 4(3) went on to provide that subordinated loan capital had to fulfil certain further criteria, including that the loans had an original maturity of at least 5 years and were repaid early only if "the *solvency of the credit institution in question [was] not affected*".

34. A Council Directive of 15 March 1993 on the capital adequacy of investment firms and credit institutions (93/6/EEC) **[J/4]** provided for capital adequacy requirements for investment firms and cap tal adequacy rules for credit institutions related to market risk. Annex V provided that the "own funds" of investment firms and credit institutions were defined in accordance with Directive 89/299/EEC, subject to certain modifications.

35. In 2001, the Financial Services Authority ntroduced the Interim Prudential Sourcebook for Investment Businesses ("IPRU(INV)") **[J/10]**. IPRU(INV) set out the detailed financial and prudential resources and prudential standards applied by the FSA to certain firms, including investment firms. The chapter applicable to investment firms was Chapter 10. Several of the parties to the Applications refer to parts of Chapter 10 in their position papers and evidence.

36. IPRU (INV) 10-62(1)R **[J/10/513]** contained the following general rule: *"A firm must, at all times, maintain financial resources in excess of its financial resources requirement as detailed in rule 10-70 below."* A firm's financial resources had to be calculated in accordance with Table 10-62(2)A, unless it had been granted a waiver from Rules 10-200 to 10-203 (in which case Table 10-62(2)B applied), or it had notified its intention to use 10- 62(2)C: 10-62(2)R.

37. IPRU (INV) 10-63(1)R **[J/10/517]** stated that: ***"A firm may take into account subordinated loan capital in its financial resources in accordance with Tables 10-62(2)A, B and C subject to (2) to (12) below."*** In so far as material to questions of subordinated loans, IPRU (INV) 10-63(2)-(12)R provided as follows:

(a) A firm may include a subordinated loan in its financial resources only if it is drawn up in accordance with the standard forms obtained from the FSA: 10-63(2)(a).

(b) The subordinated loan must come from an approved lender, which includes the firm's controller: 10-63(3).

(c) A firm's subordinated loans must be classified as either a long-term subordinated loan (original maturity of at least 5 years) or a short-term subordinated loan (original maturity of at least 2 years): 10-63(4), (5) and (8).

(d) A firm must not (except in accordance with the terms of the loan): i. repay, prepay or terminate a short-term subordinated loan before the agreed repayment date; and ii. make any payment of interest or principal if after such action the firm's financial resources will fall below 120% of its financial resources requirement (10-63(9)).

(e) The standard forms for long-term and short-term subordinated loans appeared in Annex D, together with guidance notes in the body of Schedule 1 for their completion.

38. IPRU(INV) required instruments which a firm wished to use as part of its financial resources to be drawn up using the standard forms (which contained limited variable terms).[25] The PLC Sub-Debt and the LBHI2 Sub-Debt were drawn up on FSA standard forms pursuant to IPRU(INV) and the PLC Sub-Notes, with the FSA's approval, were adapted from such standard forms.

39. In June 2006, the Basel Committee on Banking Supervision published a revised Accord (Basel II) **[J/2]**. Paragraph 49(xii) repeated what had been said about subordinated term debt in Basel I, but an additional tier of capital was introduced (tier 3) consisting of short-term subordinated debt for the sole purpose of meeting a proportion of the capital requirements for market risks.

40. Effect was given to Basel II in the EU by the Directives of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions (2006/48/EC) **[J/6]** and on the capital adequacy

[25] Miller 1 paras 23, 31 **[C/1/4, 8]**; Dolby 1 para 28 **[C/3/36]**; and Hutcheson 1 paras 16-27 **[C/6/72-74]**

of investment firms and credit institutions (2006/49/EC) **[J/7]**. So far as relevant, the first of these Directives repeated the definition of own funds contained in Directive 89/299/EEC and repeated the requirement that subordinated loan capital could be included only 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 repoid until all other debts outstanding at the time have been settled*": article 64(3).

41. Directive 2006/49/EC came into force in July 2006 **[J/7]**. It was intended in relation to investment firms to give effect to the principles formulated in relation to banks/credit institutions in Basel II.

42. The provisions relating to own funds are set out in Chapter IV. Article 13 effectively provides Member States with a choice between: (1) applying to investment firms the own funds requirements set out in Directive 2006/48/EC in respect of credit institutions: Article 13(1); or (2) permitting investment firms which are obliged to meet capital requirements calculated in accordance with provisions relating to certain risks (Articles 21 and 28-32) to use an alternative determination of own funds for that purpose only: Article 13(2).

43. For the purposes of the alternative determination of own funds, subordinated loan capital may be taken into account, subject to conditions set out in Article 13(3) and (4): Article 13(2)(c). Article 13(4) provides that subordinated loan capital should not exceed a maximum of 150% of original own funds left to meet the requirements of Articles 21 and 28 - 32.

44. On 31 December 2006, the FSA introduced the General Prudential Sourcebook (GENPRU) which set out the capital adequacy requirements applicable to LBIE from that date until it went into administration in September 2008 **[J/11]**. GENPRU replaced IPRU(INV). The purpose of these rules, as stated in paragraph 1.2.26, was to ensure that a regulated firm would "*ot all times maintain overall financial resources, including capital resources and liquidity resources, which are adequate, both as to omount and quality, ta ensure thot there is no significant risk that its liabilities cannot be met as they fall due.*"

45. Based on Basel II and the relevant Directives, three tiers of capital were specified, which a firm was required to identify separately in its regulatory capital reporting to the FSA.

46. Subordination was a characteristic of all three tiers of capital. The amount of capital that a firm could designate as tier 2 capital was restricted to a value no greater than 50% of its tier 1 capital, with any excess capital being designated as tier 3 capital.

47. The LBHI2 Sub-Notes were not drawn up on the FSA standard forms annexed to IPRU(INV) because GENPRU had come into effect (31 December 2006) by the time the LBHI2 Sub-Notes were issued (April 2007). They qualified as lower tier 2 capital for GENPRU purposes.[26] Amendments were made to the terms and conditions of the LBHI2 Sub-Notes in September 2008 but after those amendments, the LBHI2 Sub-Notes continued to qualify as lower tier 2 capital.[27]

D. SUMMARY OF APPLICABLE LAW ON CONSTRUCTION AND RECTIFICATION

(1) The principles of construction

48. The principles of construction which appear particularly relevant in this case are set out below.

49. The court's task is to ascertain the objective meaning of the language which the parties have chosen to express their agreement. This is not a literalist exercise focused solely on a parsing of the wording of the particular clause; the court must consider the contract as a whole and, depending on the nature, formality and quality of drafting of the contract, give more or less weight to elements of the wider context in reaching its view as to that objective meaning.[28]

50. Where there are rival meanings, the court can give weight to the implications of rival constructions by reaching a view as to which construction is more consistent with business common sense.[29]

51. The court must balance the indications given both by the language in dispute and the parts of the contract that provide its context, on the one hand, and the factual background, on the other hand, in reaching its decision on the proper construction, ie to ascertain the objective meaning of the language which the parties have chosen to express their agreement. The extent to which each tool will assist the court in its task will vary according to the circumstances of the particular agreement or agreements.[30]

52. There may therefore be provisions, even in a detailed professionally drawn contract, which lack clarity and the lawyer or judge in interpreting such provisions may be particularly helped by

[26] Miller 1 para 41 **[C/1/10]**
[27] Grant 1 para 61 **[C/2/28]**
[28] Wood v Capita Insurance Services Ltd [2017] AC 1173 *per* Lord Hodge JSC at para 10 (with whom Lords Neuberger, Mance, Clarke and Sumption JJSC agreed)
[29] Wood v Capita, *supra, per* Lord Hodge JSC at para 11 (with whom Lords Neuberger, Mance, Clarke and Sumption JJSC agreed)
[30] Wood v Capita, *supra, per* Lord Hodge JSC at para 13 (with whom Lords Neuberger, Mance, Clarke and Sumption JJSC agreed)

considering the factual matrix,[31] the commercial purpose of the whole contract as appears from its face,[32] and the purpose of similar provisions in contracts of the same type.

53. In determining what will make up the relevant factual context to which the Court can have regard in carrying out the construction process identified in the preceding section above, the following matters appear to be particularly relevant in this case:

    (a) The Court will be astute not to have regard to inadmissible evidence of subjective intention when construing a contract;[33]

    (b) The question of whether the contracts would be relied on by third parties[34] and, linked to that, the question of whether the instrument would be publicly traded or negotiable;[35]

    (c) The relevant 'audience' for the contract in question;[36]

    (d) Applicable regulatory framework at the time instruments were executed.[37]

(2) The principles of rectification

54. The parties arguing the rectification case in the LBHI2 Application (LBHI/SLP3 arguing for rectification of the LBHI2 Sub-Notes as amended; Deutsche Bank and PLC arguing against it) have focussed on the authorities relating to rectification on the basis of common mistake of LBHI2 and SLP3, being the parties to a bilateral agreement.

55. In that regard:

    (a) In order for the Court to consider exercising its discretion to grant the equitable remedy of rectification of a contract based on common mistake, it is necessary to show that at the time of executing the written contract the parties had a common continuing intention (even if not amounting to a binding agreement), there was an outward expression of accord of that intention, but the intention, as a result of mistake on the part of both parties, was not recorded accurately in the written document.[38]

    (b) Since the position papers were filed in this matter, the Court of Appeal handed down judgment in FSHC Group Holdings Ltd v Glas Trust Corporation Ltd [2019] EWCA Civ 1361 (31 July 2019). That authority discusses the *obiter dicta* of Lord Hoffmann (in a judgment with which all the other judges agreed) in Chartbrook Ltd v Persimmon Homes Ltd [2009] AC 1101 where he stated that, where the document of which rectification was sought was a written contract, the relevant test of intention of the parties to the contract was purely objective, ie what a reasonable observer with knowledge of the background facts and prior communications between the parties would have thought their common intention at the time of contracting to be.

    (c) The Court of Appeal in FSHC, *supra*, held that Lord Hoffmann's *obiter* comments in Chartbrook, *supra*, do not correctly state the law (para 176 *per* Leggatt LJ with whom Rose and Flaux LJJ agreed). The correct test is that, before a written contract may be rectified on the basis of a common mistake, it is necessary for the claimant to show either (1) that the document fails to give effect to a prior concluded contract or (2) that, at the time 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 respect of the latter case, the claimant must show not only that each party to the contract had the same actual intention as 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.

56. However, it is not clear to the LBHI2 Administrators that all the requirements for common mistake rectification are necessarily relevant or determinative in this particular case, given that the rectification is sought in relation to the terms and conditions of a Note issued by a single Issuer (LBHI2) and amended by resolution of that Issuer (LBHI2), with the consent of the sole Noteholder (SLP3). The circumstances in which rectification is sought in this case may be thought to be more akin to the pensions cases, which were considered by the Court of Appeal in FSHC at paragraphs 76, 78-79, and 181 of the judgment which, in turn, was recently reviewed in a pension rules rectification claim by Chief Master Marsh in Blatchford Ltd v Blatchford [2019] EWHC 2743 (Ch) (24 October 2019) at paragraphs 20-29.

[31] In Re Sigma Finance Corporation [2010] 1 All ER 571 *per* Lord Mance at para 12 (with whom Lords Hope, Scott and Collins agreed; Lord Walker dissenting but not regarding the principles of construction to be applied – see para 40) and *per* Lord Collins at para 35 (with whom Lords Hope and Mance agreed)

[32] Sigma Finance, *supra*, *per* Lord Collins at paras 35 and 37 (with whom Lords Hope and Mance agreed)

[33] Tartsinis v Navona Management Co [2015] EWHC 57 (Comm) *per* Leggatt J at para 9

[34] Cherry Tree Investments Ltd v Landmain Ltd [2013] Ch 305 at paras 124 and 130; the discussion in Lewison: The Interpretation of Contracts, section 3.18.

[35] BNY Mellon Corporate Trustee Services Ltd v LBG Capital No 1 plc [2016] *per* Lord Neuberger at paras 30 and 33 (with whom Lords Mance and Toulson agreed)

[36] LB Re Financing No.3 Ltd v Excalibur Funding No.1 plc [2011] EWHC 2111 (Ch) *per* Briggs J, as he then was.

[37] BNY Mellon Corporate Trustee Services Ltd v LBG Capital No 1 plc [2016] *per* Lord Neuberger at paras 30-34 (with whom Lord Mance and Lord Toulson agreed; the dissenting judgment of Lord Sumption (with whom Lord Clarke agreed) also indicates that the regulatory context is part of the relevant background – see para 56).

[38] Swainland Builders Ltd v Freehold Properties Ltd [2002] 2 EGLR 71 *per* Peter Gibson LJ at para 33.

E. THE KEY ISSUES AND THE OPPOSING ARGUMENTS

57. In this section of the Skeleton Argument, the LBHI2 Administrators set out a more detailed breakdown of the issues as they appear from the various position papers in an order which appears to the LBHI2 Administrators to be the most sensible one in which to address the Applications, and with references to paragraphs in the position papers where these issues are dealt with. As already pointed out, the extent of the relevant factual matrix against which construction issues are to be determined is not agreed and there is a substantial dispute as to the admissibility of certain matters said to be relevant to issues of construction.

(1) PLC Application: priority arguments

58. **(1.1) PLC priority issue:**

Whether, on a true construction of the relevant terms and conditions of the facility agreements and notes, the claims of LBHI against PLC in respect of the PLC Sub-Debt rank for distribution after or *pari passu* with the claims of GP1 (as general partner of the Partnerships) against PLC in respect of the PLC Sub-Notes.

59. **(1.2) PLC subsidiary priority issue:**[39]

Whether, on a true construction of the facility agreements which make up the PLC Sub-Debt and the tranches of debt which make up the PLC Sub-Notes,

(1) the claims of LBHI against PLC in respect of each of the facility agreements which make up the PLC Sub-Debt rank for distribution before, after or *pari passu* with each other; and

(2) the claims of GP1 against PLC in respect of each tranche of the PLC Sub-Notes rank for distribution before, after or *pari passu* with each other.

60. **(1.3) The opposing positions:**

61. LBHI contends that the PLC Sub-Debt and the PLC Sub-Notes rank *pari passu*. As part of its analysis of this issue, LBHI also contends that the sums due under each of the three individual PLC Sub-Debt facility agreements rank *pari passu* for distribution between themselves[40] and

[39] At first sight, it might seem odd to describe these as issues at all because it is common ground that, where a claim is made up of claims under more than one instrument of the same class – for example, the claims of PLC in respect of the LBHI2 Sub-Debt or the claims of GP1 in respect of the PLC Sub-Notes, the claims rank *pari passu*. However, in their position papers, SLP3 and LBHI rely upon this in support of the position that they take in the Applications. On this basis, it will or may be necessary for the Court to investigate the basis of the assumption that is common ground. For this reason, these are identified as potential issues.

[40] LBHI/SLP3's PP para 14 **[A/5/61-63]** and Reply PP para 19 **[A/10/183]**

that each series of subordinated note making up the PLC Sub-Notes also rank *pari passu* for distribution between themselves.[41]

62. As to LBHI's key arguments:

(a) The PLC Sub-Debt and PLC Sub-Notes rank *pari passu* because both were based on the same FSA standard forms. Under those terms, the sums due under each tranche of the PLC Sub-Debt and under each series of the PLC Sub-Notes are subordinated to the same "Senior Liabilities" (as defined in the facility agreements and terms of the Sub-Notes) and, once those Senior Liabilities are discharged in full, then all the sums due under each tranche of the PLC Sub-Debt and each series of the PLC Sub-Notes can be proved for.[42]

(b) There was no commercial reason to subordinate the PLC Sub-Debt to the PLC Sub-Notes or *vice versa*.[43]

(c) It also relies on aspects of the factual matrix, namely:[44]

(1) The structure of the Lehman group at the time of the issuance of both the PLC Sub-Debt (entered into between 30 July 2004 and 31 October 2005) and PLC Sub-Notes (issued in four series between 29 March 2005 and 20 February 2006);

(2) they were transactions devised and implemented by common, centralised decision-makers within the Lehman group generally;

(3) the regulatory capital drivers for the Lehman group;

(4) the tax drivers for the transactions.

63. GP1 contends that the PLC Sub-Notes rank *pari passu* as between themselves, and ahead of the PLC Sub-Debt. Its position is that:

(a) The Court's focus should be on principles of contractual construction: LBHI overstate the importance of the factual matrix and impermissibly draw on what they perceive to have been the parties' actual (i.e. subjective) intentions.[45]

(b) The PLC Sub-Debt and the PLC Sub-Notes do not have subordination provisions which are materially the same and they are not subordinated behind the same "Senior Liabilities".[46]

[41] LBHI/SLP3's PP para 15 **[A/5/63-65]** and Reply PP para 24 **[A/10/185]**

[42] LBHI/SLP3's PP para 14 (PLC Sub-Debt) **[A/5/61-63]** and para 15 (PLC Sub-Notes) **[A/5/63-65]**and para 16 for conclusion **A/5/65-66]**

[43] LBHI/SLP3's PP para 16(4) **[A/5/66]**

[44] LBHI/SLP3's PP para 13 **[A/5/59-61]**

[45] See GP1's PP paras 10-11 **[A/9/158-159]**

[46] See GP1's PP paras 63-73 **[A/9/172-174]**

(c) There is nothing commercially absurd about the PLC Sub-Notes ranking *pari passu* between themselves and ahead of intra-Lehman group lending.[47]

64. Deutsche Bank also contends that the PLC Sub-Notes rank ahead of the PLC Sub-Debt.[48] Its key arguments can be summarised as follows:

(a) The subordination provisions in the PLC Sub-Notes and PLC Sub-Debt are in similar form.[49] But there is a significant difference in the definition of "Subordinated Liabilities" between the PLC Sub-Notes and the PLC-Sub Debt; the terms of the PLC Sub-Debt allow no scope for any other liability to rank *pari passu* with the PLC Sub-Debt whereas the PLC Sub-Notes may rank *pari passu* with other debts.[50]

(b) Which of the PLC Sub-Notes and PLC Sub-Debt ranks senior is not clear on the face of their terms, but the ranking "circularity" should be resolved by either construing the documents by reference to what the parties would objectively have intended or implying a term into one or both of the PLC Sub-Debt and PLC Sub-Notes.[51]

(c) The ranking for which Deutsche Bank contends (ie PLC Sub-Notes before PLC Sub-Debt) is consistent with the tax and commercial objectives of the Lehman group.[52]

(2) LBHI2 Application: priority arguments

65. **(2.1) LBHI2 priority issue:**

Whether, on a true construction of the terms and conditions of the relevant facility agreements and notes, the claims of PLC against LBHI2 in respect of the LBHI2 Sub-Debt rank for distribution before, after or *pari passu* with the claims of SLP3 against LBHI2 in respect of the LBHI2 Sub-Notes, as amended by written resolution dated 3 September 2008.

66. **(2.2) LBHI2 subsidiary priority issue:**[53]

Whether, on a true construction of the three facility agreements which make up the LBHI2 Sub-Debt the claims of PLC against LBHI2 in respect of each tranche of the LBHI2 Sub-Debt rank for distribution before, after or *pari passu* with each other.

[47] See GP1's PP paras 74-75 **[A/9/174]**
[48] DB's PP para 35 **[A/8/141]**
[49] DB's PP para 37 **[A/8/142]**
[50] DB's PP paras 37-41 **[A/8/142-143]**
[51] DB's PP paras 42-48 **[A/8/143-144]**
[52] DB's PP para 52 **A/8/145-146]**
[53] As with the issue identified in respect of PLC at paragraph 59 above, it might at first sight seem odd to describe these as issues at all because it is common ground that, where a claim is made up of claims under more than one instrument of the same class – for example, the claims of PLC in respect of the

67. **(2.3) Meaning of *"winding-up or dissolution"* in the LBHI2 Sub-Notes, as amended:**

In the context of this issue, whether on a true construction of the terms and conditions of the LBHI2 Sub-Notes, as amended in 2008, the words "winding-up or dissolution of the Issuer" in clause 3(a) includes a distributing administration of LBHI2 as issuer.

68. **(2.4) The opposing positions:**

69. SLP3 contends that the LBHI2 Sub-Debt and LBHI2 Sub-Notes rank *pari passu*.[54] As part of its analysis of this issue, SLP3 also contends that the sums due under each of the three individual LBHI2 Sub-Debt facility agreements rank *pari passu* for distribution between themselves.[55] PLC agrees that the sums due under each LBHI2 Sub-Debt facility agreement rank *pari passu* with each other but does not accept that this supports SLP3's analysis in relation to the respective rankings of the LBHI2 Sub-Debt and LBHI2 Sub-Notes.[56]

70. SLP3's construction arguments on this issue reflect those identified above made by LBHI in respect of the PLC Sub-Debt and the PLC Sub-Notes. In summary:

(a) The LBHI2 Sub-Debt facility agreements (executed in November 2006) were based on the FSA standard form. Although not in the same FSA standard form, the LBHI2 Sub-Notes (issued May 2007) were structured in materially the same way, following the introduction of GENPRU in December 2006.[57] Under both sets of terms, the sums due under each tranche of the LBHI2 Sub-Debt and under the LBHI2 Sub-Notes are subordinated to the same "Senior Liabilities" (as defined in the facility agreements and terms of the Sub-Notes) and, once those Senior Liabilities are discharged in full, then all the sums due under each tranche of the LBHI2 Sub-Debt and under the LBHI2 Sub-Notes can be proved for.[58]

(b) The LBHI2 Sub-Notes evince no objective intention for them to rank other than *pari passu* with the un-refinanced balance of the LBHI2 Sub-Debt.

(c) There was no commercial reason to subordinate the LBHI2 Sub-Debt to the LBHI2 Sub-Notes or *vice versa*, and *pari passu* ranking is consistent with market practice.

LBHI2 Sub-Debt or the claims of GP1 in respect of the PLC Sub-Notes, the claims rank *pari passu*. However, in their position papers, SLP3 and LBHI rely upon this in support of the position that they take in the Applications. On this basis, it will or may be necessary for the Court to investigate the basis of the assumption that is common ground. For this reason, these are identified as potential issues.
[54] LBHI/SLP3's PP para 20 **A/5/67]**
[55] LBHI/SLP3's PP para 22 **[A/5/69]** and Reply PP para 35 **[A/10/192]**
[56] PLC's PP para 38 **[A/7/106]**
[57] LBHI/SLP3's PP para 23 **[A/5/69-70]**
[58] LBHI/SLP3's PP para 24 **[A/5/71-72]**

71. The factual matrix on which SLP3 relies in relation to this issue can be summarised as follows:[59]

(a) The restructuring within the Lehman group which culminated in the incorporation of LBHI2 on 5 October 2006 and the entry into the LBHI2 Sub-Debt in November 2006;

(b) The further restructuring within the Lehman group which included the issuance of the LBHI2 Sub-Notes in April 2007.

72. SLP3 also argues that the 2008 Amendments to the LBHI2 Sub-Notes:

(a) are not engaged when LBHI2 is in administration, as opposed to winding-up or dissolution;[60] and

(b) in any event, do not have the effect of altering the relative ranking of the LBHI2 Sub-Debt and the LBHI2 Sub-Notes, and, accordingly, the LBHI2 Sub-Notes and LBHI2 Sub-Debt continue to rank *pari passu* after the 2008 Amendments.[61]

If its contention is not accepted, it claims rectification of the LBHI2 Sub-Notes terms and conditions, as explained in more detail below at Section E(4).

73. PLC contends that the LBHI2 Sub-Debt ranks ahead of the LBHI2 Sub-Notes.[62] As part of its analysis, it also contends that the words "winding-up or dissolution of the Issuer *[ie LBHI2]*" in clause 3(a) in the terms and conditions of the LBHI2 Sub-Notes includes a distributing administration of LBHI2 as Issuer. Its key arguments can be summarised as follows:

(a) The LBHI2 Sub-Notes state that they are junior to other LBHI2 subordinated debt, subject only to other subordinated debt which expresses itself to be *pari passu* with or junior to the LBHI2 Sub-Notes. The LBHI2 Sub-Debt does not contain the necessary expression and does not allow for *pari passu* ranking with other subordinated debt. Accordingly, as a matter of textual analysis, the LBHI2 Sub-Debt ranks ahead of the LBHI2 Sub-Notes.[63]

(b) At the date the LBHI2 Sub-Debt Agreements were executed, the LBHI2 Sub-Notes did not exist, nor is there believed to have been any other subordinated debt owed by LBHI2. By contrast, at the time the LBHI2 Sub-Notes were executed, the LBHI2 Sub-Debt was already in existence. If the draftsman had intended the LBHI2 Sub-Debt to rank junior to the LBHI2 Sub-Notes, he could have referred to the LBHI2 Sub-Debt specifically but did not.[64]

(c) SLP3's case relies too heavily on the factual matrix evidence, much of which is likely to be inadmissible.[65]

(d) The 2008 Amendments treat the LBHI2 Sub-Notes as equivalent to preference shares. This ranks the LBHI2 Sub-Notes behind all other creditors, including subordinated creditors (such as the LBHI2 Sub-Debt). The 2008 Amendments did not affect ranking as between the LBHI2 Sub-Debt and LBHI2 Sub-Notes and simply confirm the fact that the LBHI2 Sub-Debt ranks first.[66]

(e) The 2008 Amendments can apply to distributing administrations within the terms "insolvency or winding up", as it is functionally the same as a liquidation. Adopting a narrow definition would produce an arbitrary outcome, which could not have been the intention of the commercial parties to the LBHI2 Sub-Notes, and which would not be in accordance with commercial common sense or the regulatory context for the 2008 Amendments.[67]

74. Deutsche Bank agrees with PLC's position and advances certain additional points:

(a) Two alternative construction arguments by which the LBHI2 Sub-Notes rank ahead of the LBHI2 Sub-Debt in circumstances where LBHI2 is not in a winding-up.[68]

(b) Any factual matrix argument supports the view that the LBHI2 Sub-Debt ranks prior to the LBHI2 Sub-Notes:

(1) Commercial and tax reasons support this ranking;

(2) The commercial reason relied on is that, if the LBHI2 Sub-Debt was not paid, the ECAPS would (in turn) not be paid and this would cause the dividend stopper contained within the ECAPS documents to be triggered, causing adverse consequences for LBHI (with no (equally) significant downsides to not paying the LBHI2 Sub-Notes). Accordingly, LBHI2 had to be able to prioritise payments under the LBHI2 Sub-Debt over payments under the LBHI2 Sub-Notes. If the LBHI2 Sub-Notes ranked ahead of or *pari passu* with the LBHI2 Sub-Debt, LBHI2

[59] LBHI/SLP3's PP para 21 **[A/5/67-69]**
[60] LBHI/SLP3's PP paras 27-28 **[A/5/75]**
[61] LBHI/SLP3's PP para 29 **[A/5/75-76]**
[62] PLC's PP paras 6-8 **[A/7/96]**
[63] PLC's PP paras 40-46 **[A/7/106-107]**
[64] PLC's PP para 47 **[A/7/107-108]**
[65] PLC's PP para 48(6)-(7) **[A/7/109-110]**
[66] PLC's PP paras 52-55 **[A/7/113-114]**
[67] PLC's PP paras 57-67 **[A/7/115-120]**
[68] DB's PP paras 17 and 18 **[A/8/128-129]**

could not prioritise payments to PLC under the LBHI2 Sub-Debt without breaching the terms of the LBHI2 Sub-Notes.[69]

(3) The tax classification supports a junior ranking of the LBHI2 Sub-Notes (equity for US tax and debt for UK tax). The LBHI2 Sub-Debt did not need to be treated as equity for either jurisdiction. If LBHI2's distributing administration qualifies as a winding up (for the purposes of the LBHI2 Sub-Notes), the amended conditions of the LBHI2 Sub-Notes provided that no amounts should be paid under the LBHI2 Sub-Notes until the LBHI2 Sub-Debt is paid in full. The LBHI2 Sub-Notes, on their terms, rank as if they are preference shares (showing an intention to be deeply subordinated). The LBHI2 Sub-Debt has no similar clause.[70]

75. GP1 does not set out detailed arguments on the LBHI2 Application but contends that the LBHI2 Sub-Debt ranks ahead of the LBHI2 Sub-Notes.[71]

(3) PLC and LBHI2 Applications: Priority issues and the statutory scheme

76. **(3.1) The issue:**

Whether the statutory scheme set out in IA 1986 and IR 2016, and in particular IR 14.12 and IR 14.40, either as part of the process of construction of the terms of the PLC Sub-Debt, PLC Sub-Notes, LBHI2 Sub-Debt or LBHI2 Sub-Notes or otherwise, requires or supports the conclusion that the PLC Sub-Notes and PLC Sub-Debts in the PLC administration and the LBHI2 Sub-Notes and LBHI2 Sub-Debts in the LBHI2 administration each rank for distribution *pari passu* in the respective administrations of those companies.

77. **(3.2) The opposing positions:**

78. In reply to the positions of GP1, Deutsche Bank and PLC on construction of the various subordinated instruments, LBHI/SLP3 contends that insufficient or no appropriate attention has been paid to the statutory scheme relating to proof of claims in an insolvency estate and the payment out of those claims from the estate (or where the assets are insufficient the question of abatement).

79. LBHI/SLP3 contend that the other parties' construction arguments proceed on the incorrect basis that instruments creating subordinated debt only rank *pari passu* with each other if they

[69] DB's PP para 22(1)-(4) **[A/8/130-132]**
[70] DB's PP para 22(5) **[A/8/132]**
[71] GP1's PP para 5 **[A/9/156]**

expressly so provide, whereas the statutory insolvency scheme (particularly IR 2016 r.14.12 (headed "Administration and winding up by the court: debts of insolvent company to rank equally") and 14.40 (headed "Supplementary provisions as to dividends and distributions" and covering the circumstances in which a creditor can or cannot disturb a dividend or distribution) show that this is not the case.[72]

80. LBHI2 does not understand it to be contended by any party that it is not possible for creditors to agree to subordinate debt (including within already subordinated debt tranches) but LBHI/SLP3, on the one hand, and Deutsche Bank, GP1 and PLC, on the other hand, disagree as to the effect or relevance of the statutory scheme in a context where what is at issue is the construction of subordinated debt instruments and, in particular, those parts of the instruments which seek to define the other liabilities to which the liabilities under the instruments are (or are not) subordinated .[73]

(4) LBHI2 Application: 2008 Amendments and rectification

81. **(4.1) Principal issue:**

If the claims of SLP3 in respect of the LBHI2 Sub-Notes rank for distribution after the claims of PLC in respect of the LBHI2 Sub-Debts, but the answer to that issue would have been that the claims of SLP3 in respect of the LBHI2 Sub-Notes rank for distribution *pari passu* with the claims of PLC in respect of the LBHI2 Sub-Debt had the amendments approved by the written resolution dated 3 September 2008 not included the words of clause 3(a) in underlined text in the Annex to this Skeleton Argument, whether the Court should make an order rectifying the terms and conditions applicable to the LBHI2 Sub-Notes on the ground of common mistake by the deletion of words in condition 3(a) in red (underlined) text in the Annex hereto.

82. **(4.2) Common mistake:**

83. In the context of the rectification issue, whether the words sought to be deleted were inserted by mistake common to LBHI2 and SLP3 and in this regard:

(a) Whether it was the common intention of those parties that the amendments should do no more and no less than enable LBHI2 to defer payment of interest on the LBHI2 Sub-Notes;

[72] LBHI/SLP3's Reply PP paras 4-7 **[A/10/177]**
[73] LBHI/SLP3's PP paras 24-25 **[A/5/71-73]** and Reply PP para 19 **[A/10/183]**-; PLC's PP paras 39-48 **[A/7/106-110]**; Deutsche Bank's PP paras 39-40 **[A/8/142-143]**; GP1's PP paras 54-57 **[A/9/170-171]**

(b) Whether that common intention existed as at the date on which the amendments were made;

(c) Whether the clause, including the words sought to be deleted, is consistent with the parties' common intention as at the time that the amendments were made;

(d) Whether in making the amendments the parties mistakenly believed that the amendments were consistent with the common intention described in sub-paragraph (a) above.

84. **(4.3) Discretion:**

Whether the Court should as a matter of discretion order that the LBHI2 Sub-Notes be rectified by the deletion of the words underlined in red in the Annex hereto.

85. **(4.4) The opposing positions:**

86. The issues relating to the 2008 Amendments and rectification only arise if the Court considers that the LBHI2 Sub-Notes rank behind the LBHI2 Sub-Debt (rather than *pari passu* with it) as a result of the effect of the 2008 Amendments and that, absent the 2008 Amendments, they would have ranked *pari passu*.

87. SLP3 argues that rectification should be ordered in that case because LBHI2 (acting by Ms Dolby and/or Ms McMorrow) and SLP3 (also acting by Ms Dolby and/or Ms McMorrow) had a common and continuing intention that the 2008 Amendments would simply enable LBHI2 to defer interest on the LBHI2 Sub-Notes.[74] Insofar as the effect was to subordinate the LBHI2 Sub-Notes to the LBHI2 Sub-Debt, that was a mistake common to both parties and the 2008 Amendments did not reflect their common and continued intention as at the time the amendments were made (September 2008).[75] It says that there is no bar to the Court's exercise of the discretion to rectify, in particular because SLP3 has at all times been the sole noteholder of the LBHI2 Sub-Notes and, accordingly, no prejudice will be suffered by any party with an interest in the LBHI2 Sub-Notes.[76] It relies principally on the evidence of lawyers from Allen & Overy LLP instructed to draft the amendments.[77]

88. PLC's position is that SLP3's rectification case should fail.[78] Its arguments are in summary:

[74] LBHI/SLP3's PP para 30 **[A/5/76-77]** and Reply PP para 57 **[A/10/204-206]**
[75] LBHI/SLP3's PP para 30 **[A/5/76-77]** and Reply PP paras 52-58 **[A/10/202-206]**
[76] LBHI/SLP3's Reply PP para 54 **[A/10/203-204]**
[77] LBHI/SLP3's PP para 30 **[A/5/76-77]** and Reply PP para 56 **[A/10/204]**
[78] PLC's PP para 9 **[A/7/96]**

(a) SLP3 argues that virtually the entirety of clause 3 (as inserted by the 2008 Amendments) should be deleted. This is an implausible case given the sophisticated draftsman (Allen & Overy LLP) and client (Lehman personnel).[79]

(b) Further, the theme of SLP3's case is that there was no intention that the 2008 Amendments should alter priority. If and to the extent that the unamended LBHI2 Sub-Notes already ceded priority to the LBHI2 Sub-Debt, such that the 2008 Amendments merely confirmed the existing priority position upon removal of the solvency condition, then the rectification case falls away.[80]

(c) Rectification would be inappropriate given the LBHI2 Sub-Notes are freely transferrable debt securities listed on a stock exchange and were drafted in the context of a highly structured transaction against the backdrop of highly complex tax and regulatory issues.[81]

89. Deutsche Bank also argues that there is no basis for an argument of rectification of the 2008 Amendments. In particular, it says:[82]

(a) Rectification would be inappropriate given the LBHI2 Sub-Notes are freely transferrable debt securities listed on a stock exchange.

(b) If LBHI2 is not in a winding up (for the purposes of the LBHI2 Sub-Notes), the 2008 Amendments do not change the rankings under the original documents. Payments under the LBHI2 Sub-Notes could only be made if LBHI2 was solvent after making the payment. There is no equivalent solvency condition for payments under the LBHI2 Sub-Debt (showing an intention to rank ahead).

(5) PLC Application: release of LBHI's claims under the 2011 Settlement Agreement

90. **(5.1) Principal issue:**

Within the administration of PLC, whether on its true construction, which is governed by New York law, the Settlement Agreement and in particular section 8.02 thereof takes effect and operates as a release by LBHI of its claims in respect of the PLC Sub-Debt, alternatively whether LBHI's claims in respect of the PLC Sub-Debt have been partially released, discharged or diminished.

[79] PLC's PP paras 68, 71 and 77 **[A/7/120-123]**
[80] PLC's PP para 69 **[A/7/120]**
[81] PLC's PP para 80 **[A/7/123]**
[82] Deutsche Bank's PP paras 19-20 **[A/8/129]**

91. **(5.2) Issues of US law:**

92. Without limiting the issue described in the preceding sub-paragraph:

(a) Whether on the true construction of the Settlement Agreement:

(1) The release given by section 8.02 operates as a general or a limited release and, if limited, in what manner; and

(2) The release given by section 8.02 extends to claims which were acquired by a releasing party after the date of the Settlement Agreement and/or after a date on which the release became effective.

(b) Whether the principle that a release expressed in general terms is construed most strongly against the releasing party:

(1) Is applicable to section 8.02;

(2) May be varied by agreement; and

(3) If the answer to sub-paragraph (ii) above is "yes", whether it has been varied by the terms of the Settlement Agreement in this case.

(c) Whether, and if so to what extent and in what manner:

(1) The parol evidence rule is modified in cases concerned with the construction of contractual releases; and

(2) Without limiting the issue described in the preceding sub-paragraph, the court is entitled to take into account events occurring after the transaction as evidence of the parties' intentions as to the scope of contractual releases.

(d) Whether claims based on rights of subrogation, indemnification, contribution or reimbursement can be said, for the purposes of the construction of section 8.02, to be similar or comparable to claims acquired by the releasing party after the date and/or the effective date of the Settlement Agreement.

(e) Whether Article 25 of the Settlement Agreement is applicable and operates in this case so as to bar or prevent Deutsche Bank and other persons not being parties to the Settlement Agreement from seeking to enforce and/or relying upon its terms.

(f) Whether and if so to what extent the decision in *In re Professional Satellite and Communication LLC*, 2017 WL 4286995 (SD Cal Sept 27, 2017) **[D/89]**, appeal dismissed,

No 56489, 2018 WL 1586478 (9th Cir. Mar 15 2018) **[D/90]** would be accepted by a court applying the law of the State of New York.

93. **(5.3) The opposing positions:**

94. In pre-action correspondence from February 2018, Deutsche Bank's solicitors suggested that LBHI's claims under the PLC Sub-Debt had been released in full by the Settlement Agreement entered into in 2011 between, amongst others, LBHI and PLC.[83] Accordingly, the issue has been included for determination in the PLC Application.

95. LBHI argues in its position paper that its claims under the PLC Sub-Debt have not been released by the Settlement Agreement.[84] The Settlement Agreement is governed by New York law and LBHI relies on the expert evidence of Judge Gropper in relation to the questions of New York law raised by this issue.

96. Deutsche Bank argues that the claims have been released in full[85] or, as a secondary position, that the claims have been released or discharged in part or diminished by the amount for which LBHI is liable in its capacity as guarantor of PLC's obligations under the PLC Sub-Debt.[86] It relies on the evidence of Judge Smith in relation to questions of New York law.

97. In reply, LBHI reiterates its position that the claims have not been released (Reply PP paras 59-63 **[A/10/206-210]**) and also denies that Deutsche Bank's secondary position is correct (Reply PP para 64 **[A/10/210-211]**).

98. The issues of New York law which appear to require determination are set out above at paragraph 92. Certain principles are agreed between the two experts (see the Joint Report of Experts dated 25 July 2019 at **[D/4/3-7]**.

(6) PLC Application: proof and quantification of PLC's liability under the PLC Sub-Notes

99. **(6.1) Principal issue:**

Within the administration of PLC and in respect of the quantum of PLC's liability under the PLC Sub-Notes, whether that liability falls to be discounted under IR 14.44, or by reference to some other method and if so which method.[87]

[83] Bruce 3 para 113 **[A/4/47]**
[84] LBHI/SLP3's PP para 33 **[A/5/80]**
[85] Deutsche Bank's PP para 24 **[A/8/133]**
[86] Deutsche Bank's PP para 25 **[A/8/132]**
[87] There is some analysis of the valuation of future debts in the first instance decision of David Richards J in Waterfall IIA, July 2015, [2016] Bus LR 17 at paras 184-225 (not appealed to the Court of Appeal).

100. **(6.2) Future liability:**

Without limiting the issue described in the preceding paragraph, whether PLC's liability under the PLC Sub-Notes is a future liability for the purposes of IR 14.44 and in particular:

(a) Whether, on a true construction of the terms and conditions of the PLC Sub-Notes, the admission of a proof or a distribution made on account of a proved claim in respect of that liability in a distributing administration of PLC amounts to a redemption or payment at the option of the issuer for the purposes of condition 6(c) of the PLC Sub-Notes; and

(b) If the answer to the issue described in sub-paragraph (a) above is "*yes*", then what are the consequences and, in particular, whether it follows that a proof in respect of that liability must be admitted for the full face-value of the principal and without discount under IR 14.44 or otherwise; and/or

(c) Whether, on a true construction of the terms and conditions of the PLC Sub-Notes, the parties are to be taken as having agreed that the PLC Sub-Notes should be treated as immediately due and payable for the full face-value of the principal in a distributing administration of PLC; and/or

(d) Whether there is to be implied a term into the terms and conditions of the PLC Sub-Notes that in a distributing administration of PLC they would become immediately due and payable at their full face value, such term to be implied on the grounds that it is obvious, or alternatively necessary to make the contract work and to give it commercial and practical coherence; and/or

(e) Whether the admission of a proof or a distribution made on account of a proved claim in respect of that liability in a distributing administration of PLC amounts to a redemption or payment otherwise than in accordance with clause 6(a)-(c) of the terms and conditions of the PLC Sub-Notes, and thereby a repudiatory breach of condition 6(d), such that GP1 is entitled to accept the repudiation and prove for damages in an amount equal to the full face value of the principal of the PLC Sub-Notes.

101. **(6.3) Directions to the PLC Administrators:**

If the liability in respect of the PLC Sub-Notes falls to be discounted under IR 14.44, whether the PLC Administrators ought to be directed to act so as to make the PLC Sub-Notes currently due at their full face value pursuant to IA 1986 Sch B1 para 74 and/or the rule in *Ex parte James* (1873-74) LR 9 Ch App 609.

102. **(6.4) Non-provable debt:**

Whether PLC's liability in respect of the PLC Sub-Notes is a non-provable debt and, if so:

(a) Whether the provisions of IR 14.44 apply to non-provable debts; and/or

(b) If the provisions of IR 14.44 do not apply, whether PLC's liability should be reserved for in full; and/or

(c) If PLC's liability is nevertheless to be discounted, whether it should be at a commercial rate and, if so, what is that rate.

103. **(6.5) Future interest:**

Whether a proof in respect of PLC's liability under the PLC Sub-Notes to pay interest ought to be admitted and, in this regard, whether on the true construction of IR 14.23 such interest is or is not to be treated as interest bearing on a debt.

104. **(6.6) The opposing positions:**

105. There are several interlinked sub-issues which relate to the quantum of PLC's liability under the PLC Sub-Notes. The first relates to the discounting of the principal amount of the notes. LBHI contends for some discounting to that liability whereas Deutsche Bank argues that it should not be discounted at all, alternatively should be discounted by a lower rate than under IR 2016 r.14.44. The issue is significant because the PLC Sub-Notes mature in 2035 or 2036; the question of the correct approach to discounting for futurity, therefore, will have a material effect on the quantification of these liabilities given the long maturity dates and the size of the debt outstanding.[88]

106. LBHI argues that PLC's liability under the PLC Sub-Notes ought to be discounted under IR 2016 14.44.[89] Deutsche Bank argues that it should not be discounted under IR 14.44 or at all.[90]

107. Deutsche Bank argues that on a true construction of the terms and conditions of the PLC Sub-Notes (including the regulatory background), the admission of a proof or a distribution made on account of a proved claim in respect of that liability in a distributing administration of PLC amounts to a redemption or payment at the option of the issuer for the purposes of condition 6(c) of the PLC Sub-Notes and, accordingly, a proof in respect of that liability must be admitted

[88] Bruce 3 paras 107-111 **[A/4/46]**
[89] LBHI/SLP3's PP para 45 **[a/5/87]**; Reply PP para 67 **[A/10/211]**
[90] Deutsche Bank's PP paras 54-55 **[A/8/147]**

for the full face value of the principal and without discount under IR 14.44 or otherwise.[91] LBHI argues that that is wrong as a matter of construction.[92]

108. Deutsche Bank argues that on a true construction of the terms and conditions of the PLC Sub-Notes, the parties are to be taken as having agreed that the PLC Sub-Notes should be treated as immediately due and payable for the full face value of the principal in a distributing administration of PLC.[93] LBHI argues again that is wrong as a matter of construction.[94]

109. Deutsche Bank argues that there is to be implied a term into the terms and conditions of the PLC Sub-Notes that in a distributing administration of PLC they would become immediately due and payable at their full face-value.[95] LBHI says no such term is to be implied.[96]

110. Deutsche Bank argues that the admission of a proof or a distribution made on account of a proved claim in respect of the liability under the PLC Sub-Notes in a distributing administration of PLC amounts to a repudiatory breach of condition 6(d) (see example at **[E/9/132]**, such that GP1 is entitled to accept the repudiation and prove for damages in an amount equal to the full face value of the principal of the PLC Sub-Notes.[97] LBHI says that is wrong.[98]

111. Depending upon the determination of the issues considered above, a further set of issues arise, or may arise.

    (a) The first is whether the PLC Administrators ought to be directed to act so as to make the PLC Sub-Notes currently payable, thereby avoiding the discounting. Reliance is placed on IA 1986 Sch B1 para 74 and/or the rule in Ex parte James (1873-74) LR 9 Ch App 609. Deutsche Bank PP para 60 **[A/8/150]** argues that this direction should be made. LBHI/SLP3 Reply PP para 69(1)-(2) **[A/10/213-214]** argues that it should not.

    (b) The second is whether PLC's liability under the PLC Sub-Notes should be treated as a non-provable debt and if so with what consequences. Deutsche Bank contends that the liability is not provable, that IR 14.44 does not apply to non-provable debts and that the liability should be reserved for in full, or alternatively that it should be discounted at no more than the fixed/floating 15-year Swap Rate which is said to be 1.0016% p.a. as at the date of the position paper (Deutsche Bank PP paras 61-64 **[A/8/150-152]**).

[91] Deutsche Bank's PP paras 56-57 **[A/8/147-149]**
[92] LBHI/SLP3's Reply PP para 68(1) and (5) **[A/10/211 and213]**
[93] Deutsche Bank's PP para 56(4) **[A/8/148]**
[94] LBHI/SLP3's Reply PP para 68(2) **[A/10/212]**
[95] Deutsche Bank's PP para 56(5) **[A/8/149]**
[96] LBHI/SLP3's Reply PP para 68(3) **[A/10/212]**
[97] Deutsche Bank's PP para 56(6) **[A/8/149]**
[98] LBHI/SLP3's Reply PP para 68(4) **[A/10/213]**

    (c) The third is whether a proof can be submitted for PLC's liability under the PLC Sub-Notes to pay interest and, in this regard, whether on the true construction of IR 14.23 such interest is or is not to be treated as interest bearing on a debt. Deutsche Bank contends that if PLC's liability to pay principal under the PLC Sub-Notes is a future provable debt, then interest payable under the PLC Sub-Notes is also a provable debt and is not to be treated as interest bearing on a debt for the purpose of IR 14.23 (Deutsche Bank PP paras 65-66 **[A/8/152-153]**). LBHI/SLP3 argues that this is incorrect (LBHI/SLP3 Reply PP paras 69(1)-(3) **[A/10/214-215]**).

(7) PLC Application: guarantee liabilities

112. **(7.1) The issue:**

Whether the PLC Guarantee of the ECAPS ranks before, after or *pari passu* with the PLC Sub-Debt and the PLC Sub-Notes:

113. **(7.2) The opposing positions:**

114. LBHI says[99] that the PLC Guarantee liabilities have terminated, due to the striking off of GP1 on 22 June 2010[100] and the dissolution of the Issuers of the ECAPS, alternatively, the PLC Guarantee liabilities rank after the PLC Sub-Debt and the PLC Sub-Notes.

115. Deutsche Bank says that the PLC Guarantee remains in effect[101] but is subordinated to both the PLC Sub-Notes and the PLC Sub-Debt.

116. GP1 advances no positive position as to whether or not the PLC Guarantees have terminated but contends that, if they are enforceable, they rank behind both the PLC Sub-Notes and PLC Sub-Debt.[102]

117. However, no party is asking the Court to determine this issue because LBHI/SLP3, Deutsche Bank and GP1 all agree that the PLC Guarantee Liabilities rank after the PLC Sub-Debt and the PLC Sub-Notes.[103]

[99] LBHI/SLP3 PP paras 42 and 43(1) **[A/5/84-85]**
[100] GP1 was restored to the register in February 2017: see Bruce 3 para 67 **[A/4/37]**
[101] Deutsche Bank PP para 68 **[A/8/153]**
[102] For the reasons given at paras 43(2)-(7) of SLP3/LBHI's PP **[A/5/84-87]**
[103] LBHI/SLP3's PP paras 42 and 43(2)-(7) **[A/5/84-87]**, LBHI/SLP3's Reply PP paras 65-6 **[A/10/211]**, Deutsche Bank's PP's paras 68 and 71 **[A/8/153-154]** and GP1's PP para 6.3 **[A/9/156]**

F. CONCLUSION

118. The LBHI2 Administrators invite the Court to determine the issues as set out in the Application Notices and the position papers, as further explained in this Skeleton Argument. They are neutral as to the outcome but will of course provide whatever assistance may be required or desirable.

PETER ARDEN QC

Erskine Chambers

ROSANNA FOSKETT

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31 October 2019

ANNEX

Rectification of the 2008 Amendments to the LBHI2 Sub-Notes terms and conditions
Original text of condition 3(a) at [E/4/55]; amended text of condition 3(a) at [E/5/73]

The amendments to the original wording in condition 3(a) are underlined below. The deletions sought by LBHI/SLP3 on its rectification case (see para 30(4) of its PP at **[A/5/77]**) are in red (underlined) text.

"The Notes constitute direct, unsecured and subordinated obligations of the Issuer and the rights and claims of the Noteholders against the Issuer rank *pari passu* without any preference among themselves. The rights of the Noteholders against the Issuer in respect of the Notes are subordinated in right of payment to the Senior Creditors (as defined below) and accordingly payment of principal and interest (including Arrears of Interest as defined below) in respect of the Notes is (subject as provided below) conditional upon the Issuer being solvent at the time of, and immediately after, such payment, and accordingly no such amount which would otherwise fall due for payment could make such payment and still be solvent immediately thereafter. The conditionality referred to above shall not apply 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).

If any time (sic) 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), there shall be payable by the Issuer in respect of each Note (in lieu of any other payment by the Issuer) such amount, if any, as would have been payable to the Noteholder, if, on the day prior to the commencement of the winding-up and thereafter, such Noteholder were the holder of one of a class of preference shares in the capital of the Issuer having a preferential right to a return of assets in the winding-up of the Issuer over:

(i) the holders of all other classes of issued shares in each case for the time being in the capital of the Issuer; and

(ii) the Notional Holders,

on the assumption that such preference share was entitled to receive, on a return of assets in such winding-up, an amount equal to the principal amount of such Note together with Arrears of Interest (if any) and any accrued interest (other than Arrears of Interest).

For the purposes of the above provisions:

"Notional Holder" means any creditor of the Issuer whose claims against the Issuer on a winding-up are quantified as though they held a Notional Share.

"Notional Share" means any notional and unissued shares in the capital of the Issuer which have a preferential right to a return of assets in the winding-up of the Issuer over the holders of all other classes of issued shares for the time being in the capital of the Issuer but not further or otherwise.

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 Issuer which qualify (or save where their non-qualification is due only to any applicable limitation on the amount of such capital, would qualify) as Upper Tier 2 Capital or Tier 1 Capital (within the respective meanings given to such terms in the General Prudential Sourcebook published by the Financial Services Authority, as amended, supplemented or replaced from time to time)."