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

B E T W E E N:

THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS HOLDINGS PLC (IN ADMINISTRATION)
-AND-
(1) LEHMAN BROTHERS HOLDINGS INC.
(2) THE JOINT LIQUIDATORS OF LB GP NO 1 LIMITED (IN LIQUIDATION)
(3) DEUTSCHE BANK A.G. (LONDON BRANCH)

---and---

THE JOINT ADMINISTRATORS OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)
-AND-
(1) LEHMAN BROTHERS HOLDINGS SCOTTISH LP 3
(2) LEHMAN BROTHERS HOLDINGS PLC (IN ADMINISTRATION)
(3) DEUTSCHE BANK A.G. (LONDON BRANCH)

REPLY POSITION PAPER OF LEHMAN BROTHERS HOLDINGS INC. AND LEHMAN BROTHERS HOLDINGS SCOTTISH LP 3

Introduction

1. This reply position paper has been filed and served on behalf of LBHI[1] and SLP3 in accordance with paragraph 8(c) of the Order. That paragraph gives LBHI and SLP3 permission to file and serve a single joint reply position paper. Accordingly, this joint reply position paper sets out LBHI's reply to the position papers filed and served by GP No 1 and Deutsche Bank A.G. (London Branch) ("**Deutsche Bank**") in respect of the PLC Application, and SLP3's reply to the position papers filed and served by PLC, Deutsche Bank and LBHI2 in respect of the LBHI2 Application.

[1] Save except where expressly stated otherwise, the abbreviations adopted herein are the same as those used in the joint position paper filed and served by LBHI and SLP3 on 11 January 2019.

2. SLP3 and LBHI will follow the same structure as that adopted in their joint position paper (the "**Joint Position Paper**") filed and served on 11 January 2019:

   (1) In **Part A** of this reply position paper, LBHI and SLP3 set out their respective replies in relation to Issue 2 of the PLC Application and Issue 1 of the LBHI2 Application.

   (2) In **Part B** of this reply position paper, LBHI sets out its reply in relation to Issues 1 and 4 of the PLC Application. Issue 3 of the PLC Application is now agreed by the parties and is also addressed in Part B.

3. At the outset, LBHI/SLP3 identify three overarching and fundamental flaws in the contentions advanced by PLC, GP No 1 and Deutsche Bank in their respective position papers.

Failure to take into account the statutory scheme

4. At the core of GP No 1's and Deutsche Bank's contentions in relation to Issue 2 of the PLC Application, and PLC's contentions in relation to Issue 1 of the LBHI2 Application, is the false premise that the relevant subordinated instruments operate entirely independently from the statutory insolvency scheme. In particular, their positions are incorrectly premised on the assumption that one debt can *only* rank *pari passu* with another debt if the instruments creating one or both of the debts cross-refer to each other and expressly provide that they rank *pari passu*.

5. This is incorrect. If A subordinates its debt to C, and B subordinates its debt to C, A and B rank *pari passu* in an insolvency regardless of whether the instruments creating A's debt and B's debt cross-refer to each other or expressly provide that they rank *pari passu* with each other. After C has been paid in full, A and B are entitled to prove at the same time and they rank *pari passu* and must be paid in full, unless the assets are insufficient for meeting them, in which case they abate in equal proportions between themselves: Rule 14.12 of the 2016 Rules.

6. The operation of the statutory scheme is integral to the proper construction of subordination provisions. In the case of debts drawn up on the FSA Standard Forms, the Supreme Court's judgment in *Waterfall I* at [70] makes clear that the subordination mechanism takes effect within the existing framework of the statutory scheme by prohibiting a subordinated creditor from proving until after the senior creditors have been paid in full: Rule 14.40 of the 2016 Rules.

7. LBHI's and SLP3's case is the only one to recognise that the relevant subordinated instruments must take into account the operation of the statutory insolvency scheme.

Omission of crucial contractual words

8. Despite contending for a narrow, literal interpretation of the relevant subordinated instruments, the parties misquote critical provisions and/or, in paraphrasing those provisions, omit crucial words. For example:

   (1) PLC misquotes and/or incorrectly paraphrases the definition of 'Senior Creditors' under Condition 3(b) of the LBHI2 Sub-Notes.

   (2) PLC and Deutsche Bank both misquote and/or incorrectly paraphrase the amendments to Condition 3(a) of the LBHI2 Sub-Notes under the 2008 Amendments.

9. Unsurprisingly, the words omitted are those that sit uneasily with the constructions advanced by the other parties. In PLC's case, by omitting parts of the relevant definition of 'Senior Creditors' under the LBHI2 Sub-Notes ("*whose claims rank…pari passu with…the claims of the Noteholders*"), its arguments on construction fail to attribute any meaning whatsoever to the crucial words omitted.

10. LBHI's and SLP3's case is that a *pari passu* construction is the only answer to the ranking issues arising under Part A which gives effect and meaning to all the operative words within the relevant subordinated instruments.

Demonstrably incorrect factual assertions

11. Whilst PLC, Deutsche Bank and GP No 1 all contend that the factual matrix is of limited relevance/application, they nonetheless all seek to rely on it. However, the factual assertions made in support of their respective construction cases are demonstrably incorrect and unsupported by the evidence. For example:

   (1) Contrary to Deutsche Bank's suggestion (at [22(5)(i)]), it was *not* necessary nor ever intended that the LBHI2 Sub-Notes were to be treated as equity for US tax purposes.

   (2) Contrary to Deutsche Bank's assertion (at [22(3)-)(4)]), there was no incentive for LBHI (or the Lehman Group) to prioritise distributions to ECAPS Holders in an insolvency of PLC/LBHI2. This is because (as the evidence clearly shows) the ECAPS were intended to rank equivalent to non-cumulative preference shares i.e. junior to all the subordinated debt.

   (3) Contrary to Deutsche Bank's suggestion (at [52(2)]), the evidence plainly shows that the Lehman Group did *not* receive detailed tax advice that PLC should take all commercially reasonable steps to avoid the suspension of interest on the PLC Sub-Notes.

(4) Finally, contrary to the various assertions by PLC, GP No 1 and Deutsche Bank, neither the PLC Sub-Notes nor the LBHI2 Sub-Notes were documents that were publicly available.

12. These factual assertions are all liable to be determined on a summary basis and/or struck out.

PART A: RANKING ISSUES

Issue 2 PLC Application

Relevant Background

13. Deutsche Bank adopts mutually inconsistent positions on the permissible scope of the factual matrix in relation to Issue 2 of the PLC Application and Issue 1 of the LBHI2 Application:

(1) On Issue 2 of the PLC Application, Deutsche Bank contends that, among other matters, "*the context of the Lehman Group as a whole, and its tax and commercial objectives"* (at [49(iii)]) are relevant to determining "*what would have been agreed on the issue of ranking by reasonable persons in the position of the parties to the PLC Sub-Debt and the PLC Sub-Notes*" (at [49]).

(2) On Issue 1 of the LBHI2 Application Deutsche Bank contends that there is no need to refer to any extraneous evidence or the factual matrix of the relevant instruments, and that it is "*inappropriate and unnecessary for reference to be made to any such material*" (at [21]). Deutsche Bank nevertheless then relies on an expansive matrix of fact.

(3) There is no basis for this distinction and for limiting the factual matrix in relation to Issue 1 of the LBHI2 Application but for not doing so in relation to Issue 2 of the PLC Application. Both issues arise in an inter-related and evolving matrix of fact, and involve the construction of subordinated debts drawn up on the FSA Standard Forms and subordinated notes.

(4) The range of background facts relevant to the interpretation of the PLC Sub-Debt and the PLC Sub-Notes in this case is no more restricted than in an ordinary bilateral contract case in circumstances where all of the instruments in question were (i) not publicly available documents; (ii) addressed solely to entities forming part of the Lehman Group; (iii) devised and implemented by common, centralised decision makers and operational personnel as part of the ongoing restructuring of the Lehman Group's capital structure; (iv) negotiated in a non-adversarial context by the decision makers and/or personnel referred to above; and (v) intended never to be traded or transferred outside of the Lehman Group.

14. Deutsche Bank's priority arguments in relation to Issue 2 of the PLC Application are all based on an alleged (and non-existent) commercial imperative that the PLC Sub-Notes needed to rank ahead of the PLC Sub-Debt to prioritise payments to the Partnerships which issued the ECAPS. Deutsche Bank's approach is wrong in law and is dealt with below at [30(4)]. In any event the factual basis for Deutsche Bank's contention is also unsustainable for the reasons set out immediately below.

15. Deutsche Bank's overarching assertion is that there were "*powerful commercial reasons for ensuring that the issuers of the ECAPS at all times had sufficient funds to enable them to make scheduled distributions under the ECAPS*" (at [22(3)]). Underpinning this is the so called 'Dividend Stopper' argument. It is alleged that LBHI was "*incentivised*" to ensure scheduled distributions were paid under the ECAPS because it undertook not to pay dividends or repurchase any common stock if payments under the ECAPS were suspended (at [22(3)(iv)]). Further, it is claimed that if the Dividend Stopper had been triggered this "*would have had serious adverse consequences for LBHI*" (at [22(3)(v)]).

16. The 'Dividend Stopper' argument is, in truth, unarguable both in relation to Issue 2 of the PLC Application and Issue 1 of the LBHI2 Application. The commercial incentive the Dividend Stopper is said to give rise to (i.e. the need to prioritise payments under the PLC Sub-Notes over payments under the PLC Sub-Debt to avoid the mandatory operation of the Dividend Stopper) is demonstrably incorrect whether in a solvent or an insolvent scenario. As to this:

    (1) A dividend stopper is a feature included in certain types of hybrid capital instruments, where the issuer is permitted to defer distributions or payments of interest. The dividend stopper prohibits the issuer or another entity from paying dividends on more subordinated securities or on its common stock until all deferred payments have been paid.

    (2) The Dividend Stopper under the ECAPS is an undertaking given by LBHI and recorded at Condition 2.6 of the ECAPS' terms: "*LBHI has undertaken that, in the event that any Distribution is not paid in full, it will not: (a) declare or pay any dividend on its shares of common stock; or (b) repurchase or redeem and of its non-cumulative preferred stock or common stock at its option, until…..such time as Distributions on the Preferred Securities have been paid in full for one year.*"

    (3) In a solvent scenario there was no absolute obligation under the ECAPS to make any 'Distributions' to the ECAPS Holders at all: any obligation to do so was always subject to (i) the availability of funds received by the Issuer (Condition 2.3) and (ii) the unfettered

discretion of GP No 1 not to pay "*at any time and for any reason*" (Condition 2.4).[2] This was because the ECAPS had features primarily of equity and not debt.

(4) In an insolvent scenario, the Dividend Stopper under the ECAPS ceased to be of any significance. This is because in that scenario no dividends would be payable on LBHI's common stock irrespective of the operation of the Dividend Stopper. It is therefore self-evidently wrong that the PLC Sub-Notes were intended to rank senior to the PLC Sub-Debt in an insolvency so as to avoid the operation of the Dividend Stopper. Under Condition 2.4, GP No 1 is obliged to exercise its discretion *not* to make a 'Distribution' "*if such payment will cause a Trigger Event*". A 'Trigger Event' includes LBHI's bankruptcy. In the event that LBHI went bankrupt or a 'Distribution' would cause it to go bankrupt, the Dividend Stopper would inevitably be engaged because a 'Distribution' would be impermissible. Condition 5.1 of the ECAPS also envisaged that if a 'Trigger Event' occurred, the ECAPS would be substituted by depositary shares representing non-cumulative preferred stock issued by LBHI, in which scenario the Dividend Stopper would also be irrelevant.

(5) Moreover, all relevant parties agree that the PLC Guarantees executed for the benefit of the ECAPS Holders rank junior to the PLC Sub-Notes and the PLC Sub-Debt. That is correct. The ECAPS were intended to provide the ECAPS Holders with rights on liquidation equivalent to non-cumulative preference shares of PLC, whether or not issued. If, as Deutsche Bank contends, there was a commercial imperative to prioritise the PLC Sub-Notes over the PLC Sub-Debt so as to ensure the ECAPS Holders were paid, it would be non-sensical for the ECAPS Holders' rights under the PLC Guarantees to be so deeply subordinated in an insolvency of PLC that their claims rank *pari passu* with non-cumulative preference shares. That, however, is the agreed position, which strongly suggests Deutsche Bank's factual premise is fundamentally flawed.

(6) In any event, the ECAPS structure was not the only structure which contained a dividend stopper affecting LBHI's ability to pay dividends in certain circumstances. This is consistent with dividend stoppers being standard features of hybrid capital instruments. As of 2007, excluding the three series of ECAPS, there were at least 9 instruments which contained similar dividend stoppers. There was nothing so unusual about the existence of the Dividend Stopper so as to necessitate the PLC Sub-Notes ranking above the PLC Sub-Debt.

[2] Page 5 of the ECAPS offering circular stated: "*Distributions on the Preferred Securities are not cumulative. The discretion of the General Partner to resolve that a Distribution should not be paid is unfettered*."

17. Further, Deutsche Bank asserts that the Lehman Group received detailed tax advice that PLC should take all commercially reasonable steps to avoid the suspension of interest on the PLC Sub-Notes (at [52(2)]). This is understood to be a reference to an A&O opinion dated 30 March 2005 in relation to US federal income tax. The statement Deutsche Bank paraphrases is not tax advice of any kind, but merely records PLC's intentions on a best endeavours basis to remain commercially in a position to pay interest.[3] The analysis section of the opinion[4] considered that the suspension of interest on the PLC Sub-Notes would *not* cause a tax issue provided that interest continued to accrue, such that the opinion does not proffer the tax advice Deutsche Bank asserts. Deutsche Bank is therefore plainly wrong to claim that "*the Lehman Group received detailed tax advice that PLC should take all commercially reasonable steps to avoid the suspension of interest on the PLC Sub-Notes*".

18. As regards GP No 1's position on the relevant background to Issue 2, it makes three points:

    (1) First, it contends that the answers to the ranking questions on Issue 2 "*primarily*" require consideration of the actual terms of the various notes and debt instruments, and that LBHI/SLP3 overstate the significance of the background (at [12]). At the same time, the bulk of GP No 1's position paper addresses the factual matrix, and culminates in a section headed "*Revisiting the factual matrix*" (at [73]-[75]).

    (2) Second, it is said that the PLC Sub-Notes in particular "*were addressed to and would be relied upon by a potentially wide number of third-party investors who would lack knowledge of internal Lehman Group restructurings or intentions*" (at [11]). This is factually incorrect:

        i. Whilst the PLC Sub-Notes were listed on the Channel Islands Stock Exchange (in order to be a quoted Eurobond for tax purposes), their terms were not public but stored within the stock exchange's internal records.

        ii. The ECAPS Holders' rights were represented solely by the PLC Guarantees and the ECAPS themselves, and not by the PLC Sub-Notes. The ECAPS Holders were not entitled to receive or hold the PLC Sub-Notes themselves or any payments due in respect of them.

        iii. If the PLC Sub-Notes (or the PLC Sub-Debt) had ever been assigned or transferred out of the Lehman Group that would have defeated the very regulatory and/or tax

[3] "*[PLC] does not intend to be in a financial position where interest upon Subordinated Notes will be suspended and will take all commercially reasonable steps to avoid the suspension of interest"* ("Facts" section, page 3).
[4] See at page 9 of the opinion.

objectives they were intended to achieve. There was no intention to so assign or transfer them out of the group.

(3) Third, GP No 1 contends that the extent to which background facts are admissible is limited, relying on *Re Sigma Finance Corp* [2009] UKSC 2. *Re Sigma* (and the subsequent line of cases relied upon) is plainly distinguishable. In particular, these cases did not arise in the very specific factual circumstances set out at [13(4)] above.

PLC Sub-Debt

19. LBHI's position in relation to the ranking of the three tranches of subordinated debt making up the PLC Sub-Debt is that they rank *pari passu* for distribution among themselves because each tranche is subordinated behind the same 'Senior Liabilities'.

20. GP No 1, Deutsche Bank and PLC (in relation to the LBHI2 Sub-Debt) all adopt different positions with regard to the ranking of different tranches of debt drawn up on the same FSA Standard Forms. However, no coherent counter-argument is advanced by any party in respect of LBHI's *pari passu* construction.

21. PLC's position is that it "*agrees with SLP3 that the three tranches of the LBHI2 Sub-Debt rank pari passu among themselves*" (at [38]). This view must logically apply by extension to the ranking of the three tranches of the PLC Sub-Debt among themselves because both the PLC Sub-Debt and the LBHI2 Sub-Debt are drawn up on the same FSA Standard Forms.

22. GP No 1's position is that the three tranches of the PLC Sub-Debt do not rank *pari passu* among themselves. As to this:

(1) First, it is said that "*The drafting of the PLC Sub-Debts does not recognise or admit of the concept of pari passu ranking with the debts that are being subordinated*" (at [54.1]). This argument is self-evidently incorrect:

i. It depends on the false premise that one subordinated debt can only rank *pari passu* with another subordinated debt if the contract expressly provides that it may rank *pari passu* with another debt. Rather, where two debts are entitled to prove at the same time behind the same senior creditors then, by virtue of the statutory scheme, they rank *pari passu*, irrespective of whether the contract expressly provides that they rank *pari passu* with each other.

ii. It leads to absurd commercial consequences which are all the more improbable in circumstances involving standard forms issued by the FSA under IPRU(INV). If GP

No 1 is correct, then (as occurred in this case) two loans drawn up on the FSA Standard Forms entered into by the same lender on the same day with the same borrower could never rank *pari passu* and would necessarily be 'Senior Liabilities' for each other's purposes.

(2) Second, GP No 1 maintains (at [54.1]) that LBHI is wrong at [14(6)] of the Joint Position Paper to say that 'Senior Liabilities' under the PLC Sub-Debt include "*subordinated 'Liabilities' that are not expressed to rank nor do rank…pari passu…to the Subordinated Liabilities*". GP No 1 must therefore be taken to adopt the absurd position that 'Senior Liabilities' within the meaning of the PLC Sub-Debt include other subordinated debts that are expressed to rank or do rank *pari passu* with it. That construction is unsustainable.

(3) Third, and notwithstanding what is said at [54.1], GP No 1 accepts that in principle where two subordinated debts are subordinated to the same senior liabilities they are entitled to prove at the same time: "*True, that may be, but that principle does not apply here"* because each tranche of the PLC Sub-Debt is subordinated to "*liabilities which include the other PLC Sub-Debts"* (at [56]). All of the subordination provisions and relevant definitions under the PLC Sub-Debt are materially the same and the three tranches do not cross-refer to each other in any way. As a matter of construction, the tranches are obviously subordinated to the same 'Senior Liabilities' and are not 'Senior Liabilities' for each other's purposes.

(4) Fourth, it is said that as a result of its analysis an impasse arises to which "*Potential answers are that the first in time should rank ahead of the second in time and so forth, or vice versa, or that (by some mechanism which LBHI does not articulate) they rank pari passu between themselves"* (at [57]). This argument highlights the sheer absurdity of GP No 1's position:

i. The impasse only arises where it is posited that different subordinated debts drawn up on the FSA Standard Form cannot rank *pari passu*.

ii. GP No 1 provides no sensible solution to the impasse. There is nothing in the FSA Standard Forms to support the speculative view that the first subordinated debt in time should rank ahead of the second in time, or that the last in time should rank ahead of the penultimate and so forth. It is directly at odds with the FSA Standard Forms' nature as standard forms to contend that their meaning and effect should depend on the time they were entered into, such that they could never be relied upon as having the same meaning on all occasions: see *AIB Group (UK) Ltd v Martin* [2001] UKHL 63 at [7].

iii. It is incorrect that LBHI has not articulated the mechanism by which the tranches of the PLC Sub-Debt rank *pari passu* among themselves: the mechanism by which they rank *pari passu* is the statutory scheme (whose principle and effect GP No 1 appears to accept at [56]).

23. As regards Deutsche Bank, it is equivocal about its position on this sub-issue:

(1) Deutsche Bank says that, "*In other words, the terms of the PLC Sub-Debt allow no scope for any other liability to rank pari passu with the PLC Sub-Debt"* (at [40]). It is not clear whether Deutsche Bank is saying that (i) no tranche of the PLC Sub-Debt can rank *pari passu* with another tranche (as GP No 1 contends) or (ii) the PLC Sub-Debt does rank *pari passu* inter se but cannot so rank with any other debt (as appears from [39] of Deutsche Bank's position paper).[5]

(2) On either view, Deutsche Bank's position is incorrect:

i. The argument that the tranches of the PLC Sub-Debt might rank *pari passu* with each other but cannot do so with other debts is self-evidently wrong. Once it is accepted that one subordinated debt drawn up on the FSA Standard Forms can and does rank *pari passu* with another debt drawn up on the same form, it is wrong in principle to suggest that the *only* subordinated debts that may rank *pari passu* with it are debts drawn on the FSA Standard Forms. Rather, the reason the debts drawn up on the FSA Standard Forms rank *pari passu* among themselves is that they are subordinated to the same 'Senior Liabilities'. Therefore, where a debt drawn up on the FSA Standard Forms is subordinated to the same 'Senior Liabilities' as a debt that is *not* drawn up on those standard forms, the debts will nevertheless rank *pari passu*.

ii. Insofar as Deutsche Bank's position is that there is no scope for the different tranches of PLC Sub-Debt to rank *pari passu* among themselves, this is wrong for the reasons at [22] above.

PLC Sub-Notes

24. LBHI's position is that the three series of subordinated notes making up the PLC Sub-Notes rank *pari passu* for distribution among themselves.

25. Deutsche Bank does not appear to state an express position in relation to this issue.

[5] Deutsche Bank contends that under the PLC Sub-Debt, the definition of 'Subordinated Liabilities' "*applies only to liabilities under the PLC Sub-Debt, and all other liabilities (**that is, other than under the PLC Sub-Debt**) must therefore be either Excluded Liabilities…or Senior Liabilities…"* (emphasis added) at [39].

26. GP No 1 agrees with LBHI that the PLC Sub-Notes rank *pari passu* but it adopts differing reasoning:

(1) GP No 1 contends that: "*Whilst none of the PLC Sub-Notes is expressed to rank pari passu with any other in terms, neither is any subordinated to any other on the literal interpretation of each set of PLC Sub-Notes. Accordingly, they are each subordinated to exactly the same things or level as each other, and therefore rank pari passu with one another: Rule 14.12 of the 2016 Rules. On that point of logic and principle, LBGP1 agrees with LBHI*" (at [62]).

(2) GP No 1 argues that the reason why the three series of PLC Sub-Notes *do* rank *pari passu,* but the tranches of the PLC Sub-Debt *do not* rank *pari passu*, is because there is "*one key difference*" (at [59]) in the definition of 'Subordinated Liabilities' under the former and the latter. This is the inclusion of the additional wording "*and all other liabilities of the Issuer which rank or are expressed to rank pari passu with the Notes"*. However, those words do not have the import or weight that GP No 1 seeks to attribute to them.

(3) In particular, GP No 1's emphasis on the definition of 'Subordinated Liabilities' under the PLC Sub-Notes disregards the critically important regulatory context. If the additional words in that definition under the PLC Sub-Notes had an effect that was materially different to the definition under the PLC Sub-Debt, then PLC clearly would not have obtained an IPRU(INV) waiver from the FSA. In its position paper, GP No 1 is quite right to say that "*[t]he regulatory context was such that these [FSA Standard Forms] had to be used (or a waiver obtained, **which no doubt would have been easier the closer to the standard form the revised draft was**)"* (at [73.2]). Moreover, if GP No 1 is correct that the additional words had such an effect, PLC would have been in contravention of the directions given by the FSA on its IPRU(INV) waiver applications. The FSA's direction of 21 March 2006 concerning the waiver in relation to the PLC Sub-Notes stated under the heading "*Permitted differences*" in the accompanying schedule that "*The definition of 'Subordinated Liabilities' may be changed **only** to the extent required to reflect borrowing in a bond rather than a loan"* (emphasis added). Further, the schedule to the FSA's directions required that the extent of the subordination be "*no less*" than under the FSA Standard Forms. GP No 1's construction incorrectly assumes that the Lehman Group breached the FSA direction.

(4) All the additional words under the PLC Sub-Notes do is to make express what is obviously and necessarily possible under the FSA Standard Forms themselves, namely, that debts that rank or are expressed to rank *pari passu* with debts drawn on the forms are not 'Senior

Liabilities'. If this is wrong, and the additional words in the PLC Sub-Notes have the effect of materially departing from the FSA Standard Forms, then the PLC Sub-Notes would have been in breach of the FSA's directions.

Relative Ranking of the PLC Sub-Debt and PLC Sub-Notes

27. LBHI's position is that its claims in respect of the PLC Sub-Debt rank for distribution *pari passu* with the claims of GP No 1 under the PLC Sub-Notes.

28. Given that the three tranches of the PLC Sub-Debt must rank *pari passu* among themselves, and the three series of the PLC Sub-Notes are agreed to rank *pari passu* among themselves, the question is whether (i) the PLC Sub-Debt and the PLC Sub-Notes are subordinated to the same 'Senior Liabilities' such that they are entitled to prove at the same time and rank *pari passu* (as LBHI contends), or (ii) whether the PLC Sub-Debt is subordinated to the PLC Sub-Notes (as GP No 1 and Deutsche Bank contend, albeit through contradictory arguments).

29. GP No 1's position is that the PLC Sub-Debt is subordinated to the PLC Sub-Notes (at [66]). In support of this conclusion, GP No 1 makes the following four points, which all boil down to the inclusion of additional wording in the definition of 'Subordinated Liabilities' under the PLC Sub-Notes:

    (1) First, it is said (at [63]) that the difference in the definition of 'Subordinated Liabilities' under the PLC Sub-Debts and the PLC Sub-Notes is *"key to the analysis of the ranking"* between them. That is incorrect. As set out above, for regulatory purposes, there could be no difference in the PLC Sub-Notes' definition of 'Subordinated Liabilities' beyond reflecting borrowing in a bond as opposed to a loan format. In any event, on a true construction, there is no material difference between the instruments because the tranches of the PLC Sub-Debt must necessarily rank *pari passu* amongst themselves and, therefore, are capable of ranking *pari passu* with other debts.

    (2) Second, GP No 1 repeats (at [64.1]) the bad point that the PLC Sub-Debt is not *pari passu* with anything. This view is unsustainable for the reasons above.

    (3) Third, it is said (at [65]) that the PLC Sub-Debt are 'Excluded Liabilities' for the purposes of the PLC Sub-Notes. LBHI notes that Deutsche Bank disagrees with this view (at [43]-[44]). There, Deutsche Bank says that both sets of instruments appear on their face to be 'Senior Liabilities' within their respective definitions of that term. As Deutsche Bank's position demonstrates, if the PLC Sub-Notes and the PLC Sub-Debt do not rank *pari passu* there is no logical basis on which one or the other should rank senior or junior.

(4) Fourth, it is said (at [67]) that as a consequence of not being *pari passu* with anything the PLC Sub-Debt will always fall to the 'bottom of the pile', save in respect of debts which are expressed to be more junior still. This leads to an evident absurdity in that it assumes that each tranche of the PLC Sub-Debt will fall to the bottom of the pile vis-à-vis another tranche, leading to an insoluble circularity. GP No 1 fails to articulate how, if the PLC Sub-Debt does indeed fall to the bottom of the pile, it would not rank below UT2 or even T1 capital. Further, if GP No 1 is correct that debts drawn up on the FSA Standard Forms always fall to the 'bottom of the pile' then in the context of Issue 1 of the LBHI2 Application, where the LBHI2 Sub-Notes contain additional wording in Condition 3(b) expressly envisaging other debts which "*rank…pari passu with the Notes*", the LBHI2 Sub-Debt would also fall to the 'bottom of the pile' and rank below the LBHI2 Sub-Notes by the same logic.

30. Deutsche Bank's position (at [46]) is that the PLC Sub-Notes rank senior to the PLC Sub-Debt. It reaches this conclusion by reasoning that is at odds with GP No 1:

(1) First, Deutsche Bank starts from a similar premise to GP No 1. It states (at [39]) that there is a "*significant difference*" in the definition of 'Subordinated Liabilities' between the PLC Sub-Notes and the PLC Sub-Debt, which means that "*all other liabilities (that is, other than under the PLC Sub-Debt) must therefore be either Excluded Liabilities…or Senior Liabilities*". Deutsche Bank's position is equivocal on the ranking of the PLC Sub-Debt *inter se* (see above). In any event, for the reasons stated at [23] above Deutsche Bank's starting premise is a false one.

(2) Second, it is admitted (at [42]) that "*Which of the PLC Sub-Notes and the PLC Sub-Debt ranks senior and which ranks junior is not immediately clear on the face of their terms"*. However, despite starting from a similar premise to GP No 1, Deutsche Bank does not adopt the (incorrect) 'bottom of the pile' thesis.

(3) Third, it is said (at [44]) that under the terms of the PLC Sub-Debt, the PLC Sub-Notes are 'Senior Liabilities' and that *"[b]y the same reasoning"* on the face of the terms of the PLC Sub-Notes, the PLC Sub-Debts are 'Senior Liabilities'. Deutsche Bank fails to address or explain why the PLC Sub-Debt does not "*rank pari passu"* with the PLC Sub-Notes. This is the obvious answer to the false circularity which posits that one debt *must* rank senior to the other. Deutsche Bank's position is plainly incorrect in circumstances where the *pari passu* principle is part of the matrix relevant to the construction of the instruments, especially where the alternatives are as improbable as those posited by Deutsche Bank: see *Re Golden Key* [2009] EWCA Civ 636 at [6].

(4) Fourth, it is said (at [46]) that Deutsche Bank relies on a "*different legal mechanism*" to break the circularity to the mechanism proposed by GP No 1. As to the "*legal mechanisms"* to break the purported circularity, Deutsche Bank argues as follows (at [47]):

i. First, it is said that the PLC Sub-Debt and/or the PLC Sub-Notes should be construed to give effect to what the parties would have objectively intended if they had contemplated the relative ranking "*namely that the PLC Sub-Notes must rank senior to the PLC Sub-Debt so as to avoid the possibility that neither would ever be paid"*. However, this states a conclusion without any analysis. The argument assumes the construction it seeks to justify. The circularity could equally be broken by the PLC Sub-Debt ranking senior, which would also avoid the possibility that neither would ever be paid. There is no objective (or commercial) reason to assume that one or the other would or was intended to be paid at the expense of the other.

ii. Second, it is said that a term needs to be implied "*into one or both of the PLC Sub-Debt and the PLC Sub-Notes*" on one of two bases: (i) that such a term is obvious or necessary in order to make the contracts work and give them commercial and practical coherence (relying on *Marks and Spencer Plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2016] AC 742); or (ii) on the basis that such a term must be implied to avoid the contact being incomplete in the absence of a term (relying on *Liverpool City Council v Irwin* [1977] AC 239). As to this:

(a) As to the former basis, there are no grounds to imply such a term in fact. Such an implied term is not necessary for the business efficacy of the contracts: the contracts work perfectly effectively in the context of the statutory scheme, such that the false circularity Deutsche Bank identifies never arises. It is also far from obvious in the sense required in the authorities that such a term conferring priority on one party over another should be implied (on the meaning of 'obvious' see *The Interpretation of Contracts*, Lewison, at para 6.09)[6].

(b) As to the latter basis, incompleteness in and of itself is no basis to imply a term in law into a class of contracts. Moreover, it is self-evidently wrong to seek to imply a term in law as a legal incident of the parties' relationship that the PLC Sub-Notes should rank senior. It cannot be seriously suggested that it is

[6] Indeed, were it necessary to imply a term into the FSA Standard Forms at all, the only term that would meet the obviousness test would be the inclusion of the words "…..*and all other liabilities of the Issuer which rank or are expressed to rank pari passu [with the Subordinated Liabilities]*" into the definition of "Subordinated Liabilities" i.e. the additional wording that was added in the PLC Sub-Notes because it reflects the position at law.

appropriate where one is dealing with standard form contracts and contracts based on standard forms to imply a term in law relating to the priority of one over the other: see *The Interpretation of Contracts*, Lewison, at para 6.02.

(5) Finally, Deutsche Bank seeks to rely (at [51]-[52]) on a "*timing*" point, and the "*tax and commercial objectives of the Lehman Group*". In relation to these:

i. The timing point is based on various fallacies. First, it assumes that the "*only logical conclusion*" to be drawn from the fact that the PLC Sub-Notes do not refer to the PLC Sub-Debt is that the PLC Sub-Debt is "*the most deeply subordinated*" (at [51(3)]). There is no basis for this assumption. The argument merely assumes (without more) the construction it seeks to justify. Notably, if Deutsche Bank were correct on its timing point, then, in the context of Issue 1 of the LBHI2 Application, the absence of any reference in the LBHI2 Sub-Notes to the LBHI2 Sub-Debt (which was the earlier in time) would also tend to the same "*logical conclusion*" as to the LBHI2 Sub-Notes' seniority. Second, Deutsche Bank posits that the non-inclusion of the additional *"rank or are expressed to rank pari passu"* language in the third tranche of the PLC Sub-Debt is consistent only with an intention to subordinate it to the PLC Sub-Notes (at [51(3)]). The subordination provisions under the PLC Sub-Debt and the PLC Sub-Notes had to operate in the same way. There was no need to amend one to track the wording of the other in circumstances where they already had the same meaning and effect.

ii. The tax and commercial objective points are also misconceived. There is nothing in the Dividend Stopper point to support the contention that the PLC Sub-Notes had to rank senior to the PLC Sub-Debt as opposed to *pari passu* or even junior to it for the reasons at [15]-[16] above. The tax point is also factually incorrect for the reasons at [17] above.

Issue 1 LBHI2 Application

Relevant Background

31. PLC adopts a materially similar position to that taken by GP No 1 in relation to the relevant background in respect of Issue 2 of the PLC Application. PLC's position is rejected for similar reasons as given in relation to GP No 1.

32. PLC contends (at [19.1]) that *"a very narrow factual matrix is admissible"* and (at [20]) that the Court should *"start (and, it is probable, end) with the words used by the parties"*. The principal basis advanced to justify this approach (at [19.1]) is that the LBHI2 Sub-Notes were "*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". However:

(1) The cases cited at [19.1] are distinguishable and are not on all fours with the present case because of the particular circumstances described above. Paragraph 13(4) above is repeated.

(2) The LBHI2 Sub-Notes were (as with the PLC Sub-Notes) deliberately created on the Channel Islands Stock Exchange in order to be a quoted Eurobond for tax purposes. Their terms were not public (but stored within the stock exchange's internal records). Further (and as with the PLC Sub-Notes), there was no intention to assign or transfer the LBHI2 Sub-Notes outside of the Lehman Group.

33. In this context, SLP3 and LBHI agree with PLC (at [19.2]) that a critical issue in the case will be the correct approach to factual matrix evidence in the context of agreements which are negotiated (i) in a non-adversarial context (ii) within a group structure and (iii) by the same, centralised decision-makers. The factual matrix points overwhelmingly against the construction advanced by PLC and Deutsche Bank.

34. Deutsche Bank also purports (at [21]) to adopt a textual approach. However, its ranking arguments in relation to Issue 1 rely on a much broader matrix of fact than that relied upon by SLP3: see at [22]. More particularly, Deutsche Bank argues (at [22(2)]) that there were certain (i) commercial and (ii) tax reasons why the LBHI2 Sub-Debt had to rank in priority to the LBHI2 Sub-Notes. There is nothing in either of these points:

(1) As to the alleged commercial reasons, Deutsche Bank relies on the Dividend Stopper argument in relation to Issue 1 as it did in relation to Issue 2 of the PLC Application (at [22(3)]-[22(4)]). The Dividend Stopper argument is misconceived for all the reasons set out at [16] above. The argument is even more manifestly implausible when relied on in the context of Issue 1.

i. It is said that "*In order to ensure that the issuers of the ECAPS could be kept in sufficient funds, it was necessary to ensure that LBHI2 should be able to prioritise payments under the LBHI2 Sub-Debt over payments under the LBHI2 Sub-Notes"* (at [22(4)]). This is unsustainable. The LBHI2 Sub-Notes and the LBHI2 Sub-Debt were two levels removed from the ECAPS regime in the Lehman Group's capital structure. Deutsche Bank's contention amounts to saying that the Lehman Group's capital structure as a whole was specifically designed to ensure the payment of the ECAPS Holders, notwithstanding that the ECAPS Holders' right to receive any funds under the

ECAPS was always subject to GP No 1's absolute discretion, and in an insolvency scenario it was envisaged that the ECAPS would be substituted for preferred stock in LBHI (thus implementing a structural subordination).

ii. It is also said in support of this argument that "*sums received by PLC under the LBHI2 Sub-Debt were a key source of funds for PLC, in turn, to be able to fund payments under the PLC Sub-Notes*" (at [22(4)(ii)]). This fundamentally misunderstands the way that payments in the Lehman Group (including interest payments) were made by way of book entries. The Lehman Group's ability to source cash for the payment of the ECAPS Holders was not dependent on PLC being paid by LBHI2. It was dependent solely on the UK branch of LBHI ("**LBHI UK**") having cash.

(2) As to the alleged tax reasons, it is said that "*it was necessary for the LBHI2 Sub-Notes to be treated as equity for US tax purposes and, at the same time, as debt for UK tax purposes*" (at [22(5)(i)]). Deutsche Bank's assertion is based on a misreading of the documents. Both the US tax advice from A&O dated 1 May 2007 and the memorandum circulated by Jackie Dolby in May 2007 confirm that the LBHI2 Sub-Notes were treated as *debt* (and not equity) for US tax purposes. This argument is amenable to determination on a summary basis and/or should be struck out.

First Sub-Issue: May 2007

LBHI2 Sub-Debt

35. SLP3's position in relation to the ranking of the three tranches of subordinated debt making up the LBHI2 Sub-Debt is that they rank *pari passu* for distribution among themselves.

36. As noted above, PLC (at [38]) agrees with SLP3 that the three tranches of the LBHI2 Sub-Debt rank *pari passu* among themselves. PLC does not provide any explanation or analysis. Three notable points flow from this:

(1) First, it is said (at [45]) that "*the LBHI2 Sub-Debt does not even on its face allow for the possibility of a pari passu ranking with other subordinated debt"*. Nevertheless, PLC agrees with SLP3 that on a true construction the three tranches of LBHI2 Sub-Debt rank *pari passu*. It is to be assumed that PLC agrees that this is by virtue of ranking behind the same 'Senior Liabilities' and the operation of the statutory insolvency scheme.

(2) Second, it is said (at [30]) that "*there was no published guidance or case law of which PLC is currently aware explaining what was to happen if two competing creditors were claiming under instruments which both contained the same cross-referential subordination*

wording, or how that wording was to operate". There was no need for guidance or case law because the operation of the provisions is obvious under the statutory scheme: they would rank *pari passu*.

(3) Third, it is said (at [42]) in relation to the subordination mechanism under the LBHI2 Sub-Debt that it is "*of general subordination to other debt, **save for liabilities "expressed to" rank junior in any Insolvency**"* (emphasis added). This is inconsistent with PLC's position at [38]. At a minimum, on PLC's own case, there is a general subordination to other debt, save for liabilities expressed to rank junior and liabilities ranking *pari passu*.

LBHI2 Sub-Notes

37. At the outset, SLP3 notes that PLC's description of the terms of the LBHI2 Sub-Notes is inaccurate, despite its avowed reliance on a textual construction of the instruments in question. Both prior to and after the 2008 Amendments, the definition of 'Senior Creditors' under Condition 3(b) was defined to mean:

"*creditors of the Issuer (i) who are unsubordinated creditors of the Issuer or (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**"* (emphasis added).

38. PLC repeatedly misdescribes the operative subordination provisions. It is said (at [43]) that: "*[t]he LBHI2 Sub-Notes are subordinated to Senior Creditors, who comprise (a) all unsubordinated creditors; and (b) subordinated creditors **save those expressed to rank pari passu or junior***" (emphasis added). It is also said that this is "*an expression of juniority to all subordinated debt subject only to the qualification or exception of subordinated debt which itself **is expressed to be pari passu with or junior** to the LBHI2 Sub-Notes"* (emphasis added). PLC simply omits the words in bold from the definition above, which states on its face that subordinated creditors of LBHI2 "*whose claims rank…pari passu with…the claims of the Noteholders"* are not 'Senior Creditors' for the purposes of the LBHI2 Sub-Notes.

39. PLC's omission of operative words in the LBHI2 Sub-Notes is telling:

(1) The words "*whose claims rank…pari passu with…the claims of the Noteholders"* are omitted because they are incompatible with PLC's approach to the ranking question under Issue 1.

(2) PLC's entire approach to Issue 1 is predicated on the idea that the LBHI2 Sub-Debt and the LBHI2 Sub-Notes each "*employ a referential structure*", where there is a broad

subordination to other debt but where each instrument allows for the possibility that another instrument (at [40]) "*may **express itself** to be more deeply subordinated"* (emphasis added). This view does not accommodate the wording of the LBHI2 Sub-Notes that PLC has omitted. Those words make clear that the LBHI2 Sub-Notes allow for the possibility that another instrument may rank *pari passu*. Moreover, PLC's approach is self-evidently contradictory with other aspects of PLC's own case because (i) on the one hand, PLC assumes that it is not possible for two debts to rank *pari passu* without *expressing* themselves to rank *pari passu* and (ii) on the other hand, PLC accepts that the LBHI2 Sub-Debt contains no contractual expression that it ranks *pari passu* with tranches of the same and yet it acknowledges that the tranches do rank *pari passu*.

(3) PLC's referential framework is flawed because it ignores the statutory scheme, which does not require express cross-referencing between debts for them to rank *pari passu*.

Relative Ranking of the LBHI2 Sub-Debt and LBHI2 Sub-Notes

40. SLP3's position is that SLP3 is entitled to prove for the full nominal amount of the LBHI2 Sub-Notes at the same time as PLC is entitled to prove in respect of the LBHI2 Sub-Debt and, by operation of the 2016 Rules, SLP3's claims in respect of the LBHI2 Sub-Notes and PLC's claims in respect of the LBHI2 Sub-Debt rank *pari passu* and abate in equal proportions.

41. PLC's position (at [6]) is that the LBHI2 Sub-Notes were intended to rank junior to the LBHI2 Sub-Debt when they were issued in May 2007. It relies on two principal bases (at [41]): (i) the "*differing wording"* of the instruments; and (ii) the timeline. Both arguments are flawed:

(1) First, as to the differing wording, it is said (at [45]) that the LBHI2 Sub-Debt makes "***no express reference** to its position vis-à-vis other subordinated debt"* such that "*[in] the absence of any reference to its position vis-à-vis other subordinated debt, the LBHI2 Sub-Debt does not carry the **necessary expression** required to satisfy the qualification in the LBHI2 Sub-Notes"* (emphasis added) (at [46]).

(2) PLC's case is wrong because it rests on the following false premises:

i. That the subordination provisions are based on an entirely 'referential' scheme. This is wrong for the reasons at [39] above.

ii. That in order not to be a 'Senior Creditor' for the purposes of the LBHI2 Sub-Notes, another debt must be *expressed* to rank *pari passu* with them (see at [43]). This ignores the operative words in the definition of 'Senior Creditors', which excludes debts which "*rank…pari passu*" with the LBHI2 Sub-Notes. Accordingly, the LBHI2 Sub-Debt

need not contain an express reference to the LBHI2 Sub-Notes in order to rank *pari passu* with them.

iii. That there is no difference between debts expressing themselves to rank *pari passu*, and debts ranking *pari passu*. PLC's case elides the distinction expressly drawn on the face of the LBHI2 Sub-Notes between the two categories. It thereby fails to accord any meaning to operative subordination language in the LBHI2 Sub-Notes.

(3) Second, as to the timeline point, it is said (at [47]) that this provides "*clarificatory context*". The point is made that chronologically the LBHI2 Sub-Debt preceded the LBHI2 Sub-Notes. This is said to lead to the conclusion (at [47.3]) that "*Had the draftsmen of the LBHI2 Sub-Notes wished to ensure that the LBHI2 Sub-Debt fell within the qualification to the subordination provisions, so as to avoid juniority to the LBHI2 Sub-Debt, then they could easily and would have said so, **identifying the LBHI2 Sub-Debt by name and date**"*. This argument illustrates the flaws in PLC's overarching analysis:

i. The argument assumes that the only way for debts to rank *pari passu* is for one to identify the other "*by name and date*". This is false. It is illustrated by the LBHI2 Sub-Debt. The tranches did not make any reference at all to other subordinated debts and nevertheless (as PLC accepts) they rank *pari passu*.

ii. Moreover, it is unhelpful to posit what the draftsperson could have said to make the position yet clearer. The question is what the true interpretation of the expression in the contract is: *Charrington & Co v Wooder* [1914] AC 71, 82.

iii. Since PLC is minded to undertake an inquiry into what the draftsperson in this case actually intended, then SLP3 will rely on the fact that the relevant draftspersons at A&O were not in fact aware that any other LBHI2 subordinated debt would remain in existence and outstanding after the issue of the LBHI2 Sub-Notes, so had no reason to refer to the LBHI2 Sub-Debt specifically. In that regard, the reference to "*subordinated creditors*" in the definition of 'Senior Creditors' merely allowed for the possibility that in the future LBHI2 might wish to create subordinated debt that was either not expressed to rank or did not rank *pari passu* with the LBHI2 Sub-Notes.

iv. Finally, PLC relies on a so-called "*lack of contrary express statement*" in the LBHI2 Sub-Debt. This ignores the obvious point that the LBHI2 Sub-Debt could not have expressly referred to the LBHI2 Sub-Notes because it pre-dated the LBHI2 Sub-Notes by 6 months.

42. Deutsche Bank's position (at [8]) is that the LBHI2 Sub-Notes rank for distribution behind the LBHI2 Sub-Debt. Deutsche Bank relies on three arguments. As to these:

(1) There is nothing in the first two arguments, which are based on the extended factual matrix. The Dividend Stopper argument (at [22](3)]) is wrong. The tax point (at [22(5)]) is unarguable. These points are respectively addressed at [34(1)] and [34(2)] above.

(2) As to the third argument, Deutsche Bank relies (at [18]) on the definition of "*solvent*" under the LBHI2 Sub-Notes, in particular the words "*is able to pay its debts as they fall due"*. It is said (at [18(3)]) that "*there is no equivalent solvency condition in the LBHI2 Sub-Debt"* and that this reflects an intention for the LBHI2 Sub-Notes to be "*the most deeply subordinated form of debt of LBHI2*". As to this:

i. This is a variant of GP No 1's 'bottom of the pile' thesis. There is no basis for suggesting that it was objectively intended that the LBHI2 Sub-Notes ranked below even UT2 debt, for example, by virtue of the solvency wording in circumstances where it is agreed that the LBHI2 Sub-Notes were LT2 debt: see PLC's position paper at [56.3].

ii. Once 'Senior Creditors' have been paid in full, there are no other relevant debts that need to be paid in order to satisfy the elements of the solvency condition. SLP3's position is that payment of any amount of the LBHI2 Sub-Notes is conditional on LBHI2's ability to pay its 'Senior Creditors' in full (see Joint Position Paper at [23(2)]).

iii. In any event, there is an equivalent solvency condition in the LBHI2 Sub-Debt: see Condition 5(2), "*the Borrower shall be "solvent" if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding….the Excluded Liabilities*".

(3) GENPRU 1.2.26R, cited by David Richards J in *Waterfall I* at [42], provided that the purpose of the capital adequacy requirements under that regime was to: "*at all times maintain overall financial resources, including capital resources and liquidity resources, which are adequate, both as to amount and quality, **to ensure that there is no significant risk that its liabilities cannot be met as they fall due***" (emphasis added). The words relied upon by Deutsche Bank merely reflect the purpose of the regulatory regime which applied to the LBHI2 Sub-Notes at the relevant time under GENPRU. There is nothing in the additional language.

Second Sub-Issue: 2008 Amendments

The 2008 Amendments are not engaged

43. SLP3's position is that the amended wording in Condition 3(a) is only engaged where an order is made or a resolution passed putting LBHI2 into liquidation, such that the relevant amendments are not engaged in LBHI2's administration.

44. PLC contends (at [59]) that the words "*winding up"* includes a "*distributing administration*" by which it means an administration in which the administrators are making distributions. Further, it is said (at [64.3]) that a distributing administration is "*functionally the same as a distribution through an Insolvency Act winding up*". In support of this it is contended (at [64.4]) that "*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"*. This is misconceived. Administration is functionally distinct to winding up. In a liquidation the assets of the company must be realised and distributed through the process of admission to proof and distribution to creditors. An administration is not a winding up. *First*, the primary purpose of administration is the rescue of the company as a going concern: paragraph 3 of Schedule B1. Making distributions to creditors is not a purpose of administration. There may or may not be interim or final payments or distributions to creditors. The sole purpose of winding up is the realisation and distribution of assets. *Second*, a 'distributing administration' is not a separate procedure from administration or a term used in the insolvency legislation. It is simply an informal description referring to an administration in which distributions are being made. *Third*, a "*resolution*" or "*order*" for administration cannot engage the amended wording under Condition 3(a). *Fourth*, contrary to PLC's assertion (at [65]), a distribution in an administration need not be made by "*order*" unless it falls within paragraph 65(3) of Schedule B1.

45. PLC's arguments at [60]-[67] fundamentally ignore (i) the regulatory requirements against which the LBHI2 Sub-Notes fall to be construed and (ii) the fundamental differences between liquidation and administration:

    (1) First, in order to qualify as tier two capital resources (and PLC agrees that the LBHI2 Sub-Notes qualified as LT2 capital prior to and after the 2008 Amendments at [56.3]), the LBHI2 Sub-Notes had to comply with the requirements under GENPRU. As to this:

        i. GENPRU permits acceleration only in a winding up, and not in an administration. This is because acceleration would defeat the stated purposes of administration by, among other things, terminating the ability of the company to continue as a going concern. As to this:

(a) the "*only*" event of default must be non-payment of any amount falling due or "*the winding up of the firm*" (GENPRU 2.2.159(2)R);

(b) the debt must not become due and payable prior to maturity except on an event of default under 2.2.159(2)R, and in certain other instances (GENPRU 2.2.159(5)R); and

(c) a distinction is drawn between "*winding-up*" (which may constitute an event of default) and "*administration*", which may not amount to an event of default but in which process a subordinated creditor is entitled to prove for its debt (GENPRU 2.2.159(3)R).

ii. Condition 8(b) of the LBHI2 Sub-Notes reflects GENPRU, permitting acceleration only in a winding-up. Thus, it permits the Noteholder to declare the LBHI2 Sub-Notes to be due and payable "*If an order is made by any competent court or a resolution passed for the winding-up or dissolution of the Issuer*".

iii. Condition 3(a) (as amended) reflects Condition 8(b), and the effect of the provision was to accelerate the LBHI2 Sub-Notes in a winding-up (but not in an administration). SLP3 agrees with PLC (at [62.2]) that Condition 8(b) uses "*the same wording as is used in the Clause 3(a) amendment*".

iv. Accordingly, by virtue of being an event of default entitling the Noteholder to declare the Notes to be due and payable, the term "*winding up*" under Condition 8(b) must exclude administration, whether distributing or otherwise, if the LBHI2 Sub-Notes are to comply with GENPRU. It follows that the identical phrase deployed in Condition 3(a) (which provides that the effect of a "*winding up*" is automatically to accelerate the LBHI2 Sub-Notes) should bear the same meaning as in Condition 8(b) and exclude administration.

v. In the circumstances, including the applicable regulatory context, Condition 3(a) can only apply in a winding-up (but not in an administration).

(2) Second, it is said (at [63]) that if SLP3 is right about Condition 3(a) not being engaged, then it would be without any remedy at all in a distributing administration, because Condition 8(c) states that "*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*". Under Condition 8(a), SLP3 is entitled to "***enforce payment*** *by instituting proceedings for the Insolvency of the Issuer*" in certain

circumstances. By analogy with Lewison LJ's reasoning in relation to the FSA Standard Forms in *Waterfall I*, at [39], "*the only way of obtaining payment of a debt in an insolvency is by proving it in accordance with the rules, it must in my judgment have been envisaged that the subordinated creditor would be entitled to prove for its debt"*. It follows that where Condition 8(c) provides that no remedy is available to SLP3 "*other than as specifically provided by Condition 8(a) and 8(b)*", this includes the ability for SLP3 to prove for its debt under Condition 8(a). Alternatively, the expression "winding-up" under Condition 8(c) includes an administration in circumstances where GENPRU 2.2.159(3)R expressly permits a subordinated creditor "*proving for the debt in the liquidation or administration*".

46. Deutsche Bank adds a further argument (at [17]) which is said to result in the LBHI2 Sub-Notes ranking junior even if LBHI2 is not in a "*winding-up"*. It is said that the definition of 'Excluded Liabilities' under the LBHI2 Sub-Debt includes 'Liabilities' that are "*expressed to be…junior to the 'Subordinated Liabilities' in any Insolvency of the Borrower"*. It is said (at [17(2)-(4)]) that the LBHI2 Sub-Notes fall within this definition even if LBHI2 is not actually in a winding-up. As to this:

    (1) This is misconceived. Deutsche Bank's case amounts to arguing that even in a scenario where the LBHI2 Sub-Notes rank *pari passu* with the LBHI2 Sub-Debt, the 2008 Amendments nevertheless express the LBHI2 Sub-Notes to be junior.

    (2) Deutsche Bank posits that even where (i) LBHI2 is not in the relevant insolvency process which is said to engage the language that has the effect of making the LBHI2 Sub-Notes junior; (ii) in a scenario where the unamended solvency condition applies; (iii) where the LBHI2 Sub-Debt must *ex hypothesi* rank *pari passu* with the LBHI2 Sub-Notes (otherwise the Second Sub-Issue under Issue 1 would not arise), the LBHI2 Sub-Notes are nevertheless expressed to rank junior in the insolvency. The LBHI2 Sub-Notes cannot simultaneously rank *pari passu* with and be expressed to be junior to the LBHI2 Sub-Debt.

The 2008 Amendments do not alter priorities

47. SLP3's position is that the amendments to Condition 3(a) did not have the effect of altering the relative ranking between the LBHI2 Sub-Debt and the LBHI2 Sub-Notes, such that they continued to rank *pari passu* after the 2008 Amendments.

48. PLC's position as to the precise effect of the 2008 Amendments is unclear. In its summary, PLC states (at [7]) that the seniority of the LBHI2 Sub-Debt to the LBHI2 Sub-Notes is "*confirmed by*

the 2008 Amendments". However, PLC also states (at [50.2]) that the 2008 Amendments operate by "*expressly confirming the existing position or by creating a new position by amendment"*.

49. As to the "confirmatory" argument, the solvency condition, on any view, is only disapplied in a "*winding-up*". The mechanism is different *within* a winding-up (however broadly that term is construed) as compared to outside of it. If indeed the language is intended expressly to confirm an existing position, namely, the subordination of the LBHI2 Sub-Notes to the LBHI2 Sub-Debt, it makes little sense for it to create two subordination regimes and for the new regime *only* to apply in a "*winding-up"*.

50. In support of its position, PLC relies on the amended language of Condition 3(a). However, it again, incorrectly paraphrases the express contractual wording. After having paraphrased the amendments (at [51.2(b)]) to Condition 3(a), it is said (at [51.3(b)]) that the new wording "*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"*. There are then further statements of this kind (see at [51.3(c)], [51.3(d)], [52] and [53]). This is the core of PLC's case on the 2008 Amendments. However, PLC again mischaracterises the plain wording of the amended language:

    (1) First, the "*preference share*" referred to in the body of Condition 3(a) is a hypothetical construct, the notional nature of which is conveyed by the use of the subjunctive mood as well as the express words "*on the assumption that such preference share*".[7] The Noteholder does not become the actual holder of an actual preference share.

    (2) Second, the express language used provides that the LBHI2 Sub-Notes rank above (i) actual shareholders (in relation to all issued shares i.e. ordinary and preference) and (crucially) (ii) the "*Notional Holders*". The Notional Holders are defined as a particular class of "*creditor"* of LBHI2. Only a holder of debt and not equity could conceivably be referred to as a "*creditor*". Accordingly, the 2008 Amendments expressly provide that the LBHI2 Sub-Notes rank *above* both (i) other forms of debt by ranking above other "*creditors*" as well as (ii) equity.

    (3) Third, PLC is therefore wrong when it states (at [51.3(c)]) that "*By deeming the Noteholder claims to be equivalent to those of preference shareholders, the amendment relegates the Noteholder claims behind all creditors, including all other subordinated creditors*". The

[7] "*…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"* (emphasis added).

amended language does no such thing. The Noteholders are not deemed to be equivalent to preference shareholders: they expressly rank above other creditors of LBHI2 and, in turn, above *all* shareholders. Preference shares do not rank above debts in an insolvency: see the waterfall in *In re Nortel GmbH (in administration)* [2013] UKSC 52 at [39].

(4) Fourth, PLC is also wrong to state (at [51.4]) that the italicized wording at the end of Condition 3(b) provides that the Noteholders have a right to a return of assets "***(only over) shareholders*** *for regulatory capital purposes qualifying as Upper Tier 2 or Tier 1*" (emphasis added). Again, PLC applies an impermissible gloss. The italicized language states that the Notes are intended to have a right of return in priority "*to the rights of the holders of* ***any securities*** *of the Issuer which qualify…as Upper Tier 2 Capital or Tier 1 Capital* ***(within the respective meanings given to such terms in [GENPRU])***" (emphasis added). "*Securities*" does not mean "*shares*" alone but necessarily includes debt. GENPRU 2.2.176G provides express examples of UT2 capital as including (i) cumulative preference shares and (ii) "*perpetual subordinated debt*". The italicized wording is consistent with the definition of 'Notional Holders' in that both express the LBHI2 Sub-Notes as ranking above forms of debt.

(5) Fifth, PLC seeks to rely (at [52]) on LBHI's position in the Joint Position Paper at [43(7)] in a different context relating to the PLC Guarantees. The language of the PLC Guarantees is of a different order. There, the PLC Guarantee Liabilities are expressed to rank junior to the PLC Sub-Debt and the PLC Sub-Notes by expressly specifying that they rank *pari passu* with 'Parity Securities' which are defined as including non-cumulative preference shares. Contrary to PLC's contentions, Condition 3(a) does no such thing. The comparison between the amended Condition 3(a) and the subordination language under the PLC Guarantees merely serves to underscore their differences.

51. Deutsche Bank[8] agrees (at [10]) with PLC that by Condition 3(a), as amended by the 2008 Amendments, the LBHI2 Sub-Notes are expressed to rank for distribution behind the LBHI2 Sub-Debt in a winding-up. Deutsche Bank's argument is based on a *non sequitur*:

(1) First, it is said (at [12]) that the LBHI2 Sub-Debt is "*not subordinated to, and ranks ahead of shares including preference shares*". This is manifestly correct.

(2) Second, however, it is said (at [13]) that "*Since the LBHI2 Sub-Debt ranks ahead of a holder of a preference share, it follows that the LBHI2 Sub-Debt must rank ahead of the*

[8] GP No 1 states that the "*LBHI2 Sub-Debts rank above the LBHI2 Sub-Notes*" and that "*that is the clear effect of the 2008 Amendments*" (at [5]). GP No 1 is not a party to the LBHI2 Application, and its views on Issue 1 of the LBHI2 Application are therefore irrelevant.

LBHI2 Sub-Notes". This is fallacious. The LBHI2 Sub-Notes are not preference shares, because they rank above other creditors of LBHI2. The Noteholder's claims therefore also rank ahead of preference shares like PLC's claims under the LBHI2 Sub-Debt.

(3) Third, it is said (at [14]-[15]) that the amount payable to SLP3 is zero unless and until LBHI2 has paid all debt ranking above, so that even if the LBHI2 Sub-Notes rank senior or *pari passu* under the terms of the LBHI2 Sub-Debt, there is nothing in those terms that prevents the LBHI2 Sub-Debt being paid in full where the amount payable under the LBHI2 Sub-Notes is zero. This argument is based on a false premise i.e. that the amount payable to SLP3 is zero (because the amended LBHI2 Sub-Notes have the equivalent status of equity). The conclusion (i.e. that the LBHI2 Sub-Debt is paid first even though it is *pari passu* with the LBHI2 Sub-Notes) is obviously absurd, and this construction should be dismissed out of hand.

Rectification

52. SLP3's secondary position is that if on their true construction the effect of the 2008 Amendments *was* to alter the ranking between the LBHI2 Sub-Debt and the LBHI2 Sub-Notes, or the amount for which SLP3 could prove, then the changes made by the 2008 Amendments to Condition 3(a) should in any event be rectified on the grounds of common mistake.

53. SLP3 deals with PLC's residual arguments on rectification first before turning to the factual position:

(1) First, it is said (at [71]) that SLP3's case on rectification is implausible because it seeks to rectify large parts of Condition 3(a). PLC also appears to rely (at [78]) on the "*magnitude of the mistake"* as militating against the rectification. It is not an argument to say that Condition 3(a) would require significant alteration on SLP3's case if the 2008 Amendments by mistake did not reflect the common continuing intention: see, by extension, *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101 at [25] in relation to there not being "*a limit to the amount of red ink or verbal rearrangement or correction which the court is allowed*".

(2) Second, it is said (at [73]) that "*it is doubtful whether (at least outside the pensions context) the absence of a positive statement of intention can demonstrate the necessary common intention"*. This is incorrect. The absence of a positive intention suffices for the necessary common intention and might nevertheless constitute "*convincing proof"* (see *FSHC Group Holdings Ltd v Barclays Bank Plc* [2018] EWHC 1558 (Ch) at [158], which case SLP3 says was correctly decided). There is no reason in principle why one approach should be

applicable to pensions cases and one to non-pensions cases. In any event, the factual context here is analogous to that in which the pensions rectification cases have tended to arise, involving the exercise of the power of amendment by a trustee of a pension scheme and the giving of consent to the amendment by an employer: see *IBM (UK) Pension Trusts Ltd v IBM Holdings Ltd* [2012] EWHC 2766 Ch at [23]-[24].

(3) Third, it is variously said that the "*drafter of the amendment…plainly intended to do something rather than nothing*" (at [71]), the evidence referred to is the "*weakest form of evidence*" (at [74]), the "*evidence is inconclusive*" (at [76]), the rectification case is "*so inherently unlikely that it would require clear and cogent evidence*" (at [77]) and there is "*no convincing proof*" (at [79]). These are all misconceived assessments of evidence which PLC had not yet seen. SLP3 will prove its case at trial on the basis of evidence from the relevant lawyers at A&O, among other things.

54. Deutsche Bank and PLC both contend that even if grounds for rectification are made out the Court should not exercise its discretion to rectify the LBHI2 Sub-Notes. As to this:

(1) The first reason given is common to PLC and Deutsche Bank. It is said that rectification would be inappropriate having regard to the nature of the LBHI2 Sub-Notes as freely transferable debt securities listed on a stock exchange: PLC at [80] and Deutsche Bank at [20]. As to this:

i. The rectification in question goes to the rectification of amendments that were sanctioned by a single Noteholder, SLP3, who has at all times since then remained the sole Noteholder. There is no question of prejudicing any other party with an interest in the LBHI2 Sub-Notes.

ii. The Court has jurisdiction to rectify a transferable security and neither PLC nor Deutsche Bank have provided any authority (or other commercial rationale) explaining why it would or should decline to do so as a matter of discretion in the circumstances of this case. The authority relied upon by Deutsche Bank at [20] is a construction (not a rectification) case which in turn refers to *Sigma,* another construction case. On this point SLP3 will refer to Hodge, *Rectification* (2nd ed.) para 9.01; *The Law Debenture Trust Corporation PLC v Elektrim S.A., Concord Trust* [2009] EWHC 1801 (Ch); *RHG Mortgage Securities Pty Limited & Ors v Elektra Purchase No. 19 Limited* [2009] NSWSC 258.

(2) The second reason given by PLC (at [80]) is the complexity of the tax and regulatory issues in this case, and that the Court should decline to rectify the 2008 Amendments

"*merely for the purpose of determining a priority dispute between the Lehman entities*". This does not amount to any recognisable ground for refusing rectification of a document. Once the requirements for a claim of rectification have been met the Court will be slow not to order rectification: *Barden v Commodities Research Unit International (Holdings) Ltd* [2013] EWHC 1633 (Ch) at [61].

55. Finally, Deutsche Bank makes the specific point that the rectification case is not made out "*in fact*" as well as law.

56. In support of its factual case, SLP3 intends to rely, among other evidence, on evidence from A&O. As to the role of A&O in the drafting, SLP3 relies on the following:

    (1) A&O acted on behalf of both LBHI2 and SLP3 and took instructions principally from Ms Jackie Dolby, who was in charge of European corporate tax and planning within the Lehman Group, and/or Ms Sarah McMorrow, who was in-house legal counsel to the Lehman Group.

    (2) A&O were instructed to document the amendments devised and planned by Ms Dolby and/or Ms McMorrow, namely the deferral of the payment of interest.

    (3) A&O were not instructed to amend the LBHI2 Sub-Notes in any further way.

    (4) Within A&O, the matter was allocated internally to Tom Grant, who was a senior associate in A&O's Capital Markets department.

    (5) The amendment to Condition 3(a) was made in response to advice given to Mr Grant from Amrit Dehal, a Senior Associate in the tax department of A&O. Mr Dehal was concerned that in their current form the LBHI2 Sub-Notes might be treated as equity rather than debt for tax purposes, so that the interest would not be tax deductible. To meet this concern, Mr Grant amended the subordination clause so that the Noteholder's claim in a winding-up was not conditional upon solvency. However, the purpose of the amended drafting was to assist only in relation to the tax analysis, whilst the status quo would be preserved with respect to the degree of subordination.

57. At all material times up to and including the time of the execution of the resolution approving the 2008 Amendments dated 3 September 2008 (the "**Written Resolution**"), it was the common intention of LBHI2 and SLP3 that the 2008 Amendments would do no more than to permit LBHI2 to defer the payment of interest on the LBHI2 Sub-Notes.

    (1) As to SLP3's intention:

i. SLP3's intention in relation to the 2008 Amendments was that of Ms Dolby and/or Ms McMorrow and (so far as relevant) the intention of Lehman Brothers UK Holdings Delaware Inc ("**LBDI**") and SLP2 (the general partner of SLP3) was also that of Ms Dolby and Ms McMorrow. They were the relevant decision-makers, and their knowledge/intentions are to be attributed to SLP3 for the purposes of the transaction. Alternatively, the board of directors of LBDI (in its capacity as the general partner of SLP2) was the relevant decision-maker and approved and/or sanctioned amendments to the LBHI2 Sub-Notes which gave effect to the intentions of Ms Dolby and/or Ms McMorrow.

ii. In executing the Written Resolution, SLP3's intention was to assent to amendments to the LBHI2 Sub-Notes which did no more than to permit LBHI2 to defer the payment of interest on the LBHI2 Sub-Notes. It was not the intention of SLP3, objectively determined, to alter the ranking of the LBHI2 Sub-Notes. Insofar as it is relevant, in executing the electronic consent dated 3 September 2008 in respect of the 2008 Amendments, it was the intention of the board of LBDI to assent to amendments to the LBHI2 Sub-Notes which did no more than to permit LBHI2 to defer the payment of interest on the LBHI2 Sub-Notes. It was not the intention of LBDI's board, objectively determined, to alter the ranking of the LBHI2 Sub-Notes.

(2) As to LBHI2's intention:

i. LBHI2's intention in relation to the 2008 Amendments was that of Ms Dolby and/or Ms McMorrow. They were the relevant decision-makers, and their knowledge/intentions are to be attributed to LBHI2 for the purposes of the transaction. Alternatively, the board of directors of LBHI2 was the relevant decision-maker and approved and/or sanctioned amendments to the LBHI2 Sub-Notes which gave effect to the intentions of Ms Dolby and/or Ms McMorrow.

ii. In executing the Written Resolution approving the 2008 Amendments, LBHI2's intention was to propose amendments to the LBHI2 Sub-Notes which did no more than to permit it to defer the payment of interest on the LBHI2 Sub-Notes. It was not the intention of LBHI2, objectively determined, to alter the ranking of the LBHI2 Sub-Notes.

(3) At no stage before or at the time of execution of the Written Resolution was there any consideration by LBHI2, SLP3 and/or the relevant decision-makers or other personnel

within the Lehman Group as to making the LBHI2 Sub-Debt senior to the LBHI2 Sub-Notes and/or altering the amount SLP3 could prove for in respect of the LBHI2 Sub-Notes.

(4) Insofar as it is required, the emails between Ms Dolby, Ms McMorrow and Mr Grant on 10 June 2008 in relation to the first draft of the 2008 Amendments (which did not modify Condition 3 in any way, the "**First Draft**") amounted to an outward expression of accord recording that Ms McMorrow and/or Ms Dolby were satisfied with the amendments contained in the First Draft that did no more than to permit LBHI2 to defer the payment of interest on the LBHI2 Sub-Notes (and were not intended to alter the ranking of the LBHI2 Sub-Notes). The same common intention continued up to and at the time of the execution of the Written Resolution giving effect to the 2008 Amendments in their finalised form.

(5) Further or in the alternative, by analogy with the pensions cases (see [53(2)] above) and in the inter-group context of the 2008 Amendments, it is sufficient to rectify the 2008 Amendments that SLP3 and LBHI2 shared the same converging intention in respect of the 2008 Amendments without there needing to have been an agreement or outward accord between the two.

58. Accordingly, if the 2008 Amendments do not on their true construction reflect the continuing common intention, alternatively the converging intention, that was the result of a mistake in the drafting of the 2008 Amendments and ought to be rectified in the manner set out at [30(4)] of the Joint Position Paper.

PART B: PLC ISSUES

Issue 1 PLC Application

59. LBHI's position is that its claims under the PLC Sub-Debt have not been released pursuant to the Settlement Agreement.

60. Deutsche Bank contends (incorrectly) that LBHI's claims under the PLC Sub-Debt were released in full pursuant to the Settlement Agreement (at [24]). Alternatively, if LBHI's claims under the PLC Sub-Debt[9] have not been released under the Settlement Agreement, it is said (again incorrectly) that LBHI's claims are released, discharged or diminished by the amount paid or that will be paid by LBHI in its capacity as guarantor of PLC's obligations under the PLC Sub-Debt pursuant to claims allowed by the Settlement Agreement (at [25]).

[9] There appears to be an error at [25] of Deutsche Bank's position paper: LBHI does not have claims under the "*PLC Sub-Notes*" but under the PLC Sub-Debt.

61. In support of its primary position, Deutsche Bank relies on certain propositions of New York law. Whilst the question of New York law is one for expert evidence, insofar as necessary at this stage, LBHI responds as follows:

(1) Insofar as Deutsche Bank contends (at [27(2)]) that under a general release New York law will give effect to that agreement by releasing "*all claims*", including claims not in the contemplation of the parties at the time, that proposition is wrong. As a starting point under New York law, the scope of a general release is limited to claims shown to be within the contemplation of the parties at the time the release was executed: *Mangini v. McClurg*, 24 N.Y.2d 556, 562, 301 N.Y.S.2d 508, 249 N.E.2d 386 (1969); *Consolidated Edison, Inc. v. Northeast Utilities*, 332 F.Supp.2d 639, 650-51. The meaning and purpose of a general release depend upon the purpose for which the release was given: *In re Mercer*, 141 A.D.3d 594, 597.

(2) Deutsche Bank further contends (at [27(3)]) that New York law generally treats a release as applying to all claims that are not expressly excluded in enumerated expressions. This is an overly broad statement of the law, and not in fact supported by the authorities that Deutsche Bank relies upon (which are in any event all decisions of the Appellate Division, and not the Court of Appeals).

(3) Insofar as Deutsche Bank contends (at [27(6)]) that extrinsic evidence in the form of the parties' course of performance is only admissible if the court first determines that the contract is ambiguous, that proposition is incorrect. Even a release that appears to be unambiguous is limited to matters that the parties contemplated as falling within the release's scope, such that the parties' conduct in relation to the release is relevant and admissible evidence.

62. As to the arguments relied upon by Deutsche Bank in relation to Issue 1:

(1) First, it is said (at [29]) that LBHI agreed to release all Causes of Action against PLC "*provided only*" that: "*(1) The "occurrence of the Effective Date" had occurred; and (2) The Cause of Action arose from, was based on ,was connected, alleged in or related to any facts or circumstances in existence prior to the date of the Settlement Agreement"* (at [29]). Taking the two points in turn:

i. The "*Upon the occurrence of the Effective Date"* wording militates against Deutsche Bank's position. It indicates that the release took effect on the Effective Date and extended only to Causes of Action held by the Debtors on the Effective Date. This wording was not a condition precedent.

ii. The second point flows from the incorrect propositions of New York law articulated by Deutsche Bank (in particular at [27(2)] and [27(3)]) (see [61] above). As a matter of New York law, the release of an after-acquired claim would need to be expressly provided for in the terms of a general release, without which after-acquired claims would not be treated as being within the contemplation of the parties at the time of execution of the release. The claims assigned by LBDI to LBHI under the PLC Sub-Debt on 19 April 2017 (i.e. more than 5 years after the 6 March 2012 'Effective Date' of the Settlement Agreement) were not in the parties' contemplation upon the date of execution of the Settlement Agreement and/or at the 'Effective Date' such that the PLC Sub-Debt does not fall within the scope of the Section 8.02 release.

(2) Second, it is said that there is no temporal restriction on the 'Causes of Action' released by Section 8.02 and that "[i]*n particular, there is nothing in section 8.02 or in the Settlement Agreement that restricts the term "Cause of Action" acquired by a Debtor prior to the date of the Settlement Agreement or to a Cause of Action held by a Debtor and the Effective Date*" (at [31(3)]). Again, this is wrong. Deutsche Bank's approach puts the cart before the horse. The issue is not whether after-acquired claims are expressly *excluded* from the scope of Section 8.02, but whether the ambit of the Section 8.02 release *extends* to claims acquired by the Debtor more than 5 years after the Effective Date.

(3) Third, it is said by reference to the language of Section 8.02(iii) that it "*therefore refers to Causes of Action that LBHI could acquire by subrogation, indemnification, contribution or reimbursement only after the date of the Settlement Agreement"* (at [31(4)(iii)]) such that it "*shows that the release in section 8.02 is capable of and did encompass Causes of Action acquired by a Debtor after the date of the Settlement Agreement and after the Effective Date*" (at [31(4)(iv)]). The conclusion does not follow from its stated premise. Any "*claims based upon an asserted right of subrogation, indemnification…contribution or reimbursement"* are expressly said to be "*based upon a guarantee or similar document by LBHI*" under Section 8.02(iii). Any such claims were not "*acquired"* in any sense by LBHI after the Effective Date. They were legal incidents of guarantees already entered into by LBHI as at the date of the Settlement Agreement and/or the Effective Date. The relevant guarantee here was entered into by LBHI on 9 June 2005 (the "**LBHI Guarantee**"). Upon the effective date of the Settlement Agreement, a claim by LBUKH in relation to the LBHI Guarantee was allowed under Section 2.04 of the Settlement Agreement (see Schedule 9) (the "**LBUKH Allowed Claim**"). LBHI's right of subrogation against the principal debtor, PLC, in respect of the LBUKH Allowed Claim was plainly in the contemplation of the parties at the time and was not "*acquired*" subsequently.

(4) Fourth, Deutsche Bank relies on the case of *Re Professional Satellite and Communication, LLC*, 2017 WL 4286995 (S.D. Cal. Sept. 27, 2017), a California law decision (at [31(5)]). LBHI notes that this appears to be the only decision cited by Deutsche Bank in its position paper in which a general release was held as releasing a claim acquired by the releasor *after* the effective date of the settlement. But the case turns on very particular facts that are of no application here. The facts involved duplicitous conduct in relation to the assignment of claims, which was held to be in contravention of the spirit of the settlement agreement. Further, the case does not appear to have been cited in any subsequent reported decision, demonstrating the uniqueness of its factual context.

(5) Fifth, notwithstanding Deutsche Bank's position that extrinsic evidence is inadmissible unless there is ambiguity (at [32]), Deutsche Bank nevertheless relies on facts relating to the subsequent conduct of the parties. As to the matters relied on, the evidence shows that:

i. The underlying commercial purpose of the Settlement Agreement posited by Deutsche Bank is erroneous. The commercial objective of the agreement was to reconcile and allow the claims each way between, on the one hand, LBHI and the Debtors, and, on the other hand, the UK Affiliates, based on the inter-company positions in the accounting records as at 14 September 2008.

ii. In relation to the settlement agreement between, amongst others, LBIE and LBHI dated 10 October 2014 (the "**STG Agreement**"), the provision stating that "*any releases in the 2011 Settlement Agreement shall not apply to the Agreed Proof Creditors' Admitted Claims*" was 'belt-and-braces', and the fact that it was agreed is consistent with the parties' conduct in not treating after-acquired claims as released.

iii. In relation to the settlement agreement between, amongst others Deutsche Bundesbank dated 11 October 2014 (the "**DBB Agreement**"), the express exclusion of "*future assigned*" claims under that contract is not evidence of the parties' course of performance in relation to the Settlement Agreement. The DBB Agreement was negotiated with a different party in a different situation and, therefore, is inadmissible and/or irrelevant for the purposes of interpreting the Settlement Agreement.

63. In relation to Deutsche Bank's primary case on Issue 1, LBHI also notes that Deutsche Bank is not a party to the Settlement Agreement. Article 25 thereunder is a 'no third-party beneficiary clause', excluding any third-party rights under the Settlement Agreement. As a matter of New York law, such clauses are strictly enforced: *Morse/Diesel, Inc. v. Trinity Industries, Inc.*, 859 F.3d 242,249 (2d Cir. 1988); *In re Lehman Brothers Holdings Inc.*, 479 B.R. 268 (S.D.N.Y.

2012). Deutsche Bank's arguments in relation to Issue 1 amount, as a matter of New York law, to a third party seeking to enforce a release under the Settlement Agreement for its own benefit in contravention of Article 25.

64. In the alternative, Deutsche Bank argues that LBHI's claims have been "*released, discharged or diminished in part*" by payment made by LBHI to LBUKH in respect of the LBUKH Allowed Claim (at [33]). There is nothing in this alternative contention:

(1) First, it is said that under the LBHI Guarantee certain distributions were made in respect of the LBUKH Allowed Claim (at [33(2)]-[33(3)]). It is contended that "*[t]he effect of such payments was to release or otherwise diminish the amount of any primary claim that may be asserted by LBHI as assignee of LBHUK under the PLC Sub-Debt in the administration of PLC.*"

i. As to the "*release*" of the PLC Sub-Debt, it is impossible on any view that a partial payment to LBUKH by LBHI on the LBHI Guarantee had the effect of releasing or otherwise extinguishing the PLC Sub-Debt. Deutsche Bank offers no explanation as to how this could be even theoretically possible, in circumstances where *ex hypothesi* the PLC Sub-Debt has not been released under Section 8.02.

ii. As to the argument that payments under the LBHI Guarantee reduced or diminished LBHI's claims under the PLC Sub-Debt, the two cases relied on by Deutsche Bank (at [33(4)]) do not support its position in any way. The cases are authority for the proposition that (a) a creditor has a right to prove against both a surety and the principal debtor and (b) a proof in the *surety's* estate is reduced by any receipts or dividends from the principal's estate prior to but not after proof. The position here is plainly distinguishable. Here, LBHI is seeking to prove in respect of a debt claim against the principal debtor, in circumstances where the assignor (LBUKH) has previously received certain payments from LBHI in its capacity as guarantor.

iii. Further, SLP3 will rely on the well-established principle that a creditor is entitled to prove for the full amount of its debt in an insolvency of the principal debtor, notwithstanding that payments have been made by the surety in respect of such claim, unless and until the surety has paid in full: *Re Sass Ex p. National Provincial Bank of England Ltd* [1896] 2 Q.B. 12; *Sugar Hut Brentwood Ltd v Norcross* [2008] EWHC 2634 (Ch).

(2) Second, it is said that any secondary claim LBHI may have against PLC by subrogation, indemnification, contribution or reimbursement by reason of its payments under the LBHI

Guarantee has been expressly released by Section 8.02(iii) of the Settlement Agreement. That is correct but LBHI's claim against PLC is based on the PLC Sub-Debt (the primary claim) and not any right arising in connection to the LBHI Guarantee.

(3) Third, in the further alternative, it is said that pursuant to Paragraph 7(f) of the PLC Sub-Debt, the proceeds of enforcement of any guarantee of the PLC Sub-Debt are held on trust for PLC such that "*LBHI's claims under the PLC Sub-Debt therefore fall to be reduced by the amount that are or should have been held on trust for PLC*" (at [33(6)]). This argument is not particularised, is unsupported by any authority and cannot be realistically pursued.

Issue 3 PLC Application

65. The answer to this issue now appears to be agreed by the parties. All the relevant parties agree that the PLC Guarantees are subordinated to both the PLC Sub-Notes and the PLC Sub-Debt: Deutsche Bank at [68]; GP No 1 at [6.3]; LBHI at [42].

66. Given the agreement between all the parties on the relative ranking of the PLC Guarantees, LBHI will be asking the Court to make a declaration in relation to Issue 3 to confirm the agreed position.

Issue 4 PLC Application

67. LBHI's position is that the quantum of PLC's liability under the PLC Sub-Notes for distribution purposes falls to be discounted under Rule 14.44 of the 2016 Rules.

68. Deutsche Bank's primary position is that the quantum of PLC's liability under the PLC Sub-Notes for distribution purposes does not fall to be discounted under Rule 14.44 of the 2016 Rules or otherwise because "*PLC's liability is not, or should not be treated, as a future debt*" (at [54]). Four arguments are relied upon by Deutsche Bank to support the overarching contention that claims under the PLC Sub-Notes "*should be admitted or accepted for its full face amount as a form of current debt or liability"* (at [56]):

(1) First, it is said that if and to the extent there is to be redemption or payment of the PLC Sub-Notes in a distributing insolvency of PLC otherwise than at term "*such redemption or payment amounts to redemption at the option of the Issuer for the purpose of Condition 6(c) [of the PLC Sub-Notes] on its true construction*" (at [56(3)]). Deutsche Bank's contention is self-evidently wrong. A payment of a dividend by PLC's joint administrators would neither be "*at the option of the issuer"* nor in any sense a "*redemption*" of the PLC Sub-Notes:

i. As to the former, dividends in an insolvency can only be paid once a creditor has elected to prove for its debt: Rule 14.3(1) of the 2016 Rules. Once a creditor has proved, the statutory mechanism for adjudicating on a proof, valuing it and paying dividends on the proof are of mandatory application. For example, the statutory regime obliges the office-holder to deal with the proof within a certain period of time: Rule 14.32(1) of the 2016 Rules. A payment of a dividend is in no sense "*at the option*" of PLC. It is part of a mandatory process/scheme.

ii. As to the latter, payment of dividends by PLC's joint administrators would not be made on GP No 1's underlying claims on the PLC Sub-Notes but in discharge of its proved claims. Deutsche Bank's suggestion that a payment of a dividend is in respect of the claims underlying the PLC Sub-Notes so as to amount to "*redemption*" runs directly contrary to the statements of David Richards J in *Waterfall IIA* at [206]; and the Court of Appeal in *Waterfall IIA* at [57].

(2) Second, it is said that a "*distributing insolvency process in respect of [PLC] was neither intended nor contemplated in the drafting of Condition 6*" and that "*[it] is clear from the terms of the PLC Sub-Notes on their true construction that the parties would have intended that the Sub-Notes could only be treated as currently payable for the full face amount of principal payable in such circumstances*" (at [56(4)]). This is legally incoherent. The parties deliberately selected and/or accepted maturity dates for the PLC Sub-Notes which are in the distant future. Their agreement also expressly addresses subordination requirements that would apply both inside and outside of an 'Insolvency': Condition 3(a)(i) and Condition 3(a)(ii). The construction Deutsche Bank relies on plainly runs contrary to the express terms of the PLC Sub-Notes.

(3) Third, it is argued that some form of implied term is required such that "*the amounts payable [under the PLC Sub-Notes] become immediately due and payable in their full face value amount in circumstances where PLC has entered a distributing administration, subject at all times to the subordination provisions in Condition 3"* (at [56(5)]). As to this:

i. For the same reasons given at [68(2)] above, any such term runs contrary to the express wording of the PLC Sub-Notes and is impermissible.

ii. Further, any term that would have the effect of causing the automatic acceleration of the PLC Sub-Notes would run contrary to the limited "*Permitted differences*" approved by the FSA's directions in respect of the PLC Sub-Notes, and thus be in contravention of IPRU(INV).

(4) Fourth, it is contended that an attempt to "*redeem or pay the PLC Sub-Notes other than in accordance with Conditions 6(a)-(c) is a repudiatory breach of Condition 6(d) and the Conditions generally, such that the holder of the Sub-Notes is entitled to accept the repudiation and prove for damages in an amount equivalent to the full face value amount of the PLC Sub-Notes*" (at [56(6)]. This argument is unsustainable. Payment of a dividend on the PLC Sub-Notes is not a "*redemption*" and so it cannot amount to a breach of Condition 6(d) or of the Conditions generally. If PLC is able to pay its 'Senior Liabilities' and thus comply with the "*solvency*" condition under Condition 3(a)(ii), GP No 1 will be entitled to prove and be admitted to proof for its claims under the terms of the PLC Sub-Notes: see *Waterfall I* at [70] per Lord Neuberger. Further, the payment is triggered by GP No 1's proof, not a voluntary act by PLC (see at [68(1)] above).

(5) Fifth, Deutsche Bank state (at [57]) that "*no part of the regulatory regime or IPRU INV necessitates that the PLC Sub-Notes be treated as outstanding future debts*". Again, this is incorrect. IPRU(INV) required the use of the FSA Standard Form. This did not allow for acceleration. In this regard, IPRU(INV) 10-63(6)R states that "*a firm must not (except in accordance with the terms of the loan): (a) repay, prepay or terminate a long term subordinated loan before the agreed payment date unless it has provided the FSA with at least five years' written notice*".

69. In the further alternative, Deutsche Bank argues that the joint administrators of PLC "*should act (and be directed to act) so as to make the PLC Sub-Notes currently due in their full face amount*" (at [60]). There is no basis for providing PLC's joint administrators to be directed to act in the manner suggested by Deutsche Bank. As to this:

(1) The authorities cited by Deutsche Bank on paragraph 74 of Schedule B1 of the 1986 Act, and the rule in *Ex parte James*, should now be read subject to *Heis v Financial Services Compensation Scheme Ltd* [2018] EWHC 1372 (Ch) at [143] per Hildyard J (overturned by the Court of Appeal on different grounds); *and Lehman Brothers Australia Ltd (In Liquidation) v Lomas* [2018] EWHC 2783 (Ch) at [61] per Hildyard J.

(2) Applying those two recent decisions, neither paragraph 74 nor the rule in *Ex parte James* is engaged in the present circumstances. The terms of the PLC Sub-Notes were freely accepted by the relevant Partnership/GP No 1 and PLC. There is no unfairness in the discounting of a future debt for the purpose of dividend. That is precisely what the statutory scheme envisages and was confirmed at all levels in *Waterfall I*: per David Richards J at [77]; per Lewison LJ at [94]; per Lord Neuberger at [105]. The sole effect of PLC's joint administrators making the PLC Sub-Notes currently due would be to increase

the dividend payable on the PLC Sub-Notes, thus decreasing the dividend payable on the PLC Sub-Debt. This despite the fact that the PLC Sub-Debt has already matured and, subject to the subordination provisions, would otherwise be due.

(3) Deutsche Bank's contentions would be applicable in all cases where office-holders declined to exercise a contractual redemption clause on the grounds that there is an inherent unfairness under the statutory scheme applicable to future debts.

70. In the further alternative, Deutsche Bank seek to argue that PLC's liability under the PLC Sub-Notes is, in truth, a non-provable liability to which Rule 14.44 is inapplicable (at [61]). This argument is simply wrong:

(1) The claims under the PLC Sub-Notes are plainly provable liabilities: Rule 14.1(3), applying the Supreme Court's reasoning in *In re Nortel GmbH (in administration)* [2013] UKSC 52 at [39].

(2) It is said that statutory interest can only be calculated and paid after payment of all provable debts, such that PLC's liability under the PLC Sub-Notes is "*necessarily classified as a non-provable debt*" (at [61]). Deutsche Bank's case is based on the fallacy that all statutory interest must actually be paid at a single point in time. That is wrong. Statutory interest is payable on postponed debts which are provable debts, which may not be proved until provable non-postponed debts have been paid "*in full with interest…under rule 14.23"*: see Rule 14.2(4) and *Pearson v Primeo* (Grand Court of the Cayman Islands, Kawaley J, 27 August 2018, at [77]-[78]). Statutory interest is also payable on subordinated debts drawn on the FSA Standard Forms: *Waterfall I* per Lord Neuberger at [70]. There is thus no conceptual problem in relation to statutory interest being calculated and paid/provided for in respect of different classes of debt which become entitled to prove at different stages in the insolvency.

(3) In view of this, little weight should be placed on the *obiter* dictum of Lord Neuberger in *Waterfall I* at [71].

71. Deutsche Bank's final contention on Issue 4 (at [65]) is that a claim for future interest on the PLC Sub-Notes should be admitted or accepted for distribution purposes to reflect the contractual right to interest payable prior to the date at which the debt would otherwise have fallen due. As to this:

(1) Deutsche Bank's argument is based on pure assertion: "*PLC's liability to pay interest under the PLC Sub-Notes is also a provable debt, and is not to be treated as interest*

bearing on a debt proved for the purpose of Rule 14.23 on its true construction" (at [66]). This contention is contrary to the plain wording of the statute and binding authority.

(2) Interest is only provable on a debt bearing interest up to the date of administration: see Rule 14.23(1) of the 2016 Rules. Irrespective of whether or not the debt is a future or present debt, in the event of a surplus, statutory interest will be payable on the debt in respect of the period commencing with the date of administration: see Rule 14.23(7) of the 2016 Rules.

(3) In *Waterfall IIA*, David Richards J held that statutory interest runs on future debts from the commencement of administration: [209] and [225]. David Richards J's decision on future debts was not appealed to the Court of Appeal, but his decision on contingent debts was appealed. The Court of Appeal rejected the argument that statutory interest was not payable on a contingent debt from the date of administration because the rules provide "*the same regime for statutory interest for all provable debts, whether due at the date of administration, due then only in the future, or subject then to a contingency which may, in fact, never occur"* (at [53]).

(4) The effect of Deutsche Bank's argument is that GP No 1 would have a provable claim for future interest as well as a claim to statutory interest on that future interest in the event of a surplus. That is a non-sensical outcome, and the wrong conclusion.

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