No: 7942 of 2008

IN THE HIGH COURT OF JUSTICE

CHANCERY DIVISION

COMPANIES COURT

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN:-

(1) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)
-and-

(1) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS LIMITED (IN ADMINISTRATION)
Applicant

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

(3) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS EUROPE LIMITED (IN ADMINISTRATION)

-and-

(4) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS HOLDINGS PLC (IN ADMINISTRATION)
Third Party/Respondent

Skeleton Argument of the Joint Administrators of Lehman Brothers Limited (In Administration) for the Part A Trial of Waterfall III

A) Introduction

1. This is the Part A Trial of the application of the Joint Administrators of Lehman Brothers International Limited (Europe) (in administration) ("**LBIE**" and "**LBIE Administrators**") dated 25 April 2016 for directions in respect of its administration (**"Waterfall III"** at T1/1[1]), as directed on 4 November (Order at T1/4, p. 3 at para 6). A cross-application has also been made by the Joint Administrators of Lehman Brothers Limited (in administration) ("**LBL**" and

[1] All references are to the PTR/CMC or Trial Bundle and Volume Number/Tab/Page or para, as appropriate

"**LBL Administrators**") by way of application notice dated 17 October 2016, for declaratory relief. Whilst parts of that relief depend upon LBL's case that it is entitled to recharge liabilities incurred by it as a member of LBIE (a matter for the Part B trial) other parts of the relief follow in the event that the Court accepts LBL's position on nomineeship and indemnification, which affect Issue 7 ("**LBL Application**", at T1/2).

2. The principal focus of this trial is anticipated to be upon Issues 1, 3, 7, Issue 9 Preliminary Issue and 10, namely:

    a. Issue 1: Whether the obligations of LB Holdings Intermediate 2 Limited (in administration) ("**LBHI2**") and/or LBL to contribute to the assets of LBIE pursuant to section 74 of the Insolvency Act 1986 ("**Section 74**" or "**Contribution Claim**" and "**IA 86**") include an obligation to contribute to the assets of LBIE to the extent necessary to enable LBIE to pay sums owed to LBHI2 pursuant to three subordinated loan agreements entered into on 1 November 2006 between LBHI2 (as lender) and LBIE (as borrower) ("**Sub-Debt**" and **"Sub-Debt Agreements"**) (T1/1 at p.2);

    b. Issue 3: Whether the value of the Sub-Debt Contribution Claim, for the purposes of proof and set-off, is (i) the full amount of the Sub-Debt; (ii) limited to the estimated value that is applied to LBHI2's claim for the Sub-Debt for the purposes of proof; or (iii) some other value (T1/1 p.2);

    c. Issue 7: In light of the fact that LBL owns one ordinary share of $1 in LBIE, and LBHI2 owns 2 million 5% redeemable Class A preference shares of $1000 each, 5.1 million 5% redeemable Class B shares of $1000 each and 6,237,113,999 ordinary shares of $1 each in LBIE:

        i. Whether their obligations to contribute to the assets of LBIE pursuant to Section 74 are joint and several, joint, several or otherwise as against LBIE;

        ii. Whether they are entitled to a contribution or indemnity from one another in respect of:

a. Any payments made pursuant to such obligation; and/or

b. Any set-off pursuant to any such obligation,

and, if so, the nature and extent of such right of contribution or indemnity;

iii. whether, in addition to or instead of any right of contribution or indemnity (as referred to in sub-paragraph (ii) above), LBL or LBHI2 are liable to contribute to LBIE's assets to any amount sufficient for the adjustment of the rights of contributories among themselves and what the effect of such adjustment is;

iv. to what extent any right to contribution or indemnity (as referred to in sub-paragraph (ii)) and/or adjustment (as referred to in sub-paragraph (iii) above) is affected by any other claims which LBHI2 and LBL have against one another or any other party; and

v. whether the LBIE Administrators should be directed to assert less than 100% of the Contribution Claim against LBL and/or LBHI2 and, if so, by how much the Contribution Claim should be reduced as against LBL and/or LBHI2 and what factors should the Court take into account in reaching this decision (T1/1 at pp.3-4).

d. Issue 9 Preliminary Issue: Whether, as a matter of law, it is possible for a member of a company to enter into with that company an enforceable agreement which has the effect of enabling that member to avoid what would otherwise be its obligation to contribute to the assets of the company under Section 74 in the event of the company's winding up or otherwise to reverse the effect of that section (whether by claiming to be contractually entitled to reimbursement from that company in respect of such contributions or otherwise (T1/4, p. 3 at para 5)); and

e. Issue 10: Whether, if LBL is entitled, under the terms of a service agreement between LBL and LBIE dated 20 May 2004 or otherwise, to recover from LBIE sums paid or payable by it to LBIE in respect of a Contribution Claim, LBL's recharge claim against LBIE in respect of the Sub-Debt Contribution Claim and LBHI2's claim in respect of the Sub-Debt are to be paid *pari passu* and, if not, in what order or priority (T1/1 at p.4).

3. The context in which these Issues will need to be considered is set out in detail in LBL's Position Paper ("**PP**") at T1/14, paras 5 to 55, which the Court is invited to read in full. The background to Waterfall III, and to LBL's particular position, can also be found in the Waterfall I judgment at T1/8 and in Section B below.

4. As regards the above Issues it is LBL's position, in summary, that:

a. Since the parties are agreed that, in the event that the Sub-Debt falls to be repaid, any Sub-Debt Contribution Claim is to be dealt with in LBIE's administration by way of set-off as against LBHI2 (as lender), and that the effect of this is to extinguish (to the extent of that set-off) any Sub-Debt Contribution Claim that LBIE might otherwise have had against LBL, Issue 1 is now of very limited import. Nonetheless, the LBIE Administrators appear to continue to assert that there is a residual right to make a Sub-Debt Contribution Claim against LBL on a contingent basis and/or for the limited purpose of the adjustment of rights as between LBHI2 and LBL as members *inter se* (see LBIE PP at T1/16, paras 28 and 29(4)). The need for such adjustment is not understood, in particular where it is not sought by LBHI2 (LBL Reply at T1/20, paras 2.1 and 2.2; see too LBHI2 PP at T1/17 at para 3.1). In any event and as regards Issue 1, LBL's position is that LBIE has a complete defence in circuity against LBHI2's claim that it repay the Sub-Debt, such that that claim must fail and no Sub-Debt Contribution Claim lie. Alternatively, the terms of the Sub-Debt Agreements (whether construed in their commercial context or otherwise by implication) preclude recourse to LBIE's members in order to meet the

Sub-Debt. Such exclusion is to be given effect to pursuant to section 74(2)(e) IA 86, which provides in connection with an unlimited company (such as LBIE) that "*nothing in the Companies Act or this Act invalidates any provision contained in a policy of insurance or other contract whereby the liability of individual members on the policy or contract is restricted, or whereby the funds of the company alone are made liable in respect of the policy or contract*" (emphasis added) (LBL PP at T1/14, in particular at paras 111 to 113)[2]. The circumstances leading to the application of s.74(2)(e) are set out in detail below.

b. As regards Issue 3, LBL had understood the principles relevant to the valuation of the Sub-Debt Contribution Claim to be broadly agreed (see LBL PP at T1/14, para 121; LBIE PP at T1/16, para 25; LBHI2 PP at T1/17, para 3.5-3.6; LBH Plc at PP T1/19, para 20) such that, for the purposes of proof and set-off, any Sub-Debt Contribution Claim is to be valued, on a genuine and fair basis, as a contingent claim and having regard to the likelihood of the relevant contingencies occurring. However, it appears that there is a difference in practice as between the parties' application of these principles, in particular insofar as LBIE contends that the Sub-Debt Contribution Claim is now to be afforded substantial value (LBIE, PP at T1/16, paras 23-25). For LBL's part it contends that since the Court of Appeal determined that the Sub-Debt was itself to be afforded a nil value for the purposes of proof and set-off until such time as the preceding items in the statutory Waterfall have been paid (in particular, statutory interest and currency conversion claims arising in LBIE's administration[3]), it cannot be right that the Sub-Debt Contribution Claim can now be afforded a higher value than the Sub-Debt; it is an even more remote contingency (LBL PP at T1/14, paras 120-123). It too should therefore be valued at zero.

[2] Whilst the scope of s.74, and the ability of the LBIE Administrators to make a contingent call under s.74 during an administration are being considered by the Supreme Court in Waterfall I, the application of s.74(2)(e) is not.

[3] Again, both of which are a matter under consideration by the Supreme Court in Waterfall I.

c. As regards Issue 7, the Court is limited, in the absence of evidence, in the factors that it is able to take into account in respect of the question of any adjustment of rights as between members. However, having regard to the number of shares held by LBL and LBHI2 respectively, LBL contends that its liability to meet any Contribution Claim should be restricted either to zero, or to a (tiny) rateable proportion of such claim as is made to meet any deficit in LBIE's assets; it holds a single share in LBIE, whereas LBH Plc had, and LBHI2 now has, over *6 billion* shares in LBIE. Further, on the assumption that LBL is, as it contends in the alternative to its case on rectification, a nominee shareholder for LBHI2 or LBH Plc, it is entitled to indemnification in respect of such contribution as it is required to make to LBIE's estate from LBHI2 or LBH Plc on ordinary contractual principles (LBL PP at T1/14, in particular at paras 100-102, and see too LBL Application at T1/2). This too gives rise to issues of circuity.

d. As regards Issue 9 Preliminary Issue, there are no agreed assumptions, and the Court is simply asked to consider whether it is possible "*as a matter of law*" for contract to affect the obligations arising under Section 74. This issue was introduced on LBIE's application at the CMC on 4 November 2016 with the apparent intent that if – as a matter of principle – it is not possible to contract out of Section 74 obligations, then that would prevent LBL advancing its claims in respect of the Recharge Agreement (as defined in LBL's PP at T1/14 at para 80) as against LBIE. However, the application of s.74 IA 86 is not mandatory so as to preclude the possibility of contracting out. Moreover, this very possibility is anticipated specifically by s.74(2)(e). This provides expressly for the enforceability of any agreement limiting the liability of individual members and requiring recourse to the company's own funds. It provides a statutory basis for an unlimited company to accept liabilities that will not be passed on to its members. The position is stated clearly in Halsbury's Laws (Vol 14, s.373): "*With regard to any policy of insurance or other contract, the liability*

of individual members may, however, by the terms of the policy or contract be restricted, or the funds of the company alone made liable".

e. As regards Issue 10, LBL contends that the most likely way in which any claims arising pursuant to the Recharge Agreement (**"Recharge Claims"**) would be dealt with is by way of set-off, such that the question of ranking of claims would not be required. The point is presently academic: if LBL is correct that the register should be rectified and it should be removed as a member of LBIE, no Contribution Claim will lie against it, whether in respect of the Sub-Debt or at all. If it is wrong in this, LBL still needs to prove the Recharge Agreement and its terms, before priority can be considered (LBL PP T1/14 at paras 135 to 136).

5. As regards the remaining Issues that were directed to be determined in the Part A Trial, the parties appear to be agreed that Issue 8 (which concerns the question of double-proof in respect of LBL's claims to contribution or indemnity in respect of any Contribution Claim made against it) does not arise (such that LBL at least contends the Court should not make any declaration in respect of it), and have reached agreement on Issues 2, 4, 5, 6 and 12 ("**Agreed Issues**"), variously:

a. That any Sub-Debt Contribution Claim is to be included in the insolvency set-off account in LBIE's administration as against the provable claims of its members, and that insofar as it is set-off as against the Sub-Debt claimed by LBHI2, that set-off extinguishes LBIE's Sub-Debt Contribution Claim as against LBL (Issues 2 and 4);

b. That where insolvency set-off took effect in LBIE's administration on 4 December 2009, insolvency set-off in the (subsequent) distributing administrations of LBHI2 and/or LBL is of no application to those companies' claims against LBIE which went into the set-off account in LBIE's administration (without prejudice to the ability to re-draw the balances in the set-off account on the basis of the hindsight principle) (Issue 5). Similarly, where insolvency set-off took effect in LBEL's

administration on 11 July 2012, insolvency set-off in the subsequent distributing administrations of LBHI2 and LBL has no effect on the set-off account in LBEL's administration (Issue 6); and

a. As regards Issue 12 (which concerns only LBL and LBEL) it is agreed that any set-off occurring in LBIE's estate is irrelevant to LBEL's liability to LBL (LBL at T1/14, para 140; LBEL at T1/18, paras 27-32).

6. In light of the parties' agreement on these issues, but recognising that the Court will need to be satisfied of the true position in order to grant the declaratory relief sought, LBL sets out its position on the Agreed Issues in Schedule A to this Skeleton.

7. Otherwise, the Court has directed that the Part A Trial be conducted (save as regards the Issue 9 Preliminary Issue) on the basis of various assumptions as to the status of LBL:

a. that it is the legal and beneficial owner of a single share in LBIE and is not entitled to rectification of the register;

b. that it is entitled to rectification of the register with the effect that its single share is cancelled or registered in the name either of LBH Plc or LBHI2;

c. that it holds the single share as nominee for LBH Plc and/or LBHI2 and is entitled to an indemnity from LBH Plc and/or LBHI2 (as appropriate) in respect of any liability to meet a Contribution Claim; and

d. that it is entitled to recharge its liabilities to LBH Plc and/or LBIE and/or LBHI2 and/or LBEL, including its liability to meet a Contribution Claim (T1/4, p.3–4 , para 7).

8. These assumptions are mainly relevant to Issue 7. However, it is important to note at the outset that LBL's principal position is that it is entitled to rectification of the register, such that it should never bear any responsibility for the liabilities now asserted against it by LBIE by way of Contribution Claim,

including an adjustment of rights as between itself and LBHI2 (LBL PP at T1/14, paras 57 to 75). LBL's case that it holds the share as nominee for LBH Plc and/or LBHI2 and/or that it is entitled to recharge any costs associated with its holding a single share in LBIE (including by way of Contribution Claim), is relied upon as an alternative to LBL's principal claim in rectification (to be determined in the Part B Trial).

B) Factual Background

9. The factual background to the Issues is set out in LBL's Position Paper at T1/14, paras 5 to 55. A brief summary is set out below[4].

(i) The Lehman Group

10. Prior to September 2008, Lehman Brothers operated as one of the four biggest investment banks in the United States. The ultimate parent company of the Lehman Group was Lehman Brothers Holdings Inc. ("**LBHI**"), a company incorporated in the United States, and prior to 1990 the Lehman Group conducted its business operations in the UK and Europe through a US incorporated entity.

11. Following concerns expressed by the Securities Investment Board that it was unable adequately to regulate a non-UK company, on 10 September 1990 LBIE was incorporated as a limited liability corporation under the name Lehman Brothers International Limited. On 1 December 1990, the principal business operations of the Lehman Group in the UK (with the exception of international equities trading) were transferred to LBIE upon the express undertaking of LBHI given to the Securities Investment Board that it would take responsibility for the operations of LBIE. The entire allotted share capital in LBIE was held by LBH Plc, save for a single share which was held by certain individual personnel until 22 September 1992.

[4] Pending a response to LBL's draft Schedule of Facts, it is not known which of the following facts are agreed, or in issue, as between the other parties. Nonetheless, this background is relevant to the circumstances in which LBL contends (for example) that it holds a share as nominee for LBHI2 or LBH Plc (Issue 7) and the circumstances in which the Sub-Debt was entered into (Issues 1 and 3).

12. LBL was incorporated on 27 April 1965 and from at least 1986 operated as the service company which supported the operations of the various Lehman Group entities based in the UK, Europe and Middle East. Amongst other matters LBL therefore employed the personnel who were seconded to work within the Lehman Group entities operating in in the UK, Europe and Middle East and acted as head lessee for the UK Lehman Group's headquarters at 25 Bank Street, London.

13. It is accepted at least in principle by LBEL that LBL recharged the costs associated with the provision of these services to the various members of the Lehman Group (see LBEL PP T1/18, para 42).

(ii) Profitability Review

14. In 1992 the Lehman Group undertook a profitability review in respect of its European operations in order to understand why the group was generating an "*abnormally high US tax charge*". Apparently as part of this process, on 22 September 1992 Mr Sherratt, the company secretary of LBL, transferred his single share in LBIE to LBH Plc, which thereby became the sole shareholder in LBIE, and, in December 1992 LBIE was re-registered as an unlimited company. LBL contends that this arrangement was designed to confer certain US tax benefits upon the Lehman Group, particularly LBIE and LBH Plc, enabling LBIE to be treated as a branch of its US parent company and to offset its losses against US taxable profits.

(iii) LBL's Shareholding in LBIE

15. The above remained the position until November 1994 when LBL contends that, as a result of a review of the shareholding position of LBIE carried out by Lehman Group in-house legal counsel, it was (erroneously) believed that it was a mandatory requirement that there had to be a second registered shareholder of LBIE in addition to LBH Plc. It is LBL's case that there was in fact no such requirement. Nonetheless, as a result of this error, steps were taken in November 1994, amongst other matters, to transfer a share in LBIE from LBH Plc to LBL "*as nominee*" (see T3/1, at pp.43-45).

16. In addition, in May 1997, when certain regulatory changes resulted in LBIE's acquisition of two subsidiaries (Lehman Brothers Gilts Limited and Lehman Brothers Money Brokers Limited) the entirety of LBIE's share capital (then in £) was cancelled and re-issued (in $) and, without any indication that the capacity in which LBL held its single share in LBIE was to be altered, a single $ share in LBIE was allotted to LBL (T3/1, at pp.46-47).

17. Although a matter for the Part B Trial, LBL contends that, having regard to the above matters, the register ought to be rectified to remedy the above mistake(s) and to remove its registration as shareholder of LBIE, or otherwise to reflect the fact that the decision to take a share in LBIE, an unlimited company, was taken without authority and in breach of duty by its directors, including to the knowledge of LBIE and LBH Plc (see further LBL PP at T1/14, paras 58 to 75).

(iv) Subsequent Events

18. Otherwise, and by way of background LBL contends that

    a. In 2000 certain arrangements whereby LBL recharged the cost of providing services to other Lehman companies were partly recorded in writing (see example service and secondment agreements at T3/1, pp.3-32). These matters inform Issue 9, which is a matter for the Part B Trial.

    b. Between 2006 and 2007, as a result of commercial, regulatory and US tax objectives, Lehman Group restructured its European holding company by establishing two new UK companies, being LB Holdings Intermediate 1 Limited **("LBHI1")** and LBHI2, which were interposed between LBH Plc and LBIE, and recapitalised LBIE. This project was referred to as the '*European Holding Company Restructure and LBIE Recapitalisation*'.

    c. As part of this restructuring, on 1 November 2006, agreements were implemented to interpose LBHI1 and LBHI2 between LBIE and LBH Plc, and to transfer the entire shareholding of LBIE (save for the single share held by LBL) to LBHI2.

d. In addition, the three subordinated loan facilities previously provided by LBH Plc, LBIE's then immediate parent company, were cancelled and replaced with similar facility agreements entered into by LBHI2 (as Lender) and LBIE (as Borrower):

i. An agreement for $4,500,000,000 Long Term Subordinated Loan Facility dated November 2006;

ii. An agreement for $8,000,000,000 Short Term Subordinated Loan Facility dated November 2006; and

iii. An agreement for €3,000,000,000 Long Term Subordinated Loan Facility dated November 2006,

namely, the Sub-Debt Agreements.

(v) Administration

19. On 15 September 2008 LBHI commenced Chapter 11 bankruptcy proceedings in the United States Bankruptcy Court for the Southern District of New York. On the same date each of LBL, LBH Plc and LBIE went into administration. LBEL went into administration on 23 September 2008, and LBHI2 on 14 January 2009.

20. On 14 February 2013 the Joint Administrators of LBIE, LBL, and LBHI2 issued the "Waterfall I" proceedings, seeking various directions, among other things, in relation to the position that might arise if the administration of LBIE was immediately followed by a liquidation, including as to the payment of statutory interest and the potential liability of a contributory under Section 74 (T2/198-203).

21. On 14 March 2014 the Judgment of David Richards J. (**"Waterfall I Judgment"** at T1/8) was handed down, determining as a matter of principle, among other things that:

a. The Sub-Debt ranked for payment behind all other debts in the statutory waterfall (*per* Lord Neuberger in In re Nortel GmbH [2013]

UKSC 52, at [39]; see T1/8 at p.5) including statutory interest and non-provable liabilities such as currency conversion claims;

b. The liability of members under Section 74 to contribute to LBIE's estate extends not only to provable debts but to the lesser ranking liabilities in the Waterfall, including statutory interest and non-provable liabilities (T1/8 at paras 138 to 140 and 150 to 178); and

c. LBIE was entitled to prove, on a contingent basis only, for any Contribution Claim that might arise in liquidation to meet a deficit in its assets (T1/8, at paras 179 to 226).

22. The Court of Appeal upheld the Judge's findings on the above issues (T1/9, in particular at 113-132 and 172-234). The Court of Appeal's judgment was then subject to further appeal before the Supreme Court in October 2016, with Judgment awaited.

(vi) Inter-party claims

23. Following the judgment of David Richards J., on 31 October 2014 LBIE submitted a claim for £10.4bn in LBL's administration (T2/p.137). Of this sum £10bn related to the LBIE Administrators' prudent assessment of the contingent liability of LBL to LBIE which might arise by way of Contribution Claim in any liquidation of LBIE. On 7 November 2014 the LBIE Administrators asserted a claim for £10bn in LBHI2's administration in respect of a like contingent Contribution Claim.

24. Subsequently, on 23 September 2015 the LBL Administrators:

a. requested consent from the LBIE Administrators to amend LBL's proof of debt (filed on 21 December 2011 in the sum of £363m.) to £10.934bn. to incorporate a recharge element in respect of the Contribution Claim (T2/p.168-169). On 6 April 2016 the LBIE Administrators confirmed their consent to the LBL Administrators' request to amend its proof of debt (T2/p.173);

b. submitted a proof of debt in LBHI2's estate in the sum of £10bn (T2/p.191); and

c. requested consent from the LBEL administrators to amend LBL's proof of debt (filed on 31 August 2012 in the sum of £243m.) to £4.9bn., again to incorporate a recharge element in respect of the contingent Contribution Claim (T2/194). On 12 November 2015 LBEL consented to the LBL Administrators' request to amend its proof.

25. Further related proceedings have taken place under the designation "Waterfall II" (T2/277-413) which are familiar to the Court but do not bear upon the Issues arising for determination on this occasion.

C) Issue 1

26. Issue 1 concerns the question of whether the obligations of LBHI2 and LBL to contribute to the assets of LBIE pursuant to a Contribution Claim include an obligation to contribute to the extent necessary to enable LBIE to pay the Sub-Debt (T1/1 at p.2). LBL's position on Issue 1 is set out below, and in its PP at T1/14, paras 104-116, and Reply at T1/20, paras 4-7.

27. Issue 1 is now of potentially limited effect; as set out above, the parties are agreed that in the event that the Sub-Debt does fall to be repaid, any Sub-Debt Contribution Claim is to be dealt with in LBIE's administration by way of set-off as against LBHI2 (as lender), and that the effect of this is to extinguish (to the extent of that set-off) any Sub-Debt Contribution Claim that LBIE might otherwise have had against LBL.

28. However, it appears that LBIE presses the Issue regardless, contending that it is entitled to raise a Sub-Debt Contribution Claim now, to put it in sufficient funds to pay the Sub-Debt in the event that it becomes liable to do so. It also contends that it is able to make a Sub-Debt Contribution Claim against LBL on a contingent basis or for the limited purpose of adjusting the rights as between LBHI2 and LBL as members *inter se* (see LBIE PP at T1/16, paras 28 and 29(4)).

29. The ability of LBIE to make a call in this way is rejected. Section 74(1) of IA 86 provides that when a company is wound up, "*every present and past member is liable to contribute to its assets in any amount sufficient for the payment of its debts and liabilities, and the expenses of the winding up, and for the adjustment of the rights of the contributories amongst themselves*". Section 150(1) of the Act further provides (as regards a compulsory liquidation) that the court may direct contributories to contribute in a winding-up "*to the extent of their liability, for payment of any money which the court considers necessary to satisfy the company's debts and liabilities, and the expenses of winding up, and for the adjustment of the rights of contributories among themselves, and make an order for payment of any calls so made*".

30. However, the peculiar circumstances of the Sub-Debt having been advanced by LBHI2 mean that LBIE's claims must fail for circuity. Indeed, if the claim for the Sub-Debt is pressed by LBHI2 against LBIE, then LBIE has a right of recourse akin to an indemnity which it is able to advance as against LBHI2 under Section 74. The effect of this is to invalidate LBHI2's initial claim; see Farstad Supply AS v Enviroco Ltd v Anor (the MV Far Service) [2010] UKSC 18, in particular at paras 30-34, Brumder v Motornet Services & Repairs Ltd [2013] EWCA Civ 195 and Post Office v Hampshire County Council [1980] QB 124. Further, no Sub-Debt Contribution Claim lies in the alternative as against LBL; if LBHI2 were to press its Sub-Debt Claim, LBIE would have a similar right of recourse against LBL, which would then be able to pass that liability back to LBHI2 indirectly, by way of an adjustment of rights *inter se*.

31. Alternatively or in any event, s.74(1) is circumscribed by the exceptions contained in s.74(2). The class of members and the extent to which they are liable to contribute to a call are substantially narrowed. Most importantly, s.74(2)(e) expressly provides that "*nothing in the Companies Acts or this Act invalidates any provision contained in a policy of insurance or other contract whereby the liability of individual members on the policy or contract is restricted, or whereby the funds of the company alone are made liable in respect of the policy or contract*".

32. Section 74(2)(e) can be traced back to the Joint Stock Companies Act 1848, s. 57. The form of wording now found in s.74(2)(e) first appeared in the Companies Act 1862, and has since appeared in almost identical form as s.123(1)(vi) of the Companies (Consolidation) Act 1908, s. 157(f) of the Companies Act 1929, s. 212(f) of the Companies Act 1948, and s.502 of the Companies Act 1985, before it was consolidated into the IA 86 in its current form. The LBL Administrators have been able to identify very few cases considering s.74(2)(e) (or its predecessor sections) but those they have make clear that this sub-section is intended to give contractual primacy to any agreement intended to limit the liability of members (including members of an unlimited company), and accordingly that the liability to contribute in s.74(1) is not intended to override the rights of creditors or existing contracts. In particular:

    a. In Re Athenaeum Life Assurance Company, Ex. p. Prince of Wales Life Assurance Company, 44 ER 1423, and 70 ER 216 (Durham's Case) a policy granted by the Athenaeum company provides that the capital stock of £100,000 and the other property of the company remaining at the time of the claim unapplied to other claims should alone by liable to pay the sums assured, and no shareholder should be liable beyond the amount unpaid of his shares. The insured's application (under s.7 of the Joint Stock Companies Winding-up Amendment Act 1857) for permission to proceed against an individual shareholder who had paid in full his shares, in respect of the amount of the policy, was refused. The terms of the policy precluded any remedy at law against an individual shareholder. Even if (which the Court did not find to be the case) the terms of the company's deed of settlement were more favourable to the insured than the terms of the policy, the insured's rights would be defined by the contract into which he had actually entered; "*…They [directors] made their contract, and must take it as it stands. They get all they bargained for, but they cannot be heard to say that, if they had known the provisions of the deed, they would have bargained for more. Their actual contract is all they can look to, and what that contract gives them is all they can recover*" (at 219).

b. In Re Accidental Death Co (1878) 7 Ch D. 568, Jessel MR considered the extent of protection afforded shareholders by the predecessor, section 38(6) of the Companies Act 1862. The deed of settlement of the insurance company in liquidation contained a provision that every policy issued by the company should contain a proviso limiting the claims of the policy-holder to the amount of the share capital, but left the liabilities of the shareholders in other respects unlimited. All policies issued by the company contained the required proviso. During the liquidation, some contributories compromised their liabilities but, for the purpose of funding the past and future costs of the liquidation, the liquidator made a further call on the contributories who had not compromised their liability. The contributories successfully argued that s.38(6) meant that they could not be called upon in this way.

c. In Re Great Britain Mutual Life Assurance Society (1880) 16 ChD 246, which concerned the insolvency of a mutual life assurance society, the members were held not liable to contribute to the payment of debts. Clause 140 of the deed of settlement of the society provided that no member of the society "*should be personally liable to make good, either in whole or in part, any claim or demand whatever under any policy, grant of annuity, endowment, or other assurance, issued or to be issued on behalf of the Society, but the funds or property of the Society which at the time of recovering upon any such claim or demand, policy, annuity, endowment, or other assurance, should be in the hands or power of the directors …. should alone be liable to satisfy such claim or demand, policy, annuity, endowment or other assurance".* Each policy issued by the Society contained a clause limiting the liability in respect of it in accordance with clause 140. On a policy-holder's winding up petition, Jessel MR observed (at 252):

"*I think it important to say, for the comfort of the holders of policies in this company and in other similarly constituted mutual societies, that I do not find there is any liability whatever imposed upon them to contribute one farthing. There is no contract on their part to pay*

anything. The form of the arrangement come to upon the establishment of the Society and the substance of it is this – that all the policy-holders shall pay the premiums upon their policies and nothing more; that, out of the moneys so paid, the current expenses of the Society, such as clerks' salaries and servants' wages and so forth, are to be paid by the directors, and out of the surplus the policies are to be paid as they become claims, and for that purpose and that purpose only the premiums are to be collected and invested by the directors… when the company becomes insolvent and is ordered to be wound up, the only matter to be decided, after the payment of the costs of the liquidation, is in what proportions the funds and property then belonging to the Society shall be distributed among the then policy holders."

d. In Re Agriculturist Cattle Insurance Company, Ex parte Official Manager (1874) L.R. 10 Ch App 1 the court further confirmed the effectiveness of limited liability, and considered who, in that context, bore the costs of calling up the unpaid capital. Lord Cairns LC's approach to the matter made clear that the question is one of construction of the relevant contract (at p.5-6):

"Now I read this as being a contract with the policy-holder that the funds, securities, and property of the company remaining unapplied and undisposed of, and inapplicable to prior claims and demands at the time of enforcing the agreement, shall be liable to him, and shall alone be liable to him. It is therefore a clause which gives him a right by contract to have that fund applied in a particular way. Now the way in which, so far as this contract is concerned, the fund would fall to be applied, is thus: The time of enforcing the claim, having regard to the winding-up, is the making of the winding-up order; that, I think, was admitted at the bar. Every policy-holder, however, is entitled to ask at that moment, What is the property of the company unapplied, undisposed of, and inapplicable to prior claims and demands? The answer which would be given to such a question would be: There are, in the first instance, the assets of the company in specie. No doubt, if

there are such assets, and if they are assets that require to be disposed of by sale, and costs are incurred in the sale, those costs would be deducted out of the sale moneys, and it would be the net sale moneys which would be applicable assets. But the next important item of property in this case would be the calls of the shareholders, which they ought to pay, and which have not been paid up. Now it appears to me that, both having regard to the language of this contract, and having regard to the deed of settlement which is referred to in the contract, the theory of these contracts is, that all those unpaid calls were supposed to be available at any time when they were wanted, and ought to be paid up immediately when wanted for the purpose of satisfying all demands upon the company.

e. Similarly, in Lathbridge v Adams Ex p. Liquidator of the International Life Assurance Society (1872) L R 13 Eq 547, the court rejected an argument that the shareholders were to be required to pay the full amount of policy holders' claims. Sir R Malins VC observed (at p.552) that "*the object of the deed of settlement is perfectly clear…Nothing can be more distinct or emphatic than the terms of the contract:* "no individual proprietor of the company shall be liable on any pretence whatever beyond the unpaid part of his share in the capital of the society."… *The contract is that each shareholder shall be liable for £20 per share, and not for a single farthing beyond that; and this estate having paid that amount the contract is that there shall be no liability to pay more."*

33. On a true interpretation of the Sub-Debt Agreements, or alternatively by reason of implication, a similar limitation applies here, such that the Sub-Debt was only ever to be repaid by LBIE, without recourse to its members' assets.

(i) *The terms of the Sub-Debt Agreements*

34. The Sub-Debt Agreements are summarised in the Waterfall I Judgment at T1/8, paras 48-54. The most relevant provisions are as follows:

"*Subordination*

5(1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon:-

…

(1)(b) the Borrower being "solvent" at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be "solvent".

(2) For the purposes of sub-paragraph 1(b) above, the Borrower shall be "solvent" if it is able to pay the Liabilities (other than the Subordinated Liabilities) in full disregarding –

(a) Obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and

(b) *The Excluded Liabilities [being any liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower].*

…

(4) For the purposes of sub-paragraph 1(b) above, a report given at any relevant time as to the solvency of the Borrower by its Insolvency Officer, in form and substance acceptable to the FSA, shall in absence of proven error be treated and accepted by the FSA, the Lender and the Borrower as correct and sufficient evidence of the Borrower's solvency or insolvency".

35. Further:

a. Liabilities are defined as "*all present and future sums, liabilities and obligations payable or owing by [LBIE] (whether actual or contingent, jointly or severally or otherwise howsoever)*";

b. the Standard Terms continue to provide that where the Sub-Debt is paid where the aforesaid condition of solvency is not met, then "*Any sum… shall be received by the Lender upon trust to return it to the Borrower*" (at Standard Conditions 5(5) and (6));

c. Clauses 6(a) and (f) of the Sub-Debt Agreements (standard terms) record LBIE's representations and undertaking that it was not, without the prior written consent of the FSA, to *"(a) secure all or any part of the Subordinated Liabilities*" or *"(f) arrange or permit any contract of suretyship (or similar agreement) relating to its liabilities under [the Sub-Debt agreement] to be entered into*" and (otherwise than as disclosed in writing to the FSA) had not done so prior to entry into the Sub-Debt; and

d. Similarly, clauses 7(d) and (f) record LBHI2's representation and undertakings not, without the prior consent of the FSA, to enforce the Sub-Debt otherwise "*than in accordance with the terms of [the Sub-Debt agreement]*" or to "*(f) take or enforce any security, guarantee or indemnity from any person for all or any part of the Subordinated Liabilities and the Lender shall, upon obtaining or enforcing any security, guarantee or indemnity notwithstanding this undertaking, hold the same (and any proceeds thereof) on trust for the Borrower*" and (otherwise than as disclosed in writing to the FSA) had not done so prior to entry into the Sub-Debt.

(ii) Interpretation of the Sub-Debt Agreements: Commercial Context.

36. The Sub-Debt Agreements are to be construed in their commercial context; see Rainy Sky SA v Kookmin Bank [2011] 1 W.L.R. 2900, at [21] (per Lord Clarke): *"The language used by the parties will often have more than one potential meaning. I would accept the submission made on behalf of the*

appellants that the exercise of construction is essentially one unitary exercise in which the court must consider the language used and ascertain what a reasonable person, that is a person who has all the background knowledge which would reasonably have been available to the parties in the situation in which they were at the time of the contract, would have understood the parties to have meant. In doing so, the court must have regard to all the relevant surrounding circumstances. If there are two possible constructions, the court is entitled to prefer the construction which is consistent with business common sense and to reject the other"; and further Arnold v Britton [2015] UKSC 36, at [15] and [108-110] and Lewison, The Interpretation of Contracts, 5th ed. at 1.01. (to include the First Supplement to the Fifth Edition).

37. Having regard to the commercial context, it is evident that the terms of the Sub-Debt Agreements were intended to preclude recourse to the funds of LBIE's members for the purpose of repaying the Sub-Debt:

    a. The Sub-Debt Agreements were entered into so as to ensure compliance with regulatory capital requirements. These requirements are set out in detail in the Waterfall I Judgment at T1/8, paragraphs 33 to 47. As explained by David Richards J.: "*Under capital rules made by regulators, banks and other financial institutions are required to hold capital of a certain amount, which depends in broad terms on the extent of their business and their risk exposures. The purpose of the capital adequacy rules is so far as possible to ensure that firms provide financial resources to protect their customers and other stakeholders against failure and enable them to withstand some level of loss"* (at para 33). See too, paras 60-63, including at paragraph 60 "*Although subordinated loans may rank only as lower tier 2 or even tier 3 capital, they are nonetheless to be treated as part of the capital or own funds of the institution for the purposes of providing protection to those dealing with institutions and for the purposes of absorbing losses*".

    b. This purpose accords with the express statements in Basel I (at para 23) and Basel II (para 49(xii) and (xiv)): "*For short-term subordinated*

debt to be eligible as Tier 3 capital, it needs, if circumstances demand, to be capable of becoming part of a bank's permanent capital and thus be available to absorb losses in the event of insolvency…" (at para 49(xiv)). It was thus inherent in the nature of the Sub-Debt that it was to be available to meet losses in the event of insolvency.

c. Indeed, it is clear that when the Sub-Debt was entered into, regard was had not simply to LBIE's regulatory position, but to the regulatory position of the entire UK Lehman Group so that third party creditors of the group were not to be prejudiced. This is, amongst other sources, plain from:

    i. The email of Gareth Bowen (Lehman - UK Regulatory Reporting) to Claire Edwards of the FSA dated 17 August 2006, which refers to the proposed group restructuring and explains that "…*the final form of the restructuring would not lead to an overall reduction in capital at the group, or reduction in quality of the capital available to the group*". The email exhibits a UK group organisational chart, and capital resources calculations for LBIE and the UK Group, both pre and post restructuring;

    ii. Lehman Brothers' letter to HMRC dated 18 August 2006 requesting clearance for the restructuring on behalf of the Lehman Brothers UK group, and which explained, amongst other matters, that "*....the main purpose of the transactions is to provide financing to the LB UK group for business purposes in a manner that is efficient from both a regulatory and a US tax perspective… As the proposed transaction does not displace or alter the existing amount of debt funding to the UK group it would seem that no comparison needs to be made here; the same loan amount is in place before and after the transaction and fulfils the same purpose – that of providing capital to support the general UK business activities…"*; and

iii. Lehman Brothers' further letter to HMRC dated 29 September 2006 which addressed the application of the FSA rules to the LB UK regulated group, and which included a diagram prepared by Lehman's regulatory group showing the equity and subordinated debt position of the group pre and post implementation.

d. This is also apparent from documents which subsequently address the Sub-Debt, including Lehman Brothers' letter to the FSA dated 16 March 2007, which proposes further restructuring on the basis that it will enhance the Lehman Brothers' funding structure, and "*indeed should strengthen Lehman Brothers' capital base by providing new funding for the regulated group*", and Lehman Brothers' letter to HMRC dated 30 March 2007.

e. The only conclusion that can properly be drawn from these documents is that the Sub-Debt was considered to be relevant not only to the regulatory position of LBIE, but to the regulatory position of the entire UK Lehman Group. The Sub-Debt was to be treated as or analagous to equity (lower Tier II or Tier III capital), and would not result in prejudice to third party creditors of the group.

f. LBL is itself in administration, and its creditors are principally employees, trade creditors and HMRC. Almost all of these persons were in reality providing services via LBL for the benefit of the Lehman Group as a whole and including LBIE. It would be inimical to the objective of the regulatory capital requirements which supported the entire UK Lehman Group for the provider of the Sub-Debt (LBHI2) (Tier III capital) to receive payments so as to reduce that debt at the expense of such external creditors.

38. Further and alternatively to the above:

a. Quite apart from the defence of circuity of actions arising out of LBIE's claims to indemnification under Section 74, it makes no commercial sense for there to be recourse to LBL for the purpose of

LBIE repaying the Sub-Debt, which was advanced to LBIE by LBHI2. LBHI2 owns the vast majority of shares in LBIE, as against which LBL is the registered holder of only a single share.

b. Even assuming that LBL was correctly registered as a shareholder in LBIE, the Court is entitled for the purposes of this trial to assume that it was such as nominee for LBH Plc and/or LBHI2. If this is correct, on standard contractual principles, LBL will be entitled to an indemnity in respect of any costs or liabilities associated with the share from the person on whose behalf it is held. Irrespective of these contractual rights, LBL is entitled to an adjustment of rights under Section 74.

c. Even ignoring any right of indemnification, the context still supports a construction limiting recourse to LBIE's own funds. In particular, the Sub-Debt Agreements contain no indication that repayment was to be effected by any person other than the borrower, including the borrower's members, but rather expressly refer to the application of IPRU (INV) 10 in the FSA handbook. IPRU (INV) 10-62 does not include the product of a Contribution Claim as an asset of the Company, suggesting that the sole liability to repay the Sub-Debt rests upon LBIE, without recourse to its members.

d. The Sub-Debt Agreements also contain a recital that LBIE has, as borrower, "*fully disclosed to the FSA the circumstances giving rise to the Loan or Facility and the effective Subordination of the Loan and each Advance*". However, during the course of the 2006-2007 restructuring, as part of which LBIE assumed liability to LBHI2 for the Sub-Debt, so far as the LBL Administrators are aware the role of LBL as a shareholder played no role in the calculation of LBIE's capital[5]. This is particularly pertinent where, for the reasons given above, LBL took its share in LBIE as a nominee and where this was known to both LBIE and LBH Plc (by whom the initial share was transferred).

[5] The other parties have not disputed this proposition in LBL's Reply Paper (T1/20 at para 5.5.1) and which is borne out by, inter alia, the documents referred to in paragraphs 37(c) and (d) above.

e. Clauses 6(a) and (f) and 7(d) and (f) similarly speak to the sole obligation of LBIE to repay the Sub-Debt.

39. The Sub-Debt Agreements, on their true construction, limit the exposure of LBL as permitted by s.74(2)(e). However, even if not expressly so, having regard to the matters set out above this must be the case by implication; see Attorney General of Belize v Belize Telecom Ltd (supra.) at [16] to [27] and Marks & Spencer plc v BNP Paribas Securities Trust Company (Jersey) Ltd v Anor [2016] AC 742, per Lord Neuberger at paras 14-21.

40. Further and for the avoidance of doubt:

a. whilst it is recognised that the Sub-Debt Agreements are in standard form, this does not preclude the implication of a term providing that the Sub-Debt is to be repaid by recourse to LBIE's funds and not those of LBL as one of its members in appropriate circumstances; see Greatship (India) Ltd v Oceanografia SA de CV 1 All ER [2013] 1244 at 1256.

b. Nor should the fact that the Sub-Debt Agreements are assignable be afforded any weight (cf. LBIE PP at T1/16, para 12(2)(iii)).

i. The Sub-Debt Agreements were the subject of representations and undertakings given to the FSA, which would have inhibited ready assignment.

ii. The Sub-Debt Agreements were not like Articles of Association or other documents intended to encompass future dealings by an undefined class. The Sub-Debt Agreements would inevitably have remained as a form of finance provided within the Lehman Group to meet regulatory capital requirements. As such, even if background materials have to be considered in order properly to construe the Sub-Debt Agreements, these would be readily available also to any assignee; see Chartbrook v Persimmon [2009] 1 AC 1101 at para 40 and The Interpretation of Contracts (supra.) at 3.18.

41. Consequently, there are no circumstances which realistically permit a Contribution Claim to be raised against LBL in respect of the Sub-Debt. Furthermore, insofar as (in particular) LBH Plc advances additional arguments to the same effect[6], LBL respectfully adopts them.

D) Issue 3

42. Issue 3 concerns the question of the value to be put on the Sub-Debt Contribution Claim (if any), and specifically whether the Sub-Debt Contribution Claim should be valued for the purposes of proof and set-off at the full value of the Sub-Debt, in the sum of some £3 billion (including interest), the value ascribed to the Sub-Debt by the LBHI2 for the purposes of its proof of debt of £1,254,165,598.48, or some other amount (Issue 3 at T1/1, p.2).

43. LBL sets out its position on Issue 3 without prejudice to its position, as set out above, in respect of Issue 1, that no claim for the Sub-Debt, or Sub-Debt Contribution Claim can properly be made.

44. The parties appear to be broadly agreed that, if the Sub-Debt Claim and Sub-Debt Contribution Claims are made, the Sub-Debt Contribution Claim is to be valued on a genuine and fair basis, as a contingent claim and having regard to the likelihood of the relevant contingencies eventuating (see LBL PP T1/14 at paras 121-123; LBIE T1/16, at para 25; LBHI2 PP T1/17, at paras 3.5-3.6 and LBH Plc PP T1/19, para 20, IR 2.81 and In re Danka Business Systems Plc (in MVL) [2013] EWCA Civ 92 at para 43).

45. However, LBIE appears to apply these principles to contend that the Sub-Debt Contribution Claim should be valued at the full amount of the Sub-Debt, on the basis that if certain contingencies occur resulting in the Sub-Debt becoming payable, this is the amount that it will be required to pay LBHI2 (LBIE PP at T1/16, paras 23 to 25).

46. LBIE's approach is misconceived:

[6] In particular, see LBH Plc PP at T1/19, para 12.

a. The Court of Appeal held that the Sub-Debt was itself to be valued at zero for the purposes of proof and set-off until such time as the contingencies for its repayment are met (Appeal Judgment at T1/9, para 41). This being so, the Sub-Debt Contribution Claim should be valued likewise, at zero.

b. It makes no sense for the Sub-Debt Contribution Claim to be valued more highly than the Sub-Debt, in particular in circumstances in which the parties are agreed that these are to be dealt with by way of set-off. A Contribution Claim is to be made only where *necessary* (s.150(1) IA 86) or otherwise, in a voluntary liquidation, is to be permitted only where "*just and beneficial*" (s.112(2) IA). Permitting the LBIE Administrators to put a higher value on the Sub-Debt Contribution Claim than is afforded to the Sub-Debt (for example so that it can proceed to seek additional funds from LBL and LBHI2) would plainly not be necessary (or indeed serve any useful purpose at all, since the funds raised, if not required for the purpose of discharging the Sub-Debt, would become repayable by way of adjustment *inter se*). There is certainly no need in the present instance for the LBIE Administrators (who already have extensive financial information relating to the positions of LBHI2 and LBL) to raise two Contribution Claims, one simply for the purpose of adjusting the rights of members *inter se*.

c. It would be especially nonsensical to value the Sub-Debt Contribution Claim in excess of the Sub-Debt where the contingencies for the making of a Sub-Debt Contribution Claim are more remote than the contingencies required to be met before the Sub-Debt itself falls due:

    i. LBIE may never go into liquidation (in which event it will have only a contingent right to make a Contribution Claim, assuming that the Waterfall I Judgment is upheld on this point).

    ii. If the Sub-Debt is to become repayable that presupposes LBIE's "*solvency*" and ability to discharge all of its prior ranking liabilities. In this event, it cannot require its members

to contribute by paying the full value of the Sub-Debt (since it will already have assets to apply against it for which credit must be given) and may not require them to contribute at all, if it has sufficient assets.

iii. Alternatively, the Sub-Debt may itself never become repayable, because LBIE does not meet the above solvency criteria.

F) Issue 7

47. As set out above, Section 74 provides that *"When a company is wound up, every present and past member is liable to contribute to its assets to any amount sufficient for payment of its debts and liabilities, and the expenses of the winding up, and for the adjustment of the rights of the contributories among themselves"* (emphasis added). Issue 7 raises the question whether, in light of the fact that LBL is only registered as owning a single share in LBIE, and LBHI2 owns 2 million 5% redeemable Class A preference shares of $1000 each, 5.1 million 5% redeemable Class B shares of $1000 each, and 6,237,113,999 ordinary shares of $1 each, there is to be an adjustment of rights as between LBL and LBHI2, or alternatively LBH Plc, in respect of any Contribution Claim made.

48. In the absence of factual evidence, LBL contends that the Court is unable to determine what adjustment (if any) might be appropriate as between LBIE's members save having regard to two factors: the number of shares held by each and the assumption that LBL held its share as a nominee for LBHI2 and/or LBH Plc.

49. Dealing first with the question of adjustment on the basis of the number of shares held, the parties appear broadly to be agreed that there is no requirement that the members contribute an equal amount to meet any deficit arising in LBIE's estate; this is implicit in s.150(2) IA 86 which provides that "*In making a call the court may take into consideration the probability that some of the contributories may partly or wholly fail to pay it*". However, there is a live question as to the extent of the contribution to be made by each member.

50. Where called on, that contribution is to be rateable to the member's interest and proportionate to their shareholdings; see in particular Re Hodges Distillery Co; Ex p Maude (1870) 6 Ch App 51 at 56, Paterson v M'Farlane (1875) 2 R 490 (Ct of Sess.) and McPherson at 10-025, "…*the object here is to ensure that losses suffered by the company are distributed rateably among all the members in proportion to the amounts subscribed for and not the amounts paid up…*" (per LBIE PP at T1/16, para 44(2); see too LBH Plc PP at T1/19, para 34(ii)). Any other position risks being oppressive.

51. Furthermore, where a surplus is generated (whether by reason of a call or otherwise) it is to be distributed to the company's members "*according to their rights and interest in the company*" (except as otherwise provided by the company's articles) (s.107 IA 86). It would create an obvious imbalance if the right to a distribution accords with the extent of a member's interest in the company, but the liability to contribute to a call does not.

52. In these circumstances, LBL contends that, having regard to the fact that it held a single share in LBIE (and on the assumption that it is not entitled to rectification of the register), it should be responsible either (i) for the tiny proportion of any Contribution Claim that is referable to its single shareholding or (ii) exempt from the same on the grounds that it is *de minimis.*

53. Otherwise, the LBL Administrators' position, on the assumption that it is not entitled to rectification of the register but that it holds the single share as nominee is that the nominee status of LBL must be taken into account when assessing its liability to make contribution to LBIE's estate. This may occur by the party for whom LBL holds the share reimbursing LBL for any Contribution Claim it is required to meet; see In re Overend, Gurney & Co. (Musgrave and Hart's case) [1867-68] LR 5 Eq 193 and see generally Goff & Jones, The Law of Unjust Enrichment 8th ed. 19-16 - 19-21, Duncan, Fox & Co v North and South Wales Bank (1880) 6 App. Cas. 1 at 10 and Niru Battery Manufacturing Co v Milestone Trading Ltd (No.2) [2004] 2 All E.R. (Comm) 289. Alternatively, the party for which LBL holds the share might meet the Contribution Claim itself directly.

54. In either event, the Court is at liberty to direct the LBIE office-holders to assert any Contribution Claim to be raised only as against LBHI2 and/or LBH Plc, or if as against LBL, then only to the extent that it holds the share. The ability to raise a call is a delegated power, but subject always to the Court's supervision in a compulsory liquidation, see s.150 and 160 IA 86, and also IR 4.202, and likewise in a voluntary liquidation; see s.112 IA 86. LBL adopts and supports the further reasoning of LBH Plc set out in this regard (LBH Plc PP at T1/19, para 34).

55. Otherwise, LBL rejects LBIE and LBHI2's contention that, as a matter of principle, no contribution or indemnity claim can lie as between LBIE's members in respect of a Contribution Claim (whether by way of nomineeship or otherwise, for example, recharge) because this eventuality is not provided for by statute and/or is inconsistent with the adjustment mechanism contained in Section 74.

    a. The fact that a contribution or indemnity claim is not expressly provided for by the Act does not preclude its existence. IA86 does not provide a complete code applicable to insolvencies; amendment has been required and lacunae identified[7];

    b. Such a claim is not inconsistent with the adjustment mechanism contained in Section 74; either such mechanism is to be operated within LBIE's estate (i.e. by LBIE's liquidator having regard to the existence of a contribution or indemnity claim alleged as part of the adjustment of the rights of members *inter se*), or the contribution and indemnity claim operates as a corollary to and follows from that process and is something to which the liquidator, administrator or Court must have regard, so as to ensure that any claim made is properly made.

[7] Notably (on LBL's case in Waterfall I) where an administration precedes a winding up, there is a lacuna, in the sense that s.189(2) does not provide for the payment of statutory interest to the period of the administration immediately preceding the winding up.

56. It follows (by way of summary and conclusion) that LBL's position in respect of each of the matters raised by Issue 7 is as follows:

a. The obligations of members to contribute to LBIE's assets pursuant to Section 74 are rateable and proportionate to their shareholdings (and where *de minimis* might be waived);

b. Members may be entitled to indemnification or contribution from each other, on standard contractual principles or having regard to, for example, the existence of nomineeship;

c. LBL does not presently understand that it should be required to contribute to the assets of LBIE for the purpose of adjusting its rights as against LBHI2; no such adjustment is sought by LBHI2 (at least having regard to the Sub-Debt Contribution Claim). In any event, such adjustment would be unwarranted if LBL holds its shareholding as nominee for LBHI2;

d. LBL's claims to indemnification and/or contribution are to be taken into account when considering any adjustment of rights between members, whether directly pursuant to Section 74 or as a corollary to this, to ensure that the statutory provision is exercised properly having regard to all of the circumstances; and

e. LBL contends that the LBIE Administrators should be required to assert less than a 100% Contribution Claim against LBL, for all of the foregoing reasons.

57. If LBL's position on the above is accepted, this will found the basis for the declaratory relief sought by the LBL Application at T1/2, p. 4 (on the alternative bases) paragraphs 1 to 4, ignoring for present purposes claims based upon rights of reimbursement under the Recharge Agreement.

G) Issue 9 Preliminary Issue

58. LBL does not accept that this issue is readily suitable for preliminary determination. It is fact-sensitive as to the terms of the agreement alleged, the factual circumstances which pertain to it, and the intention that the parties might have had in entering into the agreement. No detailed assumptions for the determination of the issue have been formulated, or relevant evidence served.

59. Without prejudice to this, the LBL Administrators contend that it is plain that there is no difficulty in principle with a contract which has the effect of excluding or limiting a member's liability to meet a Section 74 Contribution Claim:

    a. This is not a case in which there is attempted by contract a fundamental alteration to the statutory scheme (cf. British Eagle v Air France 1 WLR 758). Rather, it is a case in which a contract is alleged to have altered liabilities in a way that is envisaged by and consistent with statute. As addressed above, the ability to contract out of Section 74 is inherent in its terms. See too Halsbury's Laws (Vol 14/s.373, Vol 17/ s.662 and 674). IA 86 does not contain any other express prohibition on parties seeking to exclude the nature and extent of a member's liability.

    b. Further, Section 74 does not prohibit a party doing anything. Rather a Contribution Claim *may* be raised where necessary to do so in order to raise funds, and then potentially in different amounts as regards different members. It is implicit in s.150(2) that not all members will meet calls raised upon them.

    c. For a contract to be unlawful, it would need to result in the commission of an unlawful act, or be intended to do so (Halsbury's Laws, Contract, 22 (2012), at 452-454). This was not the intended effect of the Recharge Agreement, which was (on the basis set out in LBL's PP) principally entered into as a means of redistributing liabilities incurred by LBL as a service company.

d. In any event there is nothing to prohibit LBIE waiving its statutory rights, including such rights as might otherwise serve a public purpose where as a matter of fact that purpose is not jeopardised. This is so here where LBL's shareholding in LBIE was *de minimis* and it is agreed that the *prima facie* obligation of shareholders to contribute to a company's deficit is rateable.

H) Issue 10

60. By Issue 10 the LBIE Administrators ask the Court to determine whether, to the extent that LBL is entitled to recover by way of recharge from LBIE sums paid or payable in respect of a Contribution Claim, LBL's recharge against LBIE in respect of the Sub-Debt Contribution Claim and LBHI2's claim in respect of the Sub-Debt are to be paid *pari passu* and, if not, in what order of priority (T1/1 at p.4).

61. This discussion appears to LBL, at least for present purposes, to be entirely academic; the question of the entitlement of LBL to recharge any liability is has to meet a Contribution Claim is a matter for the Part B Trial, and then is an alternative to LBL's principal case that it is entitled to rectification. Otherwise, it is agreed that LBHI2's claim in respect of the Sub-Debt is to be dealt with by way of set-off in LBIE's estate.

62. In the circumstances, and having regard to the fact that the Court will not act in vain including to make declarations that serve no useful purpose, the LBL Administrators propose that this matter be stood over to or following the Part B Trial, if it then arises.

Philip Marshall QC

Ruth den Besten

Serle Court

23 January 2017