Waterfall III Application

IN THE HIGH COURT OF JUSTICE **No.7942 of 2008**
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)

Applicants

and

(1) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS LIMITED (IN ADMINISTRATION)
(2) THE JOINT ADMINISTRATORS OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)
(3) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS EUROPE LIMITED (IN ADMINISTRATION)
(4) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS HOLDINGS PLC (IN ADMINISTRATION)

Respondents

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

This position paper is filed on behalf of the Joint Administrators of LB Holdings Intermediate 2 Limited (in administration) ("LBHI2").

In this paper, LBHI2 sets out its position on the issues in the Application, insofar as they affect LBHI2 and (generally) not otherwise. The position set out below is, save where context requires otherwise, the position LBHI2 takes whichever of the four assumptions identified in the Order made at the 4 November 2016 CMC applies, unless the position set out is expressly stated to apply only on the basis of a particular assumption.

Further, this position paper is prepared on the basis that the Supreme Court does not allow any of the appeals or cross-appeals in Waterfall I. LBHI2's position may well change in the event that any of those appeals/cross-appeals are allowed and/or in light of the Supreme Court's reasoning. LBHI2 has sought to identify below the main issues likely to be affected in those circumstances.

LBHI2 reserves the right to change its position in due course if it considers that it would be in its interests to do so.

Introduction: summary of LBHI2's position

(i) If LBIE went into liquidation, the liquidator would be entitled to call on LBIE's members "for payment of any money which the court considers necessary to satisfy" the liabilities set out in Sections 74 and 150[1] and to adjust the contributories' rights.

(ii) In considering what sum was "necessary", the liquidator would be obliged to take into account the operation of insolvency set-off and may take into account the "the probability that some of the contributories may partly or wholly fail to pay" the sum for which a call is made.[2] The liquidator is not obliged to call on each member for the total shortfall (as is demonstrated by the fact that the call liability includes sums necessary for the adjustment of the rights of the contributories among themselves).

(iii) As things stand, it is likely that the only liability outstanding at the time a call is made would be the Sub-Debt. Accordingly, the only purposes of the call would be to pay the Sub-Debt and to adjust the rights of the contributories.

1 Unless otherwise stated, references to "Sections" in this position paper are to sections of the Insolvency Act 1986

2 Section 150(2).

(iv) The rights of LBIE's contributories fall to be adjusted in proportion to their ordinary shareholdings in LBIE. As LBHI2 holds 6,237,113,999 ordinary shares in LBIE and LBL holds 1 ordinary share in LBIE, LBL's liability to contribute is *de minimis* and can properly be ignored: for every £1 billion contributed by LBHI2, LBL would be liable to contribute approximately £0.16.

(v) In making calls in a liquidation of LBIE, the liquidator would (having regard to the operation of insolvency set-off and the fact that any contributory liability was effectively to be borne entirely by LBHI2) call on LBHI2 only (and not on LBL) for a sum sufficient to pay any outstanding balance of the Sub-Debt, knowing that that call would necessarily be discharged by set-off between the call and LBHI2's claim for the Sub-Debt.

(vi) The call made on each member is a separate liability of each member, so that set-off of one call does not necessarily discharge any part of the call made on the other member. This is apparent from the fact that otherwise the call would not produce the funds necessary to adjust the rights of members between themselves where such an adjustment is required.

(vii) Nor do the members have any right of contribution or indemnity from each other: their rights *inter se* are regulated pursuant to the statutory scheme, which provides for the liquidator adjusting the rights of the contributories among themselves, thus avoiding problems of double-proof.

(viii) In valuing any contingent claim that can be made against the members by LBIE's Joint Administrators while LBIE remains in administration,[3] the above points must be taken into account in calculating the call liability each contributory would be likely to face if LBIE went into liquidation, before reducing the value of that claim to reflect the relevant contingency, i.e. whether LBIE will go into liquidation.

[3] The question of whether the Joint Administrators can deal with the members' liability to contribute under Section 74 is part of the Waterfall I appeal to the Supreme Court.

The Issues in the Application

1. Whether the obligations of:

(i) LBHI2; and/or

(ii) Lehman Brothers Limited ("LBL")

To contribute to the assets of Lehman Brothers International (Europe) (in administration) ("LBIE") pursuant to Section 74 of the Insolvency Act 1986 ("Section 74") 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) (the "Sub-Debt").

1.1 A contributory's liability under Section 74 is to pay the sum he is called upon to pay in order to enable the liquidator to realise an amount sufficient for payment of the company's debts and liabilities, and the expenses of the winding up, and for the adjustment of the rights of the contributories among themselves. The liability under Section 74 extends to cover provable debts of the company in liquidation: see Waterfall I in the Court of Appeal at paras 173-5 *per* Briggs LJ.

1.2 The Sub-Debt is provable by LBHI2 in LBIE's administration and liquidation (see Waterfall I in the Court of Appeal at paras 39-40 and 62 *per* Lewison LJ), although this aspect of the Court of Appeal's decision in Waterfall I was appealed by LBIE and the decision is awaited.

1.3 Accordingly, the obligation of both members to contribute under Section 74[4] extends to the Sub-Debt (assuming it is valued at more than nil because LBIE has sufficient assets to pay all prior-ranking claims in full) to the extent that there is a shortfall in the repayment of it (by payment in cash or by set-off[5]) by LBIE to LBHI2. However, as set out above and explained in more detail below, a liquidator is not obliged to call on both

[4] Whether LBHI2 and/or LBL are liable to contribute to the assets of LBIE while it is in administration is a question currently being considered by the Supreme Court in Waterfall I.

[5] Set-off in this context is dealt with at Issue 2 below.

contributories for the same sum and in considering the amount of the call he will make on each contributory, he should properly consider the operation of set-off and his obligation to adjust the rights of the contributories as between themselves.

2. Whether any claim of LBIE against LBHI2 and/or LBL under Section 74 (a "Contribution Claim") in respect of the Sub-Debt (a "Sub-Debt Contribution Claim") is to be included in the insolvency set-off account in LBIE's administration as against the provable claims of:

(i) LBHI2; and/or

(ii) LBL.

2.1 Any Contribution Claim (whether or not it includes a Sub-Debt Contribution Claim) which LBIE's Administrators are permitted to make against LBHI2 and/or LBL[6] is to be included in the insolvency set-off account in LBIE's administration as against the provable claims of LBHI2 and/or LBL.[7]

3. Whether the value of the Sub-Debt Contribution Claim, for the purposes of proof and set-off, is:

(i) for 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.

3.1 Issue 3 (and other issues in this Application) specifically address what has been defined as the "Sub-Debt Contribution Claim", ie a part of the overall Contribution Claim made under Section 74 by LBIE's Joint Administrators (if permitted by the Supreme Court)

6 The question whether LBIE's Administrators are permitted to make such a claim is one of the issues currently being considered by the Supreme Court as part of the Waterfall I appeal

7 This issue only arises if the appeal in Waterfall I on LBIE's ability to prove for the Section 74 liability of its members or otherwise include it in the set-off account whilst LBIE remains in administration fails. Further, in that event, this position is likely to be affected if the appeals on either (a) the ranking of the Sub-Debt and/or (b) the scope of the Section 74 liability are successful.

against contributories. However, LBHI2 contends (as set out at Issue 1 above) that while LBIE's liability to pay the Sub-Debt is to be included within the scope of a Section 74 Contribution Claim by LBIE (as it is one of LBIE's debts and liabilities), in calculating the sum to be called for from each contributory, a liquidator would have to have regard to the total amount "necessary" to satisfy the company's debts and liabilities, to pay the expenses of the winding up and for the adjustment of the rights of contributories. In particular, the liquidator would take account of the operation of insolvency set-off (addressed in more detail under Issue 4 below) in calculating the sum to be called for from each contributory. In this case, it follows that the liquidator would include the value of the Sub-Debt Contribution Claim in a call made on LBHI2 but not on LBL, as no call other than one on LBHI2 is "necessary" to enable payment of the Sub-Debt claim on LBIE. The way in which this applies if the Supreme Court allows such a claim to be made in the estates of LBHI2 and LBL whilst LBIE is in administration is dealt with below.

3.2 The Insolvency Rules 1986 ("IR 1986") provide for the estimation of the value of contingent claims for the purposes of proof and set-off: see IR 2.81 and 2.85.

3.3 LBHI2's Sub-Debt claim against LBIE is contingent (ie contingent on the LBIE Administrators being able to pay all prior-ranking claims against LBIE in full): see Waterfall I in the Court of Appeal at paras 38 and 41 *per* Lewison LJ.

3.4 If the LBIE Administrators are permitted to make a Sub-Debt Contribution Claim against one or both of the members, it will also be a contingent claim in the members' insolvencies (ie contingent on whether LBIE will go into liquidation and on whether a liquidator would make a Section 74 call).

3.5 Accordingly, the value of the Sub-Debt Contribution Claim for the purposes of proof and set-off takes as its starting point the estimated value that is applied to LBHI2's Sub-Debt claim against LBIE (when LBHI2 proves in LBIE's administration).

(i) The value of LBHI2's claim for the Sub-Debt for the purposes of proof is not fixed but falls to be revalued in accordance with the principles of hindsight (see *Stein v Blake* [1996] AC 243, *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147 and

Re Danka Business Systems plc [2013] Ch 506), with the revalued figure being applied in the set-off account.

(ii) The Court of Appeal's decision in Waterfall I was that LBHI2's claim for the Sub-Debt was a contingent debt which one would expect the office-holder to value at nil when lodged, and then to revalue once it becomes clear that the contingencies are satisfied (i.e. that the office-holder has sufficient assets that he can pay the prior-ranking claims in full).

(iii) The starting point for the value of the Sub-Debt Contribution Claim must be limited to the estimated value applied to LBHI2's claim for the Sub-Debt for the purposes of proof because LBIE cannot assert (in valuing the Sub-Debt element of any Contribution Claim) that it has a liability in respect of the Sub-Debt which it values as greater than the value it puts on that same liability when asserted against it by way of LBHI2's proof in LBIE's administration. That is because the first contingency relevant to the valuation of any outgoing Sub-Debt Contribution Claim asserted by LBIE is the same contingency as applies to the valuation of the incoming liability for the Sub-Debt (asserted by LBHI2's proof in LBIE's administration), namely, whether LBIE will have sufficient assets to pay its prior-ranking liabilities in full.

3.6 The value to be placed on the Sub-Debt Contribution Claim by LBIE against LBHI2 then falls to be discounted from that starting point to reflect the further contingencies that would need to be fulfilled before a Sub-Debt Contribution Claim could be made by LBIE against LBHI2 (e.g. the unlikelihood of LBIE going into liquidation and/or its liquidator making a call under Section 74), albeit that these are contingencies of an unusual nature because of the degree of control which LBIE's Administrators are likely to have over whether they are satisfied.

3.7 It follows the value of the Sub-Debt Contribution Claim (to be advanced by LBIE's Joint Administrators) for the purposes of proof and set-off is either nil or necessarily less than the estimated value LBIE's Joint Administrators place on LBHI2's claim for the Sub-Debt.

3.8 The fact that the Sub-Debt Contribution Claim would therefore be insufficient to satisfy in full any unpaid balance of the Sub-Debt claim by LBHI2 in LBIE's administration is accordingly a consequence of the Section 74 liability being dealt with whilst LBIE

remains in administration[8]. That fact requires the Sub-Debt Contribution Claim to be treated as a contingent claim, contingent on, in particular, whether LBIE will go into liquidation and whether a call would then be made.

4. To the extent that insolvency set-off has already taken effect, in the administration of LBIE, between LBHI2's claim in respect of the Sub-Debt and LBIE's Sub-Debt Contribution Claim (if any) against LBHI2, what effect (if any) such set-off has on LBIE's ability to make a Sub-Debt Contribution Claim against LBL.

4.1 In calculating the amount to call for from each contributory, a liquidator of LBIE (and therefore also LBIE's Joint Administrators in asserting a contingent Contribution Claim, if they are permitted to do so by the Supreme Court) would have to have regard to the sum "necessary" to discharge the various elements of the contributory liability. As set out below in more detail under Issue 7, those elements include any money "necessary to satisfy the company's debts and liabilities".

4.2 In any liquidation of LBIE, and as set out under Issue 3 above, the starting point for considering the sum necessary to pay LBHI2's Sub-Debt claim against LBIE would be the estimated value that is applied to LBHI2's proof for its Sub-Debt claim against LBIE. A liquidator could never call for more than the value at which he estimated LBHI2's proof for the Sub-Debt. Accordingly, the value of a call made to meet LBHI2's Sub-Debt claim on LBIE would always be the same, or less than, the value of the Sub-Debt claim itself, so that set-off between those two claims in LBIE's liquidation would necessarily discharge the part of a call made on LBHI2 to pay the Sub-Debt.

4.3 LBHI2's position is that this is a matter which would fall to be taken into account by the liquidator in calculating the call to be made on each contributory. Accordingly, the effect of insolvency set-off between LBHI2 and LBIE properly falls to be taken into account in considering the value of the call to be made on LBL, with the conclusion that (as set out above) no call other than one on LBHI2 would be "necessary" in respect of the Sub-Debt Contribution Claim. A liquidator could therefore only properly call on LBHI2 for

[8] The Waterfall I appeal includes an appeal as to whether LBIE's Joint Administrators are entitled to deal with the Section 74 liability.

the sum required to pay the Sub-Debt claim. It follows that any contribution claims made by LBIE's Joint Administrators on LBHI2 and LBL would have to reflect that proportionate split in call liability between LBHI2 and LBL, with the entirety of the contribution claim made to satisfy any outstanding balance of LBHI2's Sub-Debt Claim being made on LBHI2. Any much smaller contribution claim made on LBL by LBIE's Administrators under Section 74 would not then be discharged (in part or in full) by set-off operating as between LBIE and LBHI2 in respect of LBHI2's separate liability to LBIE under Section 74.

5. In circumstances where insolvency set-off in LBIE's administration took effect on 4 December 2009, whether insolvency set-off in a subsequent distributing administration or liquidation of LBHI2 and/or LBL is of any application in respect of those companies' claims against, and liabilities to, LBIE.

5.1 Insolvency set-off in a subsequent distributing administration of LBHI2 will apply in respect of LBHI2's claims against and liabilities to LBIE only if and to the extent that any claim by LBHI2 against LBIE, or any claim by LBIE against LBHI2, which would fall into the insolvency set-off account in LBHI2's subsequent distributing administration did not fall into the insolvency set-off account in LBIE's administration. Claims which did fall into the insolvency set-off account in LBIE's administration are subject to set-off only in that estate, albeit the values put on the claims on either side of that set-off account may be revalued (as described in para 3.5(i) above).

5.2 For example, if the Supreme Court allows the appeal as to whether LBIE's administrators can assert a Contribution Claim under Section 74 and holds that only a liquidator of LBIE can assert such a claim, then that Contribution Claim (arising if (and only if) LBIE goes into liquidation) would be a claim which would potentially be affected by insolvency set-off in a distributing administration or liquidation of LBHI2 and/or LBL.

6. In circumstances where insolvency set-off in the administration of Lehman Brothers Europe Limited ("LBEL") took effect on 11 July 2012, whether insolvency set-off in a subsequent distributing administration or liquidation of LBL is of any application in respect of LBL's claims against, and liabilities to, LBEL.

6.1 At present, LBHI2 takes no position on this 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 any 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 the 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;

(v) whether the Joint Administrators of LBIE 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.

7.1 <u>On the assumption that LBL is the legal and beneficial owner of a single share in LBIE and is not entitled to rectification of the share register</u>:

(i) The obligation of each member to contribute is to pay the call made on him by the liquidator. As set out above, the liquidator is not obliged to call for the same

amount from each member but can make a separate call on each member. As set out below, the position as between the contributories is provided for by the liquidator's power to adjust under Sections 74 and 150.

(ii) There is no right between contributories for them to claim a contribution and/or indemnity from each other in respect of their Section 74 and 150 payments (or payments made by way of set-off).

(iii) The adjustment of the rights of contributories as between each other is provided for by Sections 74 and 150 and a right on the part of contributories to claim contribution and/or indemnity from each other would be inconsistent with that statutory mechanism, which is in place to facilitate the orderly collection of assets and their distribution in the circumstances of a liquidation. As expressly provided by Section 74, in a winding up of LBIE, LBHI2 and LBL are 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). As to the effect of such an adjustment:

(1) The purpose of the adjustment is to ensure that any surplus is distributed, or any loss shared, between the members in accordance with their "rights and interests in the company" (section 107 applying in a voluntary winding up; section 154 applying in compulsory winding up is less explicit but the same principle applies: see *Birch v Cropper* (1889) 14 App Cas 525 at 544 per Lord Macnaghten).
(2) Statute makes no provision as to what those "rights and interests in the company" are. In this case, the members' rights and interests are simply as provided by the Articles.
(3) LBIE's Articles provide that the holders of preference shares have no rights to participate in the distribution of LBIE's assets on liquidation beyond a right to receive out of the assets the return of capital subscribed in respect of each preference share. Accordingly, the adjustment in this case would be to distribute the losses between LBHI2 and LBL in

rateable proportion to the nominal amounts of the ordinary shares each holds, i.e. 6,237,113,999 to 1.

(iv) The question of a right of contribution or indemnity does not arise (given LBHI2's position on (ii) and (iii) above). In making the adjustment provided for by Sections 74 and 150, the liquidator does not take into account any other claims which LBHI2 and LBL have against one another or any other party. The adjustment provided for by Sections 74 and 150 is concerned with the members' interests as such and as creditors and/or debtors of LBIE, but not otherwise.

(v) The claim asserted by the Joint Administrators of LBIE in respect of the Contribution Claim is not the same as the call that could be made by a liquidator of LBIE (see para 3 above; further, this is a question on which the Supreme Court's decision in Waterfall I is likely to have an effect). What falls to be assessed in valuing any Contribution Claim that can be advanced by the Joint Administrators of LBIE is (a) the value of the call that would be made by the liquidator of LBIE if LBIE were in liquidation and (b) the appropriate discount to be applied to reflect the relevant contingencies. In assessing (a), the factors to be taken into account include (i) what sum the court would consider necessary to satisfy LBIE's debts and liabilities and the expenses of winding up, (ii) the likelihood that either or both contributories would partly or wholly fail to pay the call and (iii) what sum the court would consider necessary for the adjustment of the rights of the contributories (see Section 150). In assessing (b), the contingencies to be taken into account are those set out at para 3 above. Further, as set out above, the claim to be made on each contributory should properly take into account the impact of insolvency set-off.

7.2 On the assumption that LBL is entitled to rectification of the share register with the effect that the single share in LBIE currently registered in LBL's name is (i) cancelled; (ii) registered in the name of LBH; or (iii) registered in the name of LBHI2: the position stated at para 7.1 above on Issues 7(i) to (v) applies mutatis mutandis.

7.3 On the assumption that LBL holds the single share in LBIE as nominee for LBH and/or LBHI2 and is entitled to an indemnity from LBH and/or LBHI2 (as appropriate) in

respect of its liability under section 74 of the Insolvency Act 1986: the position stated at para 7.1 above on Issues 7(i) to (v) applies mutatis mutandis. A registered shareholder who holds his shares in the company as a nominee is, nonetheless, the contributory (rather than the beneficial owner of the shares who is liable to indemnify the nominee in respect of sums it is obliged to pay): see *City of Glasgow Bank; Buchan's Case, Re* (1879) 4 App Cas 547; *Muir v City of Glasgow Bank* (1879) 4 App Cas 337; *Imperial Mercantile Credit Association; Chapman's Case, Re* (1867) 3 Eq 361; *European Society Arbitration Acts, Re* (1878) 8 Ch D 679 at 708.

7.4 On the assumption that LBL is otherwise entitled to recharge its liabilities to LBH (and/or LBIE, LBHI2 and/or LBEL), including its liability to make contribution to LBIE's estate under section 74 of the Insolvency Act 1986: the position stated at para 7.1 above on Issues 7(i) to (v) applies mutatis mutandis. This is particularly because, as set out at para 7.1(ii) and (iv) above, there is no right of contribution or indemnity between contributories as such, and in making the adjustment provided for by Sections 74 and 150, the liquidator does not take into account any other claims which LBHI2 and LBL have against one another or any other party.

8. How, if at all, any claim for a contribution or indemnity as referred to in paragraph 7(ii) above and/or any adjustment as referred to in paragraph 7(iii) above would be affected by the rule against double-proof in circumstances where LBIE had not yet been paid in full in respect of a Contribution Claim.

8.1 The rule against double proof is the principle that one insolvency estate should not pay two dividends in respect of what is in substance the same debt (and, accordingly, there should not be a double proof of what is in substance the same debt against one insolvency estate): *In re Kaupthing Singer & Friedlander Ltd (in administration) (No.2)* [2012] 1 AC 804 at [10]-[11] *per* Lord Walker, citing *In re Oriental Commercial Bank* (1871) LR 7 Ch App 99 at 103-104 *per* Mellish LJ:

> "*But the principle itself—that an insolvent estate, whether wound up in Chancery or in Bankruptcy, ought not to pay two dividends in respect of the same debt—appears to me to be a perfectly sound principle. If it were not so, a creditor could always manage, by getting his debtor to enter into several distinct contracts with different people for the same debt, to obtain higher dividends than the other creditors, and perhaps get his debt paid in full. I apprehend that is*

what the law does not allow; the true principle is, that there is only to be one dividend in respect of what is in substance the same debt, although there may be two separate contracts."

8.2 The primary purpose of the rule is the protection of other creditors of the insolvent estate against unfair treatment in circumstances where there are multiple creditors in respect of what is in substance the same debt. So, for example, in the context of a principal debtor (D) whose obligations to a creditor (C) are guaranteed by a guarantor (G), such that G has a right of indemnity against D if G discharges the obligation owed to C, the effect of the rule if D goes into insolvency is that, so long as C has not been paid in full, G may not compete with C either directly by proving in D's insolvency for an indemnity in respect of the debt owed to C, or indirectly by setting off his right to an indemnity against any separate debt owed by G to D: *Kaupthing No.2* at [12].

8.3 Accordingly, even if (contrary to LBHI2's position set out at para 7.1 above) one member could in principle claim against the other for a contribution or indemnity in respect of its Section 74 liability, in circumstances where LBIE's Joint Administrators had not yet been paid in full in respect of a Contribution Claim, neither LBHI2 nor LBL could pursue a claim for a contribution or indemnity from the other in respect of its liability to contribute under Section 74 (as referred to in Issue 7(ii)), including by proving for such a claim in the other's administration or liquidation. It follows that set-off as between LBHI2 and LBL would not include any claim for such a contribution or indemnity against or from the other unless and until LBIE had been paid in full in respect of a Contribution Claim.

8.4 A claim for an adjustment of the rights of the contributories among themselves is a claim of a different nature, being expressly provided for by Section 74. Accordingly, the rule against double proof does not apply to such a claim, because the right of adjustment is provided for by the liquidator after the payment of the other liabilities in respect of which the members are required to contribute, so there is no risk of the adjustment of the rights of contributories competing with the prior-ranking liabilities.

9. Whether and to what extent LBL is entitled, under the terms of the Service Agreement between LBL and LBIE dated 20 May 2004 or otherwise, to recover from LBIE:

(i) sums paid or payable by it to LBIE in respect of a Contribution Claim;

(ii) sums claimed by LBL from insolvent members of the UK Lehman group of companies, but not ultimately recovered by LBL from such companies ("Bad Debt Claims"); and

(iii) certain (and if so, which) expenses of LBL's administration.

9.1 LBL has been unclear as to whether and, if so, on what basis it contends that it is entitled to recharge any payment made by it in respect of a Contribution Claim by LBIE to LBHI2.

9.2 LBL has now asserted (in its Supplemental Position Paper) that it is entitled to recharge the Contribution Claim liability to LBHI2. LBHI2 disputes that claim, which appears to be made on no reasoned basis.

9.3 In any event, LBHI2 cannot see any basis (as alleged by LBL or at all) for a contention that there was an express or implied agreement between LBL and LBHI2 in relation to recharge of such a liability on the part of LBL (as appears to be alleged in LBL's position paper at para 76.2 and paras 78-95) and/or that there is an entitlement to an indemnity "*in restitution*" (as alleged in LBL's position paper at para 76.2). LBHI2 is not and never has been a trading company and, accordingly, the arguments of LBL at paras 78-95 of its position paper dated 30 September 2016 cannot apply in relation to LBHI2. LBL did not hold the share as nominee and/or on behalf of LBHI2, nor as a service for LBHI2. LBHI2 will further rely on the fact that it was incorporated only on 5 October 2006.

9A. 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 Insolvency Act 1986 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).

9A.1 Regardless of the factual allegations relating to this issue, LBHI2's position is that any agreement which has the effect of enabling a member of a company to avoid what would otherwise be its obligation to contribute 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) is unenforceable as being unlawful and/or contrary to public policy, namely contrary to Section 74 which provides for the liability of a member to contribute to the assets of the company in winding up. This is supported by McPherson's Law of Company Liquidation, 3rd ed, Sept 2013, at pp. 607-608: a company cannot contradict, vary or subtract from the liability imposed by Section 74.

10. If the answer to the issue at sub-paragraph 9(i) is yes, whether 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 of priority.

10.1 As set out above at paras 9.3 and 9A.2 above, there is no factual or legal basis for a recharge argument against LBIE or LBHI2 in respect of the Contribution Claim by LBIE against LBL.[9] Further and in any event, as set out above, it is LBHI2's position that no Sub-Debt Contribution Claim will be made against LBL.

10.2 If LBL has some enforceable recharge claim against LBIE in respect of the Sub-Debt Contribution Claim (contrary to LBHI2's contentions at Issues 9 and 9A above), and on the further assumption that the claim is more than *de minimis*, LBHI2 will contend that that claim does not rank *pari passu* for payment in LBIE's administration with LBHI2's claim in respect of the Sub-Debt.

10.2.1 If LBHI2 has a claim for the Sub-Debt against LBIE which remains unsatisfied, then, as set out at paras 8.1 to 8.2 above, the rule against double-proof would apply to prevent LBL claiming a recharge for the Sub-Debt Contribution Claim against LBIE and/or using the recharge claim in set-off as against the Sub-Debt Contribution Claim[10] because the Sub-Debt claim by LBHI2 and the Sub-Debt Contribution Claim recharge claim by LBL against LBIE are in substance the same debt;

[9] LBHI2 assumes that LBIE will make arguments in relation to the factual basis for any such recharge claim by LBL against LBIE and also in relation to the legal position. LBHI2's position as to the unlawfulness of any such recharge arrangement is set out above at para 9A.1.

[10] The rule against double proof trumps set-off: see *Kaupthing No.2* at [53] *per* Lord Walker.

10.2.2 Dependent on the Court's characterisation of any such recharge claim, LBHI2 reserves the right to argue that LBL's recharge claim against LBIE would fall within the terms of s.74(2)(f) of the Insolvency Act 1986, being a sum due to LBL in its character of a member; accordingly, the recharge claim would not be deemed a debt of LBIE and would be postponed to be paid after other debts (including the Sub-Debt);

10.3 Accordingly, even if LBL has an enforceable recharge claim, in circumstances where LBHI2 had not yet been paid in full in respect of the Sub-Debt, LBL could not pursue a claim against LBIE for recharge of the Sub-Debt Contribution Claim.

11. Whether and to what extent LBL is entitled, under the terms of the Service Agreement between LBL and Lehman Brothers Europe Limited ("LBEL") dated 20 May 2004 or otherwise, to recover from LBEL:

(i) sums paid or payable by it to LBIE in respect of a Contribution Claim;

(ii) Bad Debt Claims claimed by LBL; and

(iii) Certain (and if so, which) expenses of LBL's administration.

11.1 At present, LBHI2 takes no position on this issue.

12. If the answer to the question set out at sub-paragraph 11(i), 11(ii) or 11(iii) above would otherwise be in the affirmative, is it impacted (and if so, to what extent) by any set-off occurring in LBIE's administration as between (i) the Contribution Claim; and (ii) provable claims of LBL against LBIE.

12.1 At present, LBHI2 takes no position on this issue.

13. Whether the share register of LBIE ought to be rectified:

(a) on the basis that LBL did not hold a share in LBIE; or

(b) on any other basis;

or LBL should, on any other basis, not have the liabilities of a member of LBIE, notwithstanding its holding of a LBIE share.

13.1 LBIE's share register should not be rectified and/or there is no other basis on which LBL should not be subject to liability as a contributory of LBIE.

13.2 LBL's position paper dated 30 September 2016 claims two grounds for rectification of the share register: (1) common mistake in that the directors of LBL, LBH and LBIE incorrectly believed that it was mandatory for there to be two shareholders in LBIE (which was not in fact mandatory as a matter of company law) and accordingly made LBL a shareholder in LBIE on that basis and (2) lack of authority/breach of duty by LBL's directors in the purported acquisition of a share in LBIE in 1994 and 1997.

13.3 Mistake: There was no relevant mistake even on LBL's own analysis; all parties involved in the decision for LBL to become a shareholder in LBIE in 1994 and 1997 intended there to be two shareholders of LBIE, with LBL being one of those two shareholders and that is what occurred.

13.4 Breach of duty/lack of authority of LBL's directors:

13.4.1 LBL's case in the position paper is confused.

13.4.2 LBL alleges that:

13.4.2.1 the LBL directors had no actual authority in 1994 or 1997 to make LBL a shareholder in LBIE because such a step was (a) not in LBL's best interests (paras 59.1 and 59.3) and/or (b) for an improper purpose (see position paper at paras 59.3-60) and/or (c) not made on the exercise of independent judgment (paras 62 and 63); and

13.4.2.2 LBIE/LBH could not rely on the LBL directors' apparent authority so to act because they were all the same individuals (see paras 61 and 69).

13.4.3 Even if those allegations are made out, LBL is wrong to say that it follows that the transactions by which LBL became a shareholder are void and of no effect (see paras 70 - 71).

13.4.3.1 If the LBL directors were found not to have acted in LBL's best interests in entering into the transactions, the transaction would be voidable (not void) provided the counterparty had notice of the breach of duty: see *Rolled Steel Products (Holdings) Ltd v British Steel Corp* [1986] Ch 246 (CA).

13.4.3.2 If the LBL directors were found to have exercised their powers for an improper purpose, the transaction would be voidable, not void: *Howard Smith Ltd v Ampol Petroleum Ltd* [1974] AC 821, Privy Council.

13.4.3.3 LBL's apparent contention that the LBL directors did not act within their powers (because they acted in breach of their duties to LBL) and that the transaction is therefore void and of no effect is wrong. Although if directors act in excess of the authority granted to them by the Articles, the transaction will be void because the purported exercise of the power is a nullity[11], if directors abuse their authority by doing something that was within their power but was in breach of their duty owed to the company (eg not in the company's best interests or for an improper purpose), then the transaction is voidable (if the counterparty was on notice of the same) and not void.

13.5 Given the passage of time, it is also likely that one or more of the following defences would be available with the result that the transactions in 1994 and 1997 must stand:

13.5.1 Limitation;

13.5.2 Acquiescence / laches;

13.5.3 Ratification of LBL's board's acts;

13.5.4 Estoppel by convention.

13.6 Alternatively, in the event that LBL can (contrary to LBHI2's primary position) make out a case for rectification of the register by removing LBL as a shareholder of LBIE, the appropriate relief would be neither the cancellation of the share currently registered in LBL's name nor its registration in the name of LBHI2, but its registration in the name of LBH.

14. Whether and to what extent LBL is entitled to recover from Lehman Brothers Holdings Plc sums paid or payable by it to LBIE in respect of a Contribution Claim.

14.1 At present, LBHI2 takes no position on this issue.

[11] In addition to *Guinness v Saunders*, see also Snell's Equity, 32nd ed, para 10-029

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18 November 2016