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

B E T W E E N :

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 LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)

Introduction

1. This position paper has been filed and served on behalf of the Joint Administrators of Lehman Brothers International (Europe) (In Administration) (the "**LBIE Administrators**" and "**LBIE**") in accordance with the Order of Mr Justice Hildyard dated 4 November 2016 (the "**Order**") requiring the LBIE Administrators, the Joint Administrators of LB Holdings Intermediate 2 Limited (In Administration) (the "**LBHI2 Administrators**" and "**LBHI2**") and the Joint Administrators of Lehman Brothers Europe Limited (In Administration) (the "**LBEL Administrators**" and "**LBEL**") to file and serve position papers setting out in detail: (i) their respective positions (insofar as they take any positions) in respect of the Part A Issues (as defined in the Order) and the Part B Issues (as defined in the Order); and (ii) the basis upon

which they adopt such positions, including references to the principal authorities which they anticipate, at that stage, relying upon at trial.

2. In this position paper, the LBIE Administrators proceed on the basis of the reasoning and conclusions of the Court of Appeal in *In re Lehman Bros International (Europe) (In Administration)* [2015] EWCA Civ 485, [2016] Ch 50 (the "**Waterfall I CA Judgment**"), without prejudice to their cross-appeals against the Waterfall I CA Judgment and/or the arguments advanced by them before the Supreme Court. The LBIE Administrators reserve their right to amend or supplement their positions on the Part A Issues and/or the Part B Issues where necessary or appropriate in the event of any aspect of the Court of Appeal's reasoning or conclusions being overturned or departed from by the Supreme Court.

3. Part A of this position paper addresses the issues identified in paragraph 6 of the Order (the "**Part A Issues**") in light of the assumptions of fact identified in paragraph 7 of the Order (in the form sent by Linklaters LLP to Dechert LLP on 11 November 2016).

4. Whilst Part B of this position paper identifies the LBIE Administrators' positions and their grounds for those positions, together with the principal authorities on which they anticipate relying, the LBIE Administrators recognise that this position paper is not a vehicle for factual evidence. As envisaged by paragraph 19 of the Order, the LBIE Administrators will file and serve witness statements of fact in advance of the trial of the issues identified in paragraph 9 of the Order (the "**Part B Trial**").

5. This position paper is accordingly without prejudice to the LBIE Administrators' rights to file and serve witness statements of fact in response to the factual allegations contained in the position paper dated 30 September 2016 (the "**LBL Position Paper**") on behalf of the Joint Administrators of Lehman Brothers Limited (the "**LBL Administrators**" and "**LBL**") and/or the supplemental position paper dated 11 November 2016 on behalf of the LBL Administrators (the "**LBL Supplemental Position Paper**"). Nothing stated or not stated by the LBIE Administrators in this position paper should be taken to indicate any acceptance by the LBIE Administrators of the factual allegations contained in the LBL Position Paper or the LBL Supplemental

Position Paper; and the LBIE Administrators reserve the right to challenge those factual allegations in advance of and during the course of the Part B Trial.

6. The LBIE Administrators also reserve their right to amend and/or supplement their positions on the issues in the Part B Trial, to the extent necessary or appropriate in light of any determination of Part A Issues in advance of the Part B Trial.

PART A

Issue 1

7. Issue 1 is:

> "*Whether the obligations of* [LBHI2] *and/or* [LBL] *to contribute to the assets of* [LBIE] *pursuant to section 74 of the Insolvency Act 1986* [(the "**1986 Act**")] *include an obligation to contribute to the assets of LBIE to the extent necessary to enable LBIE to pay* [the Sub-Debt]".

8. **The LBIE Administrators' position on Issue 1 is that the liability under section 74 of the 1986 Act includes the obligation to contribute to the assets of LBIE to the extent necessary to enable LBIE to pay the Sub-Debt.**

9. The basis on which the LBIE Administrators adopt this position is that:

   (1) Section 74(1) of the 1986 Act provides:

   > "*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 winding up, and for the adjustment of the rights of the contributories among themselves*".

   (2) Section 150(1), which is ancillary to section 74(1), provides further that:

"*The court may, at any time after making a winding up order, and either before or after it has ascertained the sufficiency of the company's assets, make calls on all or any of the contributories for the time being settled on the list of the contributories 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 the contributories among themselves, and make an order for payment of any calls so made*".

(3) In the Waterfall I CA Judgment, the Court of Appeal held that the liability of members under section 74(1) of the 1986 Act to contribute to the assets of a company in liquidation "*to any amount sufficient for payment of its debts and liabilities*" is not restricted to the funds required to pay the provable debts in the liquidation but also extends to the funds required for the payment of statutory interest and any non-provable liabilities of the company.

(4) The Sub-Debt is one of the debts and liabilities of LBIE for the purposes of section 74(1). The fact that the Sub-Debt is not currently payable is irrelevant to the analysis, as it is on any view a debt or liability of LBIE.

(5) The question of the ***value*** of the Sub-Debt for these purposes is addressed below in the context of Issue 3, which raises that question.

10. The principal authorities upon which the LBIE Administrators anticipate, at this stage, relying at trial are: sections 74 and 150 of the 1986 Act; Rule 13.12 of the Insolvency Rules 1986 (the "**1986 Rules**"); and *Webb v Whiffin* (1872) LR 5 HL 711 (in particular at 718 per Lord Hatherley LC and at 724 per Lord Chelmsford).

11. The LBL Administrators appear to accept the interpretation of section 74 set out above (see, in particular, the LBL Position Paper at para 111). However, the LBL Administrators contend that the agreements giving rise to the Sub-Debt (the "**Sub-Debt Agreements**") contain an express or implied term that the Sub-Debt is payable only from the funds of LBIE alone and not from any call that may be made against LBIE's contributories (see, in particular, the LBL Position Paper at para 112).

12. The LBIE Administrators will submit that the LBL Administrators' contention is wrong. The Sub-Debt Agreements do not contain the term for which the LBL Administrators contend:

(1) There is no express term to the effect for which the LBL Administrators contend:

(i) There is no provision in the Sub-Debt Agreements which could properly be construed to bear the meaning for which the LBL Administrators contend. The first, second and fourth authorities on which the LBL Administrators seek to rely in the LBL Position Paper at para 111 involved express terms providing for the funds of the company alone to be liable in respect of the obligation at issue. There is no such provision in the Sub-Debt Agreements. (The third case on which the LBL Administrators seek to rely in the LBL Position Paper at para 111 (*In re Great Britain Mutual Life Assurance Society* (1880) 16 Ch D 246) is not relevant, as it holds that a policyholder is not a contributory of the insurance company which issued the policy.)

(ii) Clause 5(2) of the Sub-Debt Agreements does not bear the meaning for which the LBL Administrators contend. Further, the LBL Administrators' contention in respect of the interpretation of clause 5(2) is inconsistent with the Court of Appeal's conclusion in the Waterfall I CA Judgment, which establishes that LBIE's members are liable to contribute to pay the Liabilities (as defined in the Sub-Debt Agreements) and that the liability of LBIE's members to so contribute is one of LBIE's assets.

(2) There is no basis for implying the term for which the LBL Administrators contend:

(i) In the LBL Position Paper at para 113.1, the LBL Administrators seek to rely on the fact that LBHI2 held a large number of shares in LBIE, which is an unlimited company.

(ii) However, the Sub-Debt Agreements are standard form agreements which must necessarily mean the same thing for everyone who uses them. Consequently, there is no room for implied terms deriving from the commercial circumstances of the parties in any particular case. See *Mannai Investment Co Ltd v Eagle Star Life Assurance Co Ltd* [1997] AC 749; *AIB Group (UK) plc v Martin* [2002] 1 WLR 94; *Dairy Containers Ltd v Tasman Orient CV* [2005] 1 WLR 215; *Greatship (India) Ltd v Oceanografia SA de CV* [2013] 2 Lloyd's Rep 359; *SwissMarine Corp Ltd v OW Supply and Trading AS (In Bankruptcy)* [2015] EWHC 1571 (Comm); and Lewison, *Interpretation of Contracts*, 6th ed., [3.18] and [6.04]. The relationship between the lender and the borrower in any given case (such as the holding of shares) and the facts relating to that relationship (such as the number of shares held or the status of the borrower as an unlimited company) are irrelevant and cannot give rise to any implied term.

(iii) Further and in any event, the test for an implied term is not satisfied:

(a) In the LBL Position Paper at para 113.1, the LBL Administrators rely on the concept of circularity in circumstances where LBHI2 held the vast majority of shares in LBIE, since this could result in LBHI2 having to make a contribution in order to pay the debt owing to itself.

(b) However, the Sub-Debt was freely assignable (with the permission of the Financial Services Authority). It was therefore foreseeable that LBHI2 would not always be the creditor in respect of the Sub-Debt; and the parties would have been aware from the outset that the circularity on which the LBL Administrators seek to rely was not necessarily a permanent feature of the commercial circumstances. The assignability of the Sub-Debt also militates against the relevance of the particular commercial context and/or the implication of any term: see *Dairy Containers Ltd v Tasman Orient CV* [2005] 1 WLR 215; *Phoenix Commercial Enterprises Pty Ltd v City of Canada Bay Council* [2010] NSWCA 64; and *Cherry Tree Investments Ltd v*

Landmain Ltd [2012] EWCA Civ 736, [2013] Ch 305 (in particular at [124]-[125] per Lewison LJ).

(c) In addition, as stated above, the terms of the Sub-Debt Agreements are in standard form and so: (i) bear the same meaning for everyone (whether or not the lender is a member of the borrower and whether or not the borrower is an unlimited company); and (ii) will not be influenced by the number (if any) of shares held in any particular case or the form of corporate entity of the borrower.

(d) The LBL Administrators' reliance on regulatory capital requirements (see the LBL Position Paper at para 113.2) is misplaced. The relevant creditors for regulatory capital purposes were LBIE's creditors, rather than LBL's creditors or 'external' creditors in any general sense.

(e) Further, on the assumption that LBL was a shareholder in LBIE at the time when the Sub-Debt agreements were entered into, there was no circularity in the position of LBL, which could have been called on to make a contribution to pay the debt owing to LBHI2.

Issue 2

13. Issue 2 is:

> "*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*".

14. **The LBIE Administrators' position on Issue 2 is that LBIE's Sub-Debt Contribution Claims against LBHI2 and/or LBL are to be included in the insolvency set-off account in LBIE's administration.**

15. The basis on which the LBIE Administrators adopt this position is that:

(1) As matters stand, in order to qualify for insolvency set-off in a company's insolvency proceedings, that company's claim against a creditor must be provable in insolvency proceedings in respect of that creditor: see *In re Bank of Credit and Commerce International SA (No 8)* [1996] Ch 245 at 256 per Rose LJ. (The LBIE Administrators contended in the Supreme Court on appeal from the Waterfall I CA Judgment that Rose LJ's conclusion on this point was wrong. However, this position paper is prepared on the basis of the law as it stands, without prejudice to the LBIE Administrators' right to amend or supplement their positions in due course if the Supreme Court's decision alters the law in any material respect.)

(2) At first instance in the Waterfall I Application (*In re Lehman Brothers International (Europe) (In Administration)* [2014] EWHC 704 (Ch); [2015] Ch (the "**Waterfall I FI Judgment**")), David Richards J held that LBIE's contingent claims against its contributories under section 74 are provable in those contributories' administrations and available for set-off in LBIE's administration.

(3) In the Waterfall I CA Judgment at paras 205 to 234, the Court of Appeal upheld the conclusion of David Richards J on this point.

(4) This conclusion remains valid whether the Contribution Claim by LBIE against its contributories is a Sub-Debt Contribution Claim or a Contribution Claim in respect of some other liability, such as statutory interest.

16. The principal authorities upon which the LBIE Administrators anticipate, at this stage, relying at trial are the Waterfall I FI Judgment and the Waterfall I CA Judgment.

17. The LBIE Administrators note that the LBL Administrators agree with the LBIE Administrators' position on Issue 2: see the LBL Position Paper at para 118.

18. It should be noted in the interests of completeness that the LBIE Administrators contended in the Supreme Court on appeal from the Waterfall I CA Judgment that the contributory rule would apply in the event of there being no set-off. However, this position paper is prepared on the basis of the law as it stands, without prejudice to the LBIE Administrators' right to amend or supplement their positions in due course if the Supreme Court's decision alters the law in any material respect.

Issue 3

19. Issue 3 is:

> "*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*".

20. **The LBIE Administrators' position on Issue 3 is that the Sub-Debt is to be valued in full for the purposes of the Sub-Debt Contribution Claim.**

21. Issue 3 arises in the context of Lewison LJ's conclusion in the Waterfall I CA Judgment at [41] that:

    (1) for as long as the contingencies set out in the Sub-Debt Agreement (namely, the payment in full of statutory interest and non-provable liabilities in LBIE's administration) remain unsatisfied, the provable value of the Sub-Debt is nil; and

    (2) if and when the contingencies set out in the Sub-Debt Agreement are satisfied (i.e. when statutory interest and non-provable liabilities are paid in full in LBIE's administration), the Sub-Debt will be revalued for the purposes of proof.

22. If and when the Sub-Debt is revalued for the purposes of proof on this basis, it will necessarily be revalued in its full amount, to reflect the fact that it has become payable.

23. Further, Lewison LJ's conclusion in the Waterfall I CA Judgment at [41] that the Sub-Debt is a ***contingent*** provable debt means that the trigger for the revaluation of the Sub-Debt in its full amount is not necessarily ***actual*** payment in full of statutory interest and non-provable liabilities in LBIE's administration. The revaluation in the full amount will also occur if it becomes clear that the relevant contingency will inevitably be satisfied, i.e. where it is clear that statutory interest and non-provable liabilities in LBIE's administration will be paid in full in any event.

24. The revaluation of LBHI2's contingent provable claim against LBIE in respect of the Sub-Debt is an application of the hindsight principle. The revaluation occurs not because of any change to the relevant valuation date. The relevant date for the valuation of the contingency continues to be the commencement of LBIE's administration. Hindsight is used to arrive at a more accurate assessment of the likelihood of the occurrence of the contingency as at the commencement of LBIE's administration.

25. The basis on which the LBIE Administrators adopt their position on Issue 3 is that:

    (1) The right to make a call is not limited to the right to make a call in respect of debts and liabilities within section 74 which are immediately payable. Rather, the purpose of section 74 is to enable the liquidator to raise the monies that he will require to discharge the company's liabilities as and when they become payable. The liquidator may make a call to ensure that he has sufficient monies in hand to pay liabilities of the company which are not yet payable.

    (2) The value of the Sub-Debt for the purposes of section 74 of the 1986 Act is therefore the value of the Sub-Debt ***when it becomes payable***.

    (3) The fact that the provable value of the Sub-Debt is currently nil (see the Waterfall I CA Judgment at [41] per Lewison LJ) is irrelevant. That merely reflects the fact that the Sub-Debt is not yet payable. It is not a reflection of the amount of the Sub-Debt which will become payable when the conditions precedent to the payment of the Sub-Debt are satisfied.

(4) The fact that LBIE's claims against LBHI2 and LBL are contingent on (*inter alia*) LBIE going into liquidation does not make any difference to the analysis. Whilst it is correct that the value of LBIE's contingent claims against LBHI2 and LBL under section 74 must be estimated under Rule 2.81 of the 1986 Rules, there is no basis for applying any discount. On the basis of the law as it stands in the light of the Waterfall I CA Judgment, if and to the extent that there are any debts or liabilities falling within section 74 which remain unpaid in LBIE's administration and it is necessary for LBIE to move into liquidation to make a call against its contributories, the LBIE Administrators will cause LBIE to go into liquidation.

26. The principal authorities upon which the LBIE Administrators anticipate, at this stage, relying at trial are:

(1) On the estimation of contingent liabilities: Rule 2.81 of the 1986 Rules; Rule 2.85 of the 1986 Rules; *Hardy v Fothergill* (1888) 13 App Cas 351; *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147; *In re Danka Business Systems plc* [2013] EWCA Civ 92, [2013] Ch 506;

(2) On the hindsight principle: *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147; and *In re MF Global UK Ltd (in special administration) (No 2)* [2013] EWHC 92 (Ch), [2013] Bus LR 1030 (particularly at [49] to [51] per David Richards J); and

(3) On the ability of the liquidator to make calls in respect of future liabilities of the company: *In re Contract Corporation* (1866) LR 2 Ch App 95; *Barned's Banking Co* (1867) 36 LR Ch 215.

Issue 4

27. Issue 4 is:

"*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".

28. **The LBIE Administrators' position on Issue 4 is that:**

(1) **If and when the Sub-Debt is extinguished by insolvency set-off in LBIE's administration (applying the hindsight principle to adjust the set-off account), LBL will cease to be contingently liable to LBIE under section 74 in respect of the Sub-Debt.**

(2) **At the same time, however, LBL will simultaneously become contingently liable to contribute to LBIE's assets under section 74 for the purposes of adjustment.**

29. The basis on which the LBIE Administrators adopt this position is that:

(1) LBL's contingent liability to contribute to the payment of the Sub-Debt depends on the continued existence of the Sub-Debt. If the Sub-Debt ceases to exist, LBL will cease to be contingently liable to contribute to the payment of the Sub-Debt.

(2) The Sub-Debt currently exists; but it may cease to exist. According to the reasoning in the Waterfall I CA Judgment (as explained above):

(i) For the purposes of set-off in LBIE's administration, LBHI2's contingent provable claim against LBIE in respect of the Sub-Debt is nil until such time as it becomes clear that statutory interest and non-provable liabilities will be paid in full in LBIE's administration in any event.

(ii) If and when it becomes clear that the contingency to the payment of the Sub-Debt (namely, the payment in full of statutory interest and non-provable liabilities in LBIE's administration) will occur, LBHI2's contingent provable claim against LBIE in respect of the Sub-Debt will be re-valued (applying the hindsight principle), and the set-off account in

LBIE's administration will be adjusted to include LBHI2's claim against LBIE in respect of the Sub-Debt.

(iii) In that set-off account, LBIE's Contribution Claim against LBHI2 will always be at least equal to the amount of the Sub-Debt which is unpaid and which LBIE is otherwise unable to pay (the "**Sub-Debt amount**").

(a) LBIE's Contribution Claim against LBHI2 will be at least equal to the Sub-Debt amount because it will include the Sub-Debt Contribution Claim, which (for the reasons explained above) will be equal to the Sub-Debt amount.

(b) It will exceed the Sub-Debt amount if and to the extent that statutory interest and non-provable liabilities remain unpaid.

(c) It will also exceed the Sub-Debt amount if and to the extent that LBHI2 is also liable to make any contributions for the adjustment of the rights of contributories amongst themselves.

(iv) Since LBIE's Contribution Claim against LBHI2 will always be at least equal to the Sub-Debt amount, LBHI2's claim against LBIE in respect of the Sub-Debt will be extinguished in the set-off account in LBIE's administration.

(3) If and when the Sub-Debt ceases to exist as a result of being extinguished by set-off in LBIE's administration, LBL will cease to be contingently liable to make any contribution to LBIE's assets for the payment of the Sub-Debt. Thus:

(i) Until it is clear that statutory interest and non-provable liabilities will be paid in full in LBIE's administration in any event, the Sub-Debt continues to exist as a liability of LBIE in respect of which LBL is contingently liable to contribute under section 74 of the 1986 Act.

(ii) If and when it becomes clear that statutory interest and non-provable liabilities will be paid in full in LBIE's administration in any event, the Sub-Debt will be extinguished by insolvency set-off in LBIE's administration (applying the hindsight principle to adjust the set-off account, as explained above); and LBL will cease to be contingently liable to LBIE under section 74 in respect of the Sub-Debt.

(4) If and when the Sub-Debt ceases to exist as a result of being extinguished by set-off in LBIE's administration, although LBL will cease to be contingently liable to make any contribution to LBIE's assets under section 74 for the payment of the Sub-Debt, LBL will become contingently liable to contribute to LBIE's assets under section 74 for the purposes of adjustment:

(i) The setting off of the Sub-Debt against LBHI2's contingent liability under section 74 will represent a contribution by LBHI2 to LBIE's assets.

(ii) As a result of that contribution, the respective contributions of LBHI2 and LBL to the assets of LBIE will be unequal: LBHI2 will have contributed towards the payment in full of the Sub-Debt, whilst LBL will have made no contribution at all to the payment of the Sub-Debt.

(iii) Section 74(1) provides that "*every present and past member is liable to contribute to* [the company's] *assets to any amount sufficient ... for* ***the adjustment of the rights of the contributories among themselves***" (emphasis added).

(iv) As a result of the contribution by LBHI2, as explained above, LBIE's liquidator will be entitled to make a call on LBL for the purposes of adjustment.

(v) Accordingly, whilst LBL will cease to be contingently liable to contribute to LBIE's assets for the payment of the Sub-Debt, it will simultaneously become contingently liable to contribute to LBIE's assets for the purposes of adjustment.

30. The principal authorities upon which the LBIE Administrators anticipate, at this stage, relying at trial are:

(1) On the hindsight principle: *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147; and *In re MF Global UK Ltd (in special administration) (No 2)* [2013] EWHC 92 (Ch), [2013] Bus LR 1030 (particularly at [49] to [51] per David Richards J).

(2) On the adjustment of rights of contributories amongst themselves: *Re The Lancashire Brick and Tile Company* (1865) 34 Beav 330, 55 E.R. 662; *Re Shields Marine Insurance Association* (1868) 5 Eq. 368; *Re Hodges Distillery Co; Ex p. Maude* (1870) 6 Ch App 51; *Paterson v M'Farlane* (1875) 2 R 490 (Ct of Sess); *McPherson's Law of Company Liquidation*, 3rd ed., [10-025].

Issue 5

31. Issue 5 is:

> "*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*".

32. **The LBIE Administrators' position on Issue 5 is that, in circumstances where insolvency set-off in LBIE's administration took effect on 4 December 2009, subsequent insolvency set-off in the administrations/liquidations of LBHI2 or LBL can have no effect on those companies' claims against, or liabilities to, LBIE.**

33. The basis on which the LBIE Administrators adopt this position is that insolvency set-off in LBIE's administration is automatic and self-executing, leaving only a net balance.

34. The principal authorities upon which the LBIE Administrators anticipate, at this stage, relying at trial are: *Stein v Blake* [1996] AC 243; *Re Deveze Ex p Barnett* (1874) LR 9 Ch App 293 (in particular at 295 per Lord Selborne LC); *Mersey Steel & Iron Co Ltd v Naylor Benzon & Co* (1882) 9 QBD 648 (in particular at 664 per Jessel MR); *Watkins v Lindsay & Co* (1898) 5 Mans 25 (in particular at 29 per Wright J; *Re City Life Assurance Co Ltd* [1926] Ch 191 (in particular at 203 per Pollock MR); and *Gye v McIntyre* (1991) 98 ALR 393.

35. The LBIE Administrators will submit that the LBL Administrators' arguments on Issue 5 in respect of the hindsight principle (see the LBL Position Paper at para 131) are irrelevant to this issue, because, whilst the hindsight principle could result in the re-drawing of balances in the set-off account in LBIE's administration, such that the single net balance might be adjusted as a result, it would not result in a subsequent insolvency set-off in the administrations/liquidations of LBHI2 or LBL.

Issue 6

36. Issue 6 is:

> "*In circumstances where insolvency set-off in the administration of* [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*".

37. Issue 6 is thus the same as Issue 5, save that the former involves LBEL, whereas the latter involves LBIE.

38. **The LBIE Administrators' position is that the answer to Issue 6 is the same as the answer to Issue 5, save that the former involves LBEL, whereas the latter involves LBIE.**

39. Accordingly, the LBIE Administrators refer to their position on Issue 5, as set out above, and do not advance any separate position in respect of Issue 6.

Issue 7

40. Issue 7 is:

> "*In the light of the fact that LBL owns one share of $1 in LBIE and LBHI2 owns 2 million 5% redeemable Class A preference shares of $1,000 each, 5.1 million 5% redeemable Class B shares of $1,000 each and 6,237,133,999 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 … 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 of contribution or indemnity … and/or adjustment … is affected by any other claims which LBHI2 and LBL have against one another or any other party;*
> *(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*".

41. **The LBIE Administrators' position on Issue 7 is that:**

(1) **As to sub-para (i), the liability of LBHI2 and LBL to LBIE under section 74 is a statutory liability which applies to each contributory individually. It is not joint or joint and several.**

(2) **As to sub-para (ii), since the liability is not joint or joint and several, LBHI2 and LBL are not entitled to make contribution or indemnity claims against each other.**

(3) **As to sub-para (iii), the statutory mechanism for adjusting between contributories involves the making of a further call under section 74. The adjustments are made through LBIE's estate.**

(4) **As to sub-para (iv), since there is no direct right of contribution or indemnity between the contributories and the adjustments are made through LBIE's estate, the analysis is not affected by claims which LBL and LBHI2 may have against each other. (However, if there is a direct right of contribution or indemnity, the LBIE Administrators take no position on whether the position is affected by claims which LBL and LBHI2 may have against each other.)**

(5) **As to sub-para (v), it would be wrong in principle for the Court to direct (and there is accordingly no conceivable basis for directing) the LBIE Administrators to assert less than 100% of the Contribution Claim against LBL and/or LBHI2.**

42. The basis on which the LBIE Administrators adopt this position is that:

(1) As to sub-para (i):

(i) The liability of the contributories under section 74 is a liability under a statute. The characteristics of the liability are governed by the statute and are to be ascertained on the basis of the proper construction of the statute.

(ii) As set out above, section 74(1) of the 1986 Act provides that "*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 winding up, and for the adjustment of the rights of the contributories among themselves*".

(iii) On the proper construction of section 74, the liability of the members is a statutory liability which applies to each contributory individually. Pursuant to section 74, each contributory is liable individually to pay such amount as may be required for the payment of the debts and liabilities and the expenses of the winding-up and for the adjustment of the rights of the contributories among themselves.

(iv) The statutory liability under section 74 is not a joint and several liability in contract or tort. Consequently, it is not helpful to seek the answer to Issue 7 by examining the principles of joint and several liability in contract or tort. The answer to Issue 7 must be derived from the terms of the statute.

(2) As to sub-para (ii):

(i) There is nothing in section 74 which entitles a contributory to seek a contribution or indemnity from another contributory.

(ii) Such a right of contribution or indemnity would be inconsistent with section 74 itself, which contains its own mechanism for the "*adjustment of the rights of the contributories among themselves*" – namely, the making of a call by the liquidator for that purpose.

(iii) The adjustment provisions under section 74 occupy the field insofar as adjustments between contributories *inter se* such that there is no place for the application of any general law principles of contribution or indemnity.

(3) As to sub-para (iii):

(i) As stated above, section 74 contains its own mechanism for the "*adjustment of the rights of the contributories among themselves*" – namely, the making of a call by the liquidator for that purpose.

(ii) Therefore, instead of any right of contribution or indemnity, 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. The mechanism involves the making of a call by the liquidator for the specific purpose of adjusting the rights of the contributories among themselves.

(iii) The ultimate objective of the adjustment is to achieve a rateable allocation of the deficiency among the contributories. However, whether that is possible will depend on the ability of the contributories to satisfy the call. The inability of a contributory to satisfy a call for the purpose of adjustment does not impose any obligation on that contributory to pay a sum by way of contribution or indemnity directly to any other contributory.

(4) As to sub-para (iv):

(i) As stated above in respect of sub-para (ii), there is no direct right of contribution or indemnity between the contributories and the adjustments are made through LBIE's estate.

(ii) That being the case, the analysis is not affected by claims which LBL and LBHI2 may have against each other.

(iii) However, if there is a direct right of contribution or indemnity, the LBIE Administrators take no position on whether the position is affected by claims which LBL and LBHI2 may have against each other.

(5) As to sub-para (v):

(i) As set out above, section 74(1) of the 1986 Act provides that "*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 winding up, and for the adjustment of the rights of the contributories among themselves*".

(ii) The statute thus provides for each of them to be liable in an amount sufficient for payment of LBIE's debts and liabilities, and the expenses of winding up, and for the adjustment of the rights of the contributories among themselves.

(iii) The amount of the liability is defined by statute.

(iv) The Court has no jurisdiction to re-write the words of the statute. Accordingly, it cannot provide for the liability of LBL or LBHI2 to be lower than the statutory amount.

(v) The amount of the Contribution Claim against LBL or LBHI2 therefore cannot be less than 100% of the amount required by the terms of the statute.

(vi) Further, whilst a rateable allocation of the deficiency among contributories is the ultimate objective, that is not achieved by limiting the size of LBIE's claim against any of the contributories; rather, it is achieved by the adjustment of the rights of contributories through the making of further calls for that purpose under section 74.

43. The principal authorities upon which the LBIE Administrators anticipate, at this stage, relying at trial are:

(1) On the nature of the liability under section 74: *In re General Works Company, Gill's Case* (1879) 12 Ch D 755 (in particular at 757 per Bacon V-C); *Ex parte Branwhite, Re The West of England and South Wales District Bank* (1879) 40 LT 652; and *Hansraj Gupta v Asthana* (1932) LR 60 Ind App 1 (in particular at 11-12 per Lord Russell of Killowen).

(2) On the adjustment of rights of contributories amongst themselves: *Re The Lancashire Brick and Tile Company* (1865) 34 Beav 330, 55 ER 662; *Re Shields Marine Insurance Association* (1868) 5 Eq 368; *Re Hodges Distillery Co; Ex p.*

Maude (1870) 6 Ch App 51; *Paterson v M'Farlane* (1875) 2 R. 490 (Ct of Sess); *McPherson's Law of Company Liquidation*, 3rd ed., [10-025].

44. In the context of Issue 7, the LBL Administrators contend that:

(1) LBL's liability should be nil; alternatively

(2) the contributions must be rateable to the size of the shareholdings; alternatively

(3) LBL should have a direct indemnity claim against LBHI2.

45. The LBIE Administrators will submit that the LBL Administrators' arguments are wrong. In summary:

(1) For as long as there are any sums falling within section 74 which remain unpaid, LBL's liability cannot be nil. LBL is a contributory which is liable by statute in the amount sufficient for payment of LBIE's debts and liabilities, and the expenses of winding up, and for the adjustment of the rights of the contributories among themselves. LBIE is an unlimited company; and accordingly there is no limit on LBL's liability for the sums identified in section 74(1). The fact that LBL holds a single share does not limit or otherwise affect its liability to LBIE.

(2) Further, LBL's liability to LBIE under section 74 cannot be rateable. The statutory scheme envisages that one contributory might initially have to pay more than his rateable share, as demonstrated by the existence of a provision for the adjustment of the rights of contributories amongst themselves after they have made contributions for the payment of the company's debts and liabilities and/or the expenses of the winding up.

(3) LBL has no direct claim against LBHI2 for a contribution or an indemnity. As explained above, section 74 contains its own mechanism for the "*adjustment of the rights of the contributories among themselves*" – namely, the making of a call by the liquidator for that purpose.

Issue 8

46. Issue 8 is:

> "*How, if at all, any claim for a contribution or indemnity ... and/or any adjustment ... 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*".

47. **The LBIE Administrators' position on Issue 8 is that:**

(1) **Issue 8 does not arise because:**

(i) LBL does not have a claim against LBHI2 for a contribution or indemnity; and

(ii) The statutory mechanism for adjustment (namely, the making of a further call by LBIE) does not involve any direct claim by LBL against LBHI2 (and therefore, in the context of the statutory mechanism, there is no scope for the application of the rule against double proof).

(2) **However, if, contrary to the LBIE Administrators' position, LBL has a claim against LBHI2 for a contribution or indemnity, the rule against double proof applies in LBHI2's administration (or any subsequent liquidation), with the result that LBL's claim against LBHI2 cannot compete with LBIE's claim against LBHI2. The same would be true, *mutatis mutandis*, in the event that LBHI2 were to have such a claim against LBL.**

48. The basis on which the LBIE Administrators adopt this position is that:

(1) The rule against double proof prevents more than one proof being lodged in the same estate in respect of what is in substance the same debt.

(2) The rule against double proof applies in LBHI2's administration or liquidation to prevent such competition, because LBL's claim against LBHI2 for a contribution or indemnity and LBIE's claim against LBHI2 in respect of the Contribution Claim are two claims for, in substance, the same debt – namely, the shortfall in LBIE's administration.

(3) The rule against double proof also applies in LBL's administration to prevent LBHI2 competing with LBIE.

49. The principal authorities upon which the LBIE Administrators anticipate, at this stage, relying at trial are: *In re Fenton; Ex parte Fenton Textile Association Ltd* [1931] 1 Ch 85 at 109; *In re Polly Peck International plc* [1996] 2 All ER 433; *Barclays Bank Ltd v TOSG Trust Fund Ltd* [1984] AC 626; *In re Kaupthing Singer & Friedlander Ltd (in administration) (No 2)* [2011] UKSC 48, [2012] 1 AC 804.

Issue 9 Preliminary Issue

50. The Issue 9 Preliminary Issue is:

> "*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* [of the 1986 Act] *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)*".

51. **The LBIE Administrators' position on the Issue 9 Preliminary Issue is that it is not possible as a matter of law for a member of a company to enter into an enforceable agreement with the company which has the effect of enabling the member to avoid what would otherwise be its obligation to contribute to the assets of the company under section 74 of the 1986 Act 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).

52. The basis on which the LBIE Administrators adopt this position is that:

(1) Section 74 is mandatory. It imposes a liability on every member to contribute to the company's assets to any amount sufficient for payment of its debts and liabilities, and the expenses of winding up, and for the adjustment of the rights of the contributories among themselves.

(2) It is not possible to 'contract out' of that statutory obligation. Accordingly, it is not possible for a contributory to agree with the company that the contributory will have, in the company's liquidation, a liability which is less extensive than that provided for by the terms of the statute.

(3) Further, it is not possible to enter into enforceable arrangements which have the effect of reducing indirectly the contributories' liability below the amount provided for by statute. Arrangements and devices which evade the legislative intent will be unenforceable on the principle that a person cannot be permitted to do indirectly that which he is prohibited from doing directly.

53. The principal authorities upon which the LBIE Administrators anticipate, at this stage, relying at trial are:

(1) On the mandatory nature of the statutory obligation and the inability to contract out of the statute: *In re Paraguassu Steam Tramroad Company, Black & Co's Case* (1872) LR 8 Ch App 254; *Re Cordova Union Gold Co* [1891] 2 Ch 580; *Ooregum Gold Mining Co v Roper* [1892] AC 125; *Welton v Saffery* [1897] AC 299; *Re Irma Co-operative Co* [1925] 1 DLR 27; *Re Slutzkin Pty Ltd* [1932] VLR 229; and *King v Tait* (1936) 57 CLR 715.

(2) On the enforcement of the legislative intent and the prevention of indirect attempts to evade statutory obligations: *Heydon's Case* (1584) 3 Co Rep 7a;

Deane v Clayton (1817) 7 Taunt 489*; Fox v Bishop of Chester* (1824) 2 B&C 635; *Booth & Pollard v Bank of England* (1840) Cl & Fin 509; *Madden v Nelson & Fort Sheppard Railway Co* [1899] 1 AC 626; *Regina v J* [2005] 1 All ER 1.

Issue 10

54. Issue 10 is:

"*If the answer to the issue at sub-paragraph 9(i) above 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 or priority*".

55. **The LBIE Administrators' position on Issue 10 is that:**

(1) **Issue 10 does not arise:**

(i) As a result of the answer to the Issue 9 Preliminary Issue; further or alternatively

(ii) LBHI2 can never have a claim against LBIE in respect of the Sub-Debt (since such claim would be extinguished by set-off); further or alternatively

(iii) Because LBL's claim against LBIE for a recharge of LBL's liability to LBIE under section 74 in respect of the Sub-Debt Contribution Claim would be bad for circuity; further or alternatively

(iv) Even on LBL's own case, LBL can never have a claim against LBIE for a recharge of LBL's liability to LBIE under section 74 in respect of the Sub-Debt, because there would be a set-off of those cross-claims, which would cancel each other out.

(2) **If the LBIE Administrators' position on this issue were wrong, LBL's recharge claim against LBIE (insofar as it arose from pre-insolvency obligations of LBIE) would be a provable debt which would rank ahead of LBIE's liability to pay the Sub-Debt to LBHI2. It would follow that LBIE would in those circumstances be required to pay the sums received by way of a Sub-Debt Contribution Claim to LBL, rather than to LBHI2.**

56. The basis on which the LBIE Administrators adopt this position is as follows:

(1) The premise of Issue 10 is "*If the answer to the issue at sub-paragraph 9(i) above is yes*". The issue at sub-paragraph 9(i) is whether LBL is entitled, under the terms of the Service Agreement between LBL and LBIE dated 20 May 2004 or otherwise, to recover from LBIE any sums paid or payable by LBL to LBIE in respect of a Contribution Claim.

(2) The LBIE Administrators consider that the issue at sub-paragraph 9(i) is answered by the LBIE Administrators' position on the Issue 9 Preliminary Issue: even if LBL and LBIE had agreed expressly or by implication that LBL would be entitled to recover from LBIE any sums paid or payable by LBL to LBIE in respect of a Contribution Claim, that agreement would be unenforceable, because (as set out by the LBIE Administrators above in answer to the Issue 9 Preliminary Issue) it is not possible as a matter of law for a member to contract out of its obligation to contribute to the assets of the company under section 74 of the 1986 Act. Since it is not possible to contract out of the statutory obligation, LBL cannot have succeeded in contracting out of the statutory obligation. For that reason, the answer to the issue at sub-paragraph 9(i) is "no". The premise of Issue 10 is incorrect; and Issue 10 does not arise.

(3) Further, Issue 10 assumes that LBHI2 has a claim against LBIE in respect of the Sub-Debt. This assumption is wrong. LBHI2 can never have a claim against LBIE in respect of the Sub-Debt. As explained above in the context of Issue 4, if and when it becomes clear that the contingency to the payment of the Sub-Debt (namely, the payment in full of statutory interest and non-provable liabilities in LBIE's administration) will occur, LBHI2's claim against LBIE in respect of the

Sub-Debt will be re-valued (applying the hindsight principle) and the set-off account in LBIE's administration will be adjusted to include LBHI2's claim against LBIE in the amount of the Sub-Debt. In that set-off account, since LBIE's Contribution Claim against LBHI2 will always be at least equal to the Sub-Debt amount, LBHI2's claim against LBIE in respect of the Sub-Debt will be extinguished. For this reason, it is wrong to assume that LBHI2 could have a claim against LBIE in respect of the Sub-Debt. For that reason, the premise of Issue 10 does not arise.

(4) Further, LBL's claim against LBIE to recover the amount of the Sub-Debt Contribution Claim would be void for circuity, because it would result in LBIE making a further Sub-Debt Contribution Claim against LBL, entitling LBL to make a further claim against LBIE to recover the amount of the Sub-Debt Contribution Claim, and so on *ad infinitum*.

(5) Further, Issue 10 assumes that LBL could have a recharge claim against LBIE in respect of the Sub-Debt Contribution Claim. This assumption is wrong, even on LBL's own case. On the hypothesis that LBIE has a Sub-Debt Contribution Claim against LBL and LBL has a claim against LBIE to recover the amount of that Sub-Debt Contribution Claim, there would be a set-off of those cross-claims, which would cancel each other out. Accordingly, the scenario of LBL competing with LBHI2 in LBIE's administration would not arise.

(6) If (contrary to the grounds set out above), Issue 10 does arise:

(i) LBIE's liability to pay the Sub-Debt to LBHI2 is subordinated to ordinary unsecured creditors and (as explained above) it is to be valued at nil for the purposes of proof until the prior-ranking liabilities have been paid in full.

(ii) LBL's claim against LBIE to recover the amount of the Sub-Debt Contribution Claim (arising from pre-insolvency obligations of LBIE) would be a provable debt which would rank ahead of LBIE's liability to pay the Sub-Debt.

(iii) The existence of an unpaid provable claim in favour of LBL would mean that the contingencies to the payment of the Sub-Debt remained unsatisfied. As a result, the Sub-Debt would continue to be valued at nil in LBIE's administration and would not be payable to LBHI2.

(iv) The result of this would be that LBIE is required to pay the sums received by way of a Sub-Debt Contribution Claim to LBL, rather than to LBHI2.

57. The principal authorities upon which the LBIE Administrators anticipate, at this stage, relying at trial are:

(1) On the rule against circuity: *London Joint Stock Bank Ltd v Macmillan and Arthur* [1918] AC 777; *Ginty v Belmont Building Supplies Ltd* [1959] 1 All ER 414; *Post Office v Hampshire County Council* [1980] QB 124; *Petrofina (UK) Ltd v Magnaload Ltd* [1984] QB 127; *Mercuria Energy Trading Pte Ltd v Citibank NA* [2015] EWHC 1481 (Comm).

(2) On the ranking of the Sub-Debt: the Waterfall I FI Judgment; the Waterfall I CA Judgment.

Issue 12

58. Issue 12 is:

"*If the answer to the question set out at 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*".

59. **The LBIE Administrators do not advance any position on Issue 12.**

PART B

Issue 9

60. Issue 9 is:

> "*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 from such companies ('Bad Debt Claims'); and*
> *(iii) certain (and if so, which) expenses of LBL's administration*".

61. **The LBIE Administrators' position on Issue 9 is that LBL is not entitled to recover sums payable by LBL to LBIE in respect of a Contribution Claim, or Bad Debt Claims, or any expenses of LBL's administration.**

62. The basis on which the LBIE Administrators adopt this position is that:

(1) On 22 August 2000, LBL and LBIE entered into a secondment agreement providing for the secondment of staff from LBL to LBIE and the reimbursement by LBIE of LBL's costs of providing such staff (the "**Secondment Agreement**").

(2) On 20 May 2004, LBL and LBIE entered into the 2004 Services Agreement.

(3) Rights and obligations of the parties prior to the inception of the 2004 Services Agreement (save for those under the Secondment Agreement) were superseded by the 2004 Services Agreement.

(4) From 20 May 2004 until the date of its termination, the 2004 Services Agreement and the Secondment Agreement governed the rights and obligations of the parties and set out exhaustively the contractual relationship between the parties.

(5) The Secondment Agreement did not provide for any recharge of sums paid to LBIE in respect of a Contribution Claim, Bad Debt Claims or expenses of LBL's administration (and the LBL Administrators do not so contend).

(6) Further, the 2004 Services Agreement did not provide for any recharge of sums paid to LBIE in respect of a Contribution Claim, Bad Debt Claims or expenses of LBL's administration. In summary:

(i) Clause 1 (Services) of the 2004 Services Agreement provided:

> "*Subject to the terms and conditions of this Agreement, LBL agrees to provide LBIE administrative and operational support services pursuant to this Agreement*".

(ii) Clause 4 (Consideration) of the 2004 Services Agreement provided:

> "*In consideration of LBL providing services to LBIE, LBIE agrees to pay LBL a fee. Such fee is to be calculated on the basis of the total cost of such services plus a mark-up of ten percent (10%) or such other basis of calculation which may be agreed from time to time between the parties. For the purposes of this Agreement the definition of total cost is set forth in Appendix A*".

(iii) Appendix A of the 2004 Services Agreement sets out the meaning of "*total cost*" with reference to various items such as the occupancy of premises.

(iv) As a matter of the correct construction of the 2004 Services Agreement, none of the proposed recharges falls within the scope of the "*operational support services*" within clause 1, with reference to the "*costs*" of which LBL's fee is to be calculated in accordance with clause 4.

(v) Further, on the proper construction of the 2004 Services Agreement, liabilities flowing from the insolvency of the Lehman group do not fall within the scope of the 2004 Services Agreement:

(a) The 2004 Services Agreement was contemplated to provide for recharging the liabilities which LBL incurred in the course of LBIE and LBL both acting as trading (rather than insolvent) entities.

(b) This is reflected throughout the 2004 Services Agreement, including in the Appendix A definition of "*total cost*".

(c) LBL's liability in respect of the Contribution Claim has not been incurred in LBL's capacity as a trading company but in its capacity as a shareholder of LBIE. Moreover, the Contribution Claim has not been incurred by LBL in providing operational support services to LBIE. Accordingly, the Contribution Claim falls outside the scope of the 2004 Services Agreement.

(d) The position is the same in respect of the Bad Debt Claims (which arise from the insolvency of Lehman group entities) and expenses of LBL's administration (which arise from LBL's own insolvency).

(vi) For the avoidance of doubt, if and to the extent that LBIE reimbursed LBL for any expense for which LBIE had no obligation under the 2004 Services Agreement, such reimbursement occurred on a non-contractual basis and/or subject to *ad hoc* arrangements, as further explained below.

(7) After LBIE and LBL had entered administration, the 2004 Services Agreement was superseded by a costs recharge agreement dated 23 December 2008 (the "**2008 Agreement**"). As to the 2008 Agreement:

(i) The 2008 Agreement set out the basis on which, following the collapse of the Lehman Brothers group, LBL was to provide services to LBIE and LBL was to be remunerated by LBIE for those services.

(ii) The entry by LBL and LBIE into the 2008 Agreement had the effect of superseding and replacing the 2004 Services Agreement.

(iii) Recital B to the 2008 Agreement recorded that the 2008 Agreement documents the basis on which LBIE (a "**Customer**") was to pay the costs incurred by LBL (the "**Supplier**") in providing the Services to LBIE and the basis upon which such costs were to be recharged to LBIE based on specific allocation methods.

(iv) There is no right under the 2008 Agreement to recharge Contribution Claims, Bad Debt Claims or the expenses of LBL's administration.

(8) Further or alternatively, the 2004 Services Agreement was brought to an end by the termination agreement entered into by (among others) LBL and LBIE on 31 May 2013 (the "**2013 Termination Agreement**"). In summary:

(i) The recitals to the 2013 Termination Agreement record the parties' "*wish to terminate the Recharge Agreement and the arrangements pursuant to which LBL provides Services to LBIE*". This wish was effected by clause 2.1.

(ii) The term "*Recharge Agreement*" is defined by the 2013 Termination Agreement to mean the 2008 Agreement.

(iii) The term "*Services*" is defined by the 2013 Termination Agreement to mean "*the Services (as such term is defined in the Recharge Agreement) provided from time to time pursuant to the Recharge Agreement and any similar services to the Services which are provided by and to the parties to this Termination Agreement pursuant to similar agreements to the Recharge Agreement*".

(iv) The definition of "*Services*" in the 2013 Termination Agreement therefore includes Services provided by LBL pursuant to any similar agreement to the

2008 Agreement, which would include the 2004 Services Agreement if and to the extent that it had not been terminated by the 2008 Agreement.

(v) On this basis, the reference to the parties' wish "*to terminate… the arrangements pursuant to which LBL provides Services to LBIE*" in the recitals to the 2013 Termination Agreement was a written notice of intention to terminate the 2004 Services Agreement for the purposes of clause 7 of that agreement, such that that agreement was thereby terminated (if and to the extent that it had not been terminated already).

(vi) Accordingly, the 2004 Services Agreement is no longer in force, having been terminated, and LBL is not entitled to rely upon it.

(9) Further or alternatively, LBL's claim is out of time. As noted above, the 2004 Services Agreement was superseded and replaced by the 2008 Agreement, which was in turn terminated by the 2013 Termination Agreement. Pursuant to clause 2.7.4 of the 2013 Termination Agreement, LBL had 12 months from the Termination Date (31 May 2013) to bring a Claim (as defined in the 2013 Agreement) against LBIE. LBL did not notify a Claim relating to the Contribution Claims, Bad Debt Claims or the expenses of LBL's administration to LBIE within the relevant period.

63. The LBL Administrators contend that the written agreements identified above recorded only part of the contractual arrangement and that they were accompanied by a further unwritten agreement which was evidenced by a course of conduct (see in particular the LBL Position Paper at paras 83, 86 and 92.2).

64. The LBIE Administrators' position in respect of this contention is that the LBL Administrators' contention is wrong:

(1) There is no relevant course of conduct. LBL has never previously recharged any Contribution Claims or Bad Debt Claims or any expenses of LBL's administration.

(2) In any event, the test for an implied contract is not satisfied. See *The Elli 2* [1985] Lloyd's Rep 107; *The Aramis* [1989] 1 Lloyd's Rep 213; *Blackpool and Fylde Aero Club Ltd v. Blackpool Borough Council* [1990] 1 WLR 1195; *Modahl v British Athletic Federation* [2001] EWCA Civ 147, [2002] 1 WLR *1192; Baird Textiles Holdings Ltd v Marks & Spencer plc* [2002] 1 All ER (Comm) 737; and *Re MF Global UK Ltd (In Special Administration)* [2016] EWCA Civ 569.

(3) If and to the extent that LBIE reimbursed LBL for any expense for which LBIE had no obligation under the 2004 Services Agreement, the LBIE Administrators will say that this occurred as a matter of practical convenience (without any intention to change the legal rights or obligations of the parties or give rise to new legal rights or obligations) because it was in LBIE's interests to make such reimbursement. Given LBIE's reliance on LBL to provide services under the 2004 Services Agreement, it was in LBIE's interest to ensure that LBL remained solvent and able to meet its liabilities. Therefore, to the extent that these non-contractual and/or *ad hoc* arrangements gave rise to the recharging of any amounts not covered by the 2004 Services Agreement, these did not give rise to any implied contract entitling LBL to recharge LBIE for all costs and liabilities incurred by it, whether in the course of its business or otherwise.

(4) Further, there was no variation of the terms of the 2004 Services Agreement (which required expressly in clause 6 any amendments to be in writing) or any collateral contract.

(5) In any event, the LBIE Administrators do not accept that every category of payment identified in Appendix 3 to the LBL Position Paper was recharged to LBIE. For instance, LBL did not recharge item 64 in Appendix 3 (Write-off investment in LBCL). As far as the LBIE Administrators have been able to ascertain, Appendix 3 appears to be based on data used in LBL's annual tax returns and does not reflect the conduct of any monthly accounting or recharge process within the Lehman group. In any event, the LBIE Administrators do not

accept that Appendix 3 would substantiate LBL's contention in respect of an implied contract.

(6) Further, it is not the case that every item of expense incurred by LBL was recharged to LBIE. For instance, as far as the LBIE Administrators are aware, LBL never recharged its tax liabilities to LBIE. Further, as stated above, LBL never recharged the write-off of investment in LBCL to LBIE.

(7) Further, LBIE and LBL would not have intended to make (and could not be taken to have made) an implied agreement for the recharge of Contribution Claims, Bad Debt Claims or the expenses of LBL's administration. LBIE and LBL would not have considered the administrations of LBIE or LBL to be a realistic possibility and had no reason to provide for that eventuality. They cannot be taken to have intended to make by conduct any agreement which catered for that possibility.

65. The LBL Administrators also contend that there is an agreement by custom (see in particular the LBL Position Paper at para 93).

66. The LBIE Administrators' position is that this is wrong:

(1) The concept of "custom" is irrelevant. Custom is an immutable rule with the force of law having existed since time immemorial: see *Dashwood v Magniac* [1891] 3 Ch 306 (in particular at 370 per Kay LJ) and *Lac Minerals Ltd v International Corona Resources Ltd* (1989) 16 IPR 27.

(2) The authorities on which the LBL Administrators rely relate not to custom but to usage. Usage is a market practice which is binding on the parties: see *Cunliffe-Owen v Teather & Greenwood* [1967] 1 WLR 1421 (in particular at 1438 per Ungoed-Thomas J); *General Reinsurance Corporation v Forsakringsaktiebolaget Fennia Patria* [1983] 1 QB 856 (in particular at 874 per Slade LJ); and *Pacific & General Insurance Company Ltd v Hazell* [1997] LRLR 65.

(3) Usage depends on a notorious and universal practice within a market, which is accepted by market participants as an invariable and binding rule: see *Houlder v*

General Steam Navigation Company (1862) 3 F&F 170; *Nelson v Dahl* (1879) 12 Ch D 568; *Moult v Halliday* [1898] 1 QB 125; and *Brown v Inland Revenue Commissioners* [1965] AC 244).

(4) That concept is irrelevant in the present case. The LBL Administrators do not contend that there was a market practice in that sense. The matters identified by the LBL Administrators at paragraphs 79 to 92 (assuming for present purposes that they are factually correct) do not go to any universal market practice on the basis of which it might be argued that there was an agreement by custom in the relevant sense; rather, those matters simply relate to the bilateral relationship between the parties. The authorities on which the LBL administrators rely are therefore irrelevant.

(5) There could be no usage for the repayment of Contribution Claims, Bad Debt Claims or the expenses of LBL's administration, as that would be inconsistent with the commonly accepted market practice, as reflected in the applicable OECD Transfer Pricing Guidelines.

67. The LBL Administrators also contend that there was an implied term in the written agreements "*that all services provided by LBL not expressly therein identified but provided by LBL in the capacity of a service company, were to be recharged to the Lehman Group entity with whom such agreements had been entered into and who received the benefit of such services on the terms set out therein*" (see the LBL Position Paper at para 94).

68. In support of this contention, the LBL Administrators rely in particular upon the Privy Council's decision in *A-G of Belize v Belize Telecom Ltd* [2009] 1 WLR 1988, in which Lord Hoffmann suggested at [21] that the test for an implied term was "*whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean*".

69. The LBIE Administrators' position is that there is no implied term:

(1) The test for the implication of terms is as set out by Lord Neuberger in the Supreme Court decision in *Marks & Spencer plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd* [2016] AC 742, at [15] to [31]. Lord Neuberger made it clear at [31] that Lord Hoffmann's comments in *Belize* are to be treated as "*a characteristically inspired discussion rather than authoritative guidance on the law of implied terms*".

(2) In particular, Lord Neuberger stated at [27]:

> "*When one is implying a term or a phrase, one is not construing words, as the words to be implied are ex hypothesi not there to be construed; and to speak of construing the contract as a whole, including the implied terms, is not helpful, not least because it begs the question as to what construction actually means in this context*".

(3) Further, Lord Neuberger made it clear at [24] that there has been no "*dilution*" of the test for implied terms. That test, which is a "*stringent*" one, is that the implied term contended for was strictly necessary to give the contract business efficacy or was so obvious that it went without saying ([16], [17] and [23]). See also *Impact Funding Solutions Ltd v Barrington Support Services Ltd (formerly Lawyers At Work Ltd)* [2016] UKSC 57 (26 October 2016), at [31], per Lord Hodge. And see *Hayfin Opal Luxco 3 SARL v Windermere VII CMBS plc* [2016] EWHC 782 (Ch), at [68] per Snowden J:

> "*The court will only add words to the express terms of an agreement if it is necessary to do so because the agreement is incomplete or commercially incoherent without them. Even then, the court must be certain both that the absence of the missing words was inadvertent, and that if the omission had been drawn to the attention of the parties at the time of contracting they would have agreed what additional provision should be made*".

(4) The implied term contended for by the LBL Administrators does not satisfy the test set out in these authorities.

70. In any event, the implied term for which the LBL Administrators contend in the LBL Position Paper at para 94 (namely, that "*all **services** provided by LBL not expressly therein identified but provided by LBL **in the capacity of a service company**, were to be recharged to the Lehman Group entity with whom such agreements had been entered into and who received the benefit of such services upon the terms set out therein*" (emphases added)) would not have the effect of entitling LBL to recharge LBIE in respect of the Contribution Claim, the Bad Debt Claims or LBL's administration expenses.

(1) The Contribution Claim is not a service provided by LBL in its capacity as a service company. It is a statutory liability imposed on LBL in its capacity as a contributory.

(2) The Bad Debt Claims do not represent services provided to LBIE.

(3) The expenses of LBL's administration are not payable in respect of services provided to LBIE by LBL in its capacity as a service company.

Issue 11

71. Issue 11 is:

> "*Whether and to what extent LBL is entitled, under the terms of the Service Agreement between LBL and [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*".

72. **Issue 11 involves LBL and LBEL. The LBIE Administrators do not advance any separate position in respect of Issue 11.**

Issue 13

73. Issue 13 is:

> "*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*".

74. **The LBIE Administrators' position on Issue 13 is that the share register of LBIE ought not to be rectified. LBL has the liabilities of a member of LBIE.**

75. The LBIE Administrators' basis for this position is that:

(1) There is no basis for rectifying the share register; and

(2) There is no other basis on which LBL should not have the liabilities of a member of LBIE.

76. The LBL Administrators contend that LBIE's share register should be rectified so as to remove LBL's name. In support of this, the LBL Administrators contend that:

(1) LBL became a shareholder in LBIE as a result of a common mistake (see in particular the LBL Position Paper at paras 20, 23, 26 and 58); and/or

(2) LBL's directors had no authority to act in breach of fiduciary duty by causing LBL to become a member of LBIE (see in particular the LBL Position Paper at paras 24, 25.4 and 59 to 70).

77. The LBIE Administrators will submit that these contentions are wrong.

78. As to mistake:

(1) The addition of LBL as a shareholder was an intentional and deliberate act and was not a mistake in the sense of not having been intended. Indeed, the LBL Administrators do not contend that there was any mistake in this sense.

(2) However, the LBL Administrators contend that the reason for the addition of LBL as a shareholder was not a good one. Specifically, the LBL Administrators contend that the boards of LBL, LBH plc and LBIE "*incorrectly believed that [the Companies Act 1985] made the requirement for two shareholders in LBIE mandatory*" (see the LBL Position Paper at para 58.2).

(3) As further explained below, the LBL Administrators' case would not succeed as a matter of law, even if their contentions in respect of the alleged mistake were otherwise correct. The alleged mistake was not fundamental.

(4) In any event, the LBIE Administrators will say that the LBL Administrators' contentions in respect of the alleged mistake are not otherwise correct, because there was a legal requirement for two shareholders:

(i) Until 14 July 1992, all companies, whether with or without limited liability, were required to have two or more members: see sections 1(1) and 24 of the Companies Act 1985 ("**CA 1985**") and section 122(1)(e) of the 1986 Act.

(ii) Contravention of this requirement had two key consequences:

(a) First, the sole member would become jointly and severally liable with the company for the company's debts, after the expiry of a period of six months: see section 24 CA 1985.

(b) Secondly, the company in question would become liable to be wound up: see section 122(1)(e) of the 1986 Act.

(iii) As Hoffmann LJ put it in *Nisbet v Shepherd* [1994] BCC 91 with reference to section 24 CA 1985, "*the Companies Act 1985* ***requires*** *that a company should have at least two members*" (emphasis added).

(iv) On 15 July 1992, a new section 1(3A) CA 1985 came into force which provided that, notwithstanding section 1(1) CA 1985, one person may form an incorporated company being a "*private company limited by shares or by guarantee*".

(v) This new provision was inserted by the Companies (Single Member Private Limited Companies) Regulations 1992 (SI 1992/1699) to implement the 12th Company Law Directive 89/667 on single-member private limited-liability companies [1989] OJ L395/40 (the "**12th Directive**").

(vi) Article 1 of the 12th Directive records that the relaxation of the restriction on single member companies was to apply, so far as the United Kingdom was concerned, in the case of any "*Private company limited by shares or by guarantee*".

(vii) Accordingly, notwithstanding the 12th Directive and the enactment of sub-section 1(3A) CA 1985, the requirement for at least two members continued to apply to ***unlimited*** companies.

(viii) LBIE was incorporated as a private company limited by shares on 10 September 1990. It was necessary at that stage for LBIE to have two shareholders, pursuant to section 1(1) CA 1985. Those shareholders were initially Ms Harney and Mr Bird; and subsequently LBH and Mr Cornish; and subsequently LBH and Mr Sherratt.

(ix) On 15 July 1992, when the new section 1(3A) CA 1985 came into force, it became possible for LBIE to have a single shareholder. On 22 September 1992, Mr Sherratt transferred his single share in LBIE to LBH.

(x) On 21 December 1992, LBIE was re-registered as an unlimited company. As a result, section 1(3A) ceased to apply to LBIE; and section 1(1) CA 1985 again became the governing provision.

(xi) Accordingly, from 21 December 1992 onwards, it was a mandatory requirement for LBIE to have more than one member.

(xii) Contrary to that requirement, LBH continued to be the single member of LBIE.

(xiii) This contravention of section 1(1) CA 1985 had two key consequences:

(a) First, LBH became jointly and severally liable with LBIE for LBIE's debts, pursuant to section 24 CA 1985, after six months. This was undesirable, as joint and several liability under section 24 CA 1985 is a materially more burdensome obligation than the contingent liability of a contributory under section 74 of the 1986 Act.

(b) Secondly, LBIE became liable to be wound up, pursuant to section 122(1)(e) of the 1986 Act. This was undesirable, as LBIE was a trading company required to maintain good standing which could not accept the existence of a risk of liquidation on this basis.

(xiv) The contravention was ended when LBH transferred a single share in LBIE to LBL on 23 November 1994.

(xv) Accordingly, from 23 November 1994, LBIE complied with the requirement of section 1(1) CA 1985 and the consequences of contravention of that section ceased to arise.

(5) Accordingly, the so-called 'mistake' on which the LBL Administrators seek to rely was not a mistake at all. Insofar as that formed the basis of the relevant decision, the relevant understanding was correct as a matter of law.

(6) Further, contrary to the position set out at para 63 of the LBL Position Paper, the transfer of a single share to LBL did not prevent LBIE from being a branch of LBH for US tax purposes.

(7) Alternatively, in the event that the LBL Administrators are correct to say that there was a mistaken belief that it was necessary for LBIE to have two shareholders, the LBIE Administrators will submit that the mistake was not fundamental, in that: (a) it did not make it impossible for LBL to be a member of LBIE; and (b) it did not make performance essentially different from what the parties anticipated. See *Bell v Lever Bros* [1932] AC 161; *Great Peace Shipping Limited v Tsavliris (International) Limited* [2003] QB 679; and C*hitty on Contracts*, 32nd ed., [6-015]. LBL bargained to become the holder of a single share in LBIE; and it did become the holder of a single share in LBIE. In 1994 and again in 1997, LBL was successfully registered as a shareholder in LBIE. The contractual venture – namely, the acquisition of a share – was not rendered impossible; and LBL obtained precisely what it bargained for. Accordingly, there was no relevant mistake.

(8) Further and in any event, the allotment in May 1997 was not the result of a mistake. Even if the LBL Administrators are correct to say that there was a mistaken belief in November 1994 that it was necessary for LBIE to have two shareholders, there is nothing to suggest that the allotment in May 1997 was a continuation of that mistaken belief. The allotment in May 1997 appears to have been the consequence of a desire to replace LBL's single £1 share with a single US$1 share. That objective was duly achieved.

79. As to the allegation of breach of fiduciary duty:

(1) The LBL Administrators contend that LBL's directors did not give any consideration to the separate interests of LBL and that the decision to take a share in LBIE was a breach of fiduciary duty by those directors. They say that the allotment of a share to LBL was void.

(2) The LBIE Administrators do not accept that there was no separate consideration of LBL's interests.

(3) However, if the LBL Administrators are correct in saying that there was no separate consideration of LBL's interests, it will be necessary for the Court to consider "*whether an intelligent and honest man in the position of a director of the company concerned, could, in the whole of the existing circumstances, have reasonably believed that the transactions were for the benefit of the company*" (see *Charterbridge Corp v Lloyds Bank* Ltd [1970] Ch 62 at 74 per Pennycuick J).

(4) The LBIE Administrators will submit that an intelligent and honest man in the position of a director of LBL could, in all the then existing circumstances, have reasonably believed that the transaction was for the benefit of LBL, in that (among other things):

(i) at the relevant time, LBIE was a highly successful banking company;

(ii) it was in the interests of the Lehman group for LBIE to have two shareholders for the reasons identified above; and

(iii) LBL was making profits from the recharge arrangements.

(5) Consequently, even if there was no separate consideration of LBL's position (which is not admitted), the LBIE Administrators submit that there was no breach of fiduciary duty. Further, the directors of LBL did not act for an improper purpose or breach their fiduciary duties by acting in a position of conflict of interests. It was in the interests of LBL and in any event not inconsistent with such interests for it to become a member of LBIE. There was no conflict of interests.

(6) In any event, even if the allotment did occur in breach of fiduciary duty by LBL's directors:

(i) the allotment was ratified by LBH, which owned 100% of the shares in LBL (see *Re Duomatic Ltd* [1969] 2 Ch 365; *Rolled Steel Products*

(Holdings) Ltd v British Steel Corp [1986] Ch 246 (in particular at 296 per Slade LJ); and *SNH v Hoare* [2006] EWHC 73 (Ch)); and/or

(ii) the allotment was voidable rather than void and, given that LBIE has gone into administration, it is now too late to avoid it (see *Oakes v Turquand* (1867) LR 2 HL 325 and *Snell's Equity* (33rd ed.), [15-015]); and/or

(iii) the right of rescission was lost (alternatively, the register should not be rectified) by reason of affirmation of the shareholding and/or delay.

80. The LBL Administrators seek to rely on instances where LBL's share was not mentioned. However, this is supportive neither of the LBL Administrators' case on mistake nor of the LBL Administrators' case on breach of fiduciary duty. In any event, there were a large number of occasions on which LBL's share in LBIE was mentioned, both in documents provided to third parties and in communications with legal advisers.

81. Similarly, the LBL Administrators seek to contend that LBL was never treated and/or considered as a shareholder in LBIE. Even if true, this would be supportive neither of the LBL Administrators' case on mistake nor of the LBL Administrators' case on breach of fiduciary duty. In any event, there is evidence to show that LBIE held AGMs from 1994 to 2007 inclusive and that LBL directors attended AGMs. Further, on occasions when LBIE held EGMs, LBL directors attended those EGMs and in some instances LBL signed consents to the holding of EGMs on short notice. LBL also signed shareholder resolutions. The contention that LBL was not treated or considered as a shareholder in LBIE is factually inaccurate. Further, LBL was not deprived of rights to attend AGMs or EGMs or to consider or vote on proposed resolutions.

Issue 14

82. Issue 14 is:

"*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*".

83. **The LBIE Administrators do not take any position in respect of Issue 14 , which involves an issue between LBL (on the one hand) and LBH and/or LBHI2 (on the other). As LBL has accepted, LBL's liability to LBIE under section 74 would not be reduced by a finding that it is a nominee for another company.**

William Trower QC
Daniel Bayfield QC
Stephen Robins

18 November 2016