

Party: First Applicant  
Witness: Russell Downs  
Statement No: 5  
Exhibit: "RD5"  
Date: 25 September 2013

Nos. 7942 and 7945 of 2008 and No. 429 of 2009

**IN THE HIGH COURT OF JUSTICE**  
**CHANCERY DIVISION**  
**COMPANIES COURT**

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

**AND IN THE MATTER OF THE INSOLVENCY ACT 1986**

**BETWEEN:**

- (1) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL  
(EUROPE) (IN ADMINISTRATION)**  
**(2) THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS LIMITED  
(IN ADMINISTRATION)**  
**(3) THE JOINT ADMINISTRATORS OF LB HOLDINGS INTERMEDIATE 2 LIMITED  
(IN ADMINISTRATION)**

**Applicants**

**- and -**

- (1) LEHMAN BROTHERS HOLDINGS, INC**  
**(2) LYDIAN OVERSEAS PARTNERS MASTER FUND LIMITED**

**Respondents**

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**FIFTH WITNESS STATEMENT OF  
RUSSELL DOWNS**

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I, **RUSSELL DOWNS** of PricewaterhouseCoopers LLP ("**PwC**") of 7 More London  
Riverside, London, SE1 2RT say as follows:

- 1** I am a Partner in the firm of PwC of the above address and am one of the joint  
administrators of Lehman Brothers International (Europe) (in administration)  
("**LBIE**").

- 2 I make this statement in relation to the Joint Application. This is my second witness statement in relation to the Joint Application, following my fourth witness statement dated 2 August 2013 (my "**Fourth Witness Statement**"), and my fifth witness statement altogether in LBIE's administration proceedings. In this statement terms capitalised but not defined have the definitions accorded to them in my Fourth Witness Statement.
- 3 There is now produced and shown to me a paginated bundle of documents marked "**RD5**", to which I shall refer. Save where otherwise stated, page references in this statement are to the contents of these exhibits.
- 4 The purpose of this witness statement is to comment, to a limited extent, on the following witness statements served on behalf of other parties to the Joint Application:
  - 4.1 witness statement of Michael John Andrew Jarvis dated 14 June 2013 for LBL (the "**Jervis Witness Statement**"); and
  - 4.2 witness statement of Julian Edward Jones dated 6 September 2013 for LBHI (the "**Jones Witness Statement**").
- 5 Save where otherwise stated this witness statement is made from facts and matters that are within my own knowledge.

(A) **SINGLE LBIE SHARE HELD BY LBL**

- 6 The Jervis Witness Statement states at paragraph 13 that "*LBL acquired one ordinary \$1 share in LBIE on 23 November 1994*" and goes on to suggest that LBL held this share until LBIE's entry into administration on 15 September 2008. That is incorrect.
- 7 As explained at paragraphs 8, 13.10 and 13.11 of my Fourth Witness Statement:
  - 7.1 the share acquired by LBL on 23 November 1994 was a Single Sterling Share;
  - 7.2 that share, together with all other LBIE sterling shares, was cancelled and extinguished on 1 May 1997; and
  - 7.3 on 1 May 1997 LBIE allotted to LBL a Single Dollar Share which LBL continues to hold.

(B) **REDUCTION IN LBHI2 SUB-DEBT**

- 8 At paragraphs 23 and 24 of the Jones Witness Statement, Mr Jones explains that in November 2007 there was a restructuring of the UK regulated business of Lehman Brothers, involving the transfer out of the UK regulated group (the "**UK Group**") of various companies in the Mortgage Capital Division ("**MCD**"), and that this gave rise to a "*significant reduction (US\$2.86 billion) in the relevant "Total Requirement" of capital*". Mr Jones states that this restructuring "*did significantly reduce LBIE's capital requirements and may in part explain why repayments of LBHI2 Sub-Debt took place after 30 November 2007*".
- 9 I am advised by staff working on the LBIE administration that the reduction in capital resource requirements resulting from the MCD restructuring applied to the UK Group generally rather than to LBIE specifically, and that LBIE's own regulatory capital requirements would not have been impacted by the transfer of the MCD out of the UK Group. At **pages 1 to 4 of RD5** is an email chain containing an email dated 12 November 2007 and attached spreadsheet indicating that the MCD restructuring would result in a reduction in the UK Group's capital requirement, whilst that of LBIE would remain the same.
- 10 Prior to their transfer out of the UK Group, the MCD companies within the UK Group (being Mable Commercial Funding Limited and its subsidiaries), were wholly-owned by LBHPLC, and LBIE was not required to, and did not, take into account risks associated with the presence of the MCD in the UK Group when calculating its own capital adequacy requirements. A diagram showing the indirect group relationship between LBIE and Mable Commercial Funding Limited is at **page 5 of RD5**. I am advised, therefore, that it is unlikely that the movement of the MCD out of the UK Group would have been a reason for LBIE to make repayments of LBHI2 Sub-Debt after 30 November 2007.
- 11 I am advised by staff working on the LBIE administration that the repayments of LBHI2 Sub-Debt after 30 November 2007 were more likely due to one or both of the factors described below.
- 11.1 In 2007 the Basel Committee on Banking Supervision at the Bank for International Settlements published new Basel Accords ("**Basel II**") to replace the existing accords ("**Basel I**"). In 2006 and 2007, LBIE calculated its capital resource requirement under Basel I. From January

2008, LBIE calculated its capital resource requirement under Basel II, which (generally) resulted in a lower capital requirement than under Basel I.

**11.2** During 2008, and particularly following the failure of the investment bank Bear Stearns in March 2008, the position of the Lehman Brothers group became a focus of growing market concern. This resulted in:

**11.2.1** a reduced risk appetite within LBIE; and

**11.2.2** reduced levels of counterparty activity as some counterparties began to move their trading relationships away from LBIE,

both of which would likely have reduced LBIE's capital resource requirements.

**(C) LBHI2 SUB-DEBT OUTSTANDING AS AT ADMINISTRATION**

**12** In the Jones Witness Statement, Mr Jones seeks to demonstrate that the LBHI2 Sub-Debt outstanding as at LBIE's entry into administration was:

**12.1** all drawn under the Short-Term Facility; and

**12.2** all Tier 3 regulatory capital.

**13** In doing so, Mr Jones has relied upon the way in which outstanding LBHI2 Sub-Debt was described in:

**13.1** an email dated 24 July 2007 written by Ben Hall in the Regulatory group at Lehman Brothers, which describes the then-outstanding LBHI2 Sub-Debt as "Short Dated Sub Debt"; and

**13.2** reports by LBIE to the FSA, including LBIE's daily capital adequacy report for 12 September 2008, in which the LBHI2 Sub-Debt was described as "Short term subordinated debt".

**14** I am advised that PwC staff working on the LBIE administration have conducted significant forensic work to determine whether the LBHI2 Sub-Debt outstanding as at LBIE's entry into administration can be linked conclusively to a particular LBHI2 Sub-Debt Agreement (or Agreements). I am advised that, whilst various documents suggest that the LBHI2 Sub-Debt outstanding as at LBIE's entry into administration was characterised by at least some Lehman Brothers staff as "short term" or "short dated", it is not possible definitively to connect the LBHI2 Sub-Debt outstanding as

at LBIE's entry into administration with a particular LBHI2 Sub-Debt Agreement. The context in which the terms "short term" and "short dated" were used, and the precise meaning given to them at the time, is not clear. I set out two examples of this below. These examples illustrate a lack of consistency in the meaning applied by LBIE personnel to the terms "long term" and "short term", including in reports to the FSA.

**14.1** The September 2006 Monthly Reporting Statement ("MRS") calculation appears to categorise LBIE's outstanding LBHPLC Sub-Debt (totalling \$5,828,770[,000]); it is understood that the MRS reports were presented in \$'000s) differently in different places. The first eight pages of the September 2006 MRS calculation file, showing this disparity, are at **pages 6 to 13 of RD5.**

**14.1.1** The Balance Sheet section of the MRS calculation appears to divide the LBHPLC Sub-Debt into a "short term" amount of \$3,950,000[,000] and a "long term" amount of \$1,878,770[,000].

**14.1.2** The Financial Resources section of the MRS calculation appears to divide the LBHPLC Sub-Debt into a "short-term" amount of \$4,638,101[,000] and a "long-term" amount of \$1,190,669[,000].

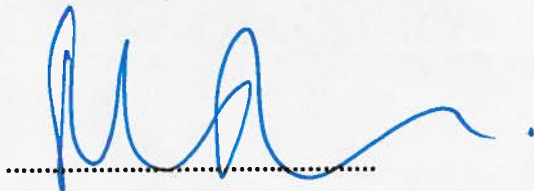
**14.2** In an email dated 29 November 2005, Gareth Bowen (who was, at that time, Vice-President/Director in the UK Regulatory Reporting function), stated that *"As at the end of October 2005 LBIE had drawn \$4,117 million under its existing long term subordinated debt agreement"*. He then goes on to describe how that amount was reported to the FSA, in the following terms: *"\$840 million was reported as Tier 2 capital (long term sub debt), being the maximum leverage permitted under 10-63(11) with the surplus \$3,277 million being reported as Tier 3 capital (short term sub debt) per 10-63(9A) and within the leverage limits for Tier 3 capital as detailed in 10-63(12)"*. In this instance, amounts of subordinated debt drawn under the same agreement are described separately as "long term" and "short term", seemingly based on their ultimate FSA capital adequacy tier ranking rather than the LBHPLC Sub-Debt Agreement under which they were drawn. A copy of this email is contained within the email chain at **pages 14 to 16 of RD5.**

15 As explained at paragraphs 50 and 51 of my Fourth Witness Statement, all LBHI2 Sub-Debt was classified in LBIE's financial statements as "*Creditors: amounts falling due within one year*" and the notes to the accounts state that amounts owing under the LBHI2 Sub-Debt Agreements are "repayable at any time at the Company's option". LBIE's financial statements, therefore, classified LBHI2 Sub-Debt according to the fact that it could be repaid at short notice, rather than based on its maturity date.

(D) **STATEMENT OF TRUTH**

16 I believe that the facts stated in this witness statement are true.

**Dated 25 September 2013**



**Russell Downs**

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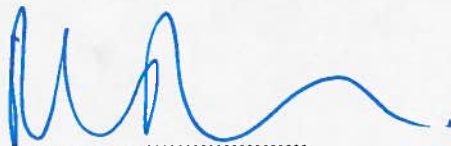
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**EXHIBIT "RD5" TO THE  
FIFTH WITNESS STATEMENT OF RUSSELL DOWNS**

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This is the Exhibit marked "RD5" referred to in the Fifth Witness Statement of Russell Downs dated 25 September 2013.

Signed .....

A handwritten signature in blue ink, consisting of several loops and a long horizontal stroke, positioned above a dotted line.

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**Respondents**

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**FIFTH WITNESS STATEMENT OF  
RUSSELL DOWNS**

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