

**WATERFALL APPLICATION**

**IN THE HIGH COURT OF JUSTICE**

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

**CHANCERY DIVISION**

**COMPANIES COURT**

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

**AND IN THE MATTER OF LEHMAN BROTHERS LIMITED (IN ADMINISTRATION)**

**AND IN THE MATTER OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN  
ADMINISTRATION)**

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

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**LIST OF ISSUES**

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This document identifies the legal issues which the parties collectively consider require determination by the Court within the Application. For convenience and intelligibility, issues are grouped thematically.

Save where otherwise indicated, abbreviations and definitions used in the Statement of Agreed Facts are also adopted in this document.

**LBL's and LBHI2's ability to prove in any liquidation of LBIE**

1. Where a company is in liquidation, is it the case that either:
  - a. a contributory is not entitled to prove in the company's liquidation until he has contributed everything that he is liable to contribute as a contributory pursuant to section 74 of the Insolvency Act 1986 (the "Act"); or

- b. a contributory who seeks to prove in the company's liquidation can receive nothing until he has contributed everything that he is liable to contribute as a contributory pursuant to section 74 of the Act,

on the basis of an equitable rule that a person who owes money to an estate cannot claim a share in that estate without first making the contribution which completes it (the "**Alleged Equitable Rule**")?

2. What, if any, is the effect on the answers to Issues 1(a) and (b) above of the fact that a call has not been made on the contributory by the company's liquidator(s)?
3. If the answer to Issues 1(a) and (b) is no, and the contributory is entitled to prove and (*prima facie*) to receive distributions in the company's liquidation, is credit required to be given in respect of the contributory's liability to contribute pursuant to section 74 of the Act, either (i) by way of insolvency set-off; and/or (ii) pursuant to the rule in *Cherry v Boulton* 41 ER 171; and/or (iii) otherwise? If so, in what circumstances is credit required to be given and how? In particular:
- a. Is credit only required to be given if a call is made on the contributory by the company's liquidator(s)?
- b. How should the potential liability of the contributory be valued for the purposes of giving credit by the company's liquidator(s)?
- c. What, if any, is the effect of the proving contributory itself being in administration or liquidation?

#### **LBL's and LBHI2's ability to prove in LBIE's administration**

4. Is a contributory *contingently* liable to contribute to the company's assets to an amount sufficient for payment of its debts and liabilities, and the expenses of the winding-up, where the company: (i) is in administration; but (ii) might subsequently move into liquidation; and (iii) might have a shortfall in respect of which the members might be liable to contribute under section 74 of the Act?
5. If the answer to Issue 4 is yes, is it the case that either:

- a. a contributory is not entitled to prove in the company's administration until he has contributed everything that he is contingently liable to contribute as a contributory pursuant to section 74 of the Act; or
- b. a contributory who seeks to prove in the company's administration can receive nothing until he has contributed everything that he is contingently liable to contribute as a contributory pursuant to section 74 of the Act

on the basis of the Alleged Equitable Rule?

6. If the answer to Issue 5 is no, and the contributory is entitled to prove and (*prima facie*) to receive distributions in the administration, is credit required to be given in respect of the contributory's contingent liability to contribute pursuant to section 74 of the Act, either (i) by way of insolvency set-off; and/or (ii) pursuant to the rule in *Cherry v Boulton* 41 ER 171; and/or (iii) otherwise? If so, in what circumstances is credit required to be given or is any deduction to be made and how? In particular:
  - a. What, if any, is the effect of the proving contributory itself being in administration or liquidation?
  - b. Should credit only be given if the company submits a proof of debt in respect of the contributory's potential liability to the company under section 74 of the Act?
  - c. Should credit only be given once the contributory's administrator(s) or liquidator(s) have placed a value upon the potential liability to the company under section 74 of the Act?
7. Does section 149 of the Act have any bearing on the answers to Issues 1 to 6? If so, in what respects is it relevant on the basis of the facts as set out in the Statement of Agreed Facts?
8. Does section 74(2)(f) of the Act have any bearing on Issues 1 to 6 above? If so, in what respects is it relevant in light of the fact that it is common ground that no sums are due to LBL or LBH12 in their capacity as Members?

**LBIE's entitlement to prove in the insolvencies of its Members (i.e. LBL and LBHI2)**

9. Is a company, acting by its administrator or liquidator, entitled to prove in the administration (or any subsequent liquidation) of a contributory in respect of the contributory's contingent liability to contribute pursuant to section 74 of the Act? In this regard:

- a. For the purposes of rule 13.12(1)(b) of the Rules, did the contributory incur an obligation to contribute to the company's assets to an amount sufficient for payment of its debts and liabilities, and the expenses of the winding-up, at a time when it became a member of the company (or at any later time prior to the contributory going into administration)?
- b. Is the quantum of the contributory's contingent liability to contribute to be calculated in the same way as it is under Issue 13 below? If not, how is it to be calculated?

10. If the company, acting by its administrator or liquidator, is entitled to prove in the administration (or any subsequent liquidation) of its contributory, is its claim liable to be reduced by insolvency set-off, or by the rule in *Cherry v Boulton* (or otherwise) in circumstances where:

- a. the contributory's cross-claim is contractually subordinated on the terms of the Sub-Debt Agreements; and/or
- b. the company's claim is in respect of the contributory's contingent liability to contribute pursuant to section 74 of the Act; and/or
- c. no call has been made by the company's liquidator(s) in respect of the contributory's liability to contribute

and, if so, how?

11. Does section 149 of the Act have any bearing on the answers to Issues 9 and 10? If so, in what respects is it relevant on the basis of the facts as set out in the Statement of Agreed Facts?

12. Does section 74(2)(f) of the Act have any bearing on Issues 9 and 10 above? If so, in what respects is it relevant in light of the fact that it is common ground that no sums are due to LBL or LBHI2 in their capacity as Members?

### **Calculating LBL's and LBHI2's liability to contribute**

13. How is the quantum of the contributory's contingent liability to contribute calculated? In this regard:

- a. What are the contingencies which have to be taken into account (e.g. LBIE going into liquidation, there being a shortfall for which the Members may be liable to contribute under section 74(1), a call being made on the Members and/or any others) and how are the prospects of those contingencies occurring to be estimated?
- b. Is rule 2.105 of the Rules relevant to the calculation of the quantum of the contributory's contingent liability and, if so, how can the formula in this rule for accelerated receipt in respect of future debts be applied, given that it is not known when, and if at all, LBIE will be wound up?
- c. Does the contributory's contingent liability extend to any interest accruing during the period of the administration under rule 2.88(7) of the Rules or otherwise?
- d. Does the contributory's contingent liability extend to the Currency Conversion Claim (if Issue 22 below is answered in the affirmative)?
- e. Does the contributory's contingent liability extend to liabilities of the company which have been contractually subordinated on the terms of the Sub-Debt Agreements?
- f. Does the contributory's contingent liability extend to interest payable in the liquidation under section 189(2) of the Act or otherwise? In this regard, if the administrator is in the process of making distributions to the company's general, unsecured creditors and it appears that he will be able to pay the company's provable debts in full, what, if any, interest will be payable under section 189(2) of the Act if the company subsequently moves from administration into liquidation and does any such interest form part of the contributory's contingent liability to the company?

14. How would the quantum of the contributory's liability to contribute be calculated if LBIE were placed into liquidation?

**The Members' obligation to contribute and their rights *inter se***

15. In the event that the Members are obliged to contribute to the assets of LBIE pursuant to Section 74 of the Act, and in light of the Members' respective shareholdings:

- a. are their obligations joint, several or otherwise as against LBIE;
- b. are they entitled to seek a contribution or indemnity from one another in respect of any payments made pursuant to any such obligation and, if so, what is the nature and extent of such right of contribution or indemnity; and
- c. to what extent is any right to contribution or indemnity as referred to in sub-paragraph (b) above affected by any other claims which LBHI2 and LBL have against one another?

16. What effect do the answers to Issue 15 above have upon the value of LBIE's proof in the administrations (or subsequent liquidations) of the Members, if any, (if the answer to Issue 9 above is yes)?

**Construction of the Sub-Debt Agreements**

17. Is the effect of the contractual subordination of LBIE's liability to LBHI2 under paragraph 5 of the Standard Terms of the Sub-Debt Agreements

- a. such that LBHI2 is entitled to: (i) prove; but (ii) not receive any dividends payable, in LBIE's administration (or a subsequent liquidation) in respect of the Sub-Debt until LBIE's creditors with provable claims which do not arise out of contracts containing subordination provisions have received full payment of the principal amounts of those provable claims, but then receive dividends payable before:
  - i. interest payable under rule 2.88(7) of the Rules (and, in a subsequent liquidation, any interest payable under section 189(2) of the Act) has been paid in full;

- ii. Currency Conversion Claims (to the extent that Issue 22 below is answered in the affirmative) have been paid in full; and
- iii. debts owed to members (potentially including itself) which were not provable or on which no dividend was payable by reason of the application of the Alleged Equitable Rule referred to in Issue 1 above have been paid in full?

or

- b. such that LBHI2 is not entitled to: (i) prove; or (ii) receive any dividends payable, in LBIE's administration (or a subsequent liquidation) in respect of the Sub-Debt until:
  - i. LBIE's creditors with provable claims have received full payment of the principal amounts of those provable claims;
  - ii. interest payable under rule 2.88(7) of the Rules (and, in a subsequent liquidation, any interest payable under section 189(2) of the Act) has been paid in full;
  - iii. Currency Conversion Claims (to the extent that Issue 22 below is answered in the affirmative) have been paid in full; and
  - iv. debts owed to members (potentially including itself) which were not provable or on which no dividend was payable by reason of the application of the Alleged Equitable Rule have been paid in full?

18. If the constructions of the Sub-Debt Agreements set out at Issue 17 above are not correct, what is the extent of the contractual subordination contained in the Sub-Debt Agreements?

**The waterfall**

19. In the event of a surplus having discharged or reserved for the provable debts, in what order of priority are the following payable by an administrator:
- a. post-administration interest payable under rule 2.88(7) of the Rules or otherwise;
  - b. the Currency Conversion Claim (if Issue 22 below is answered in the affirmative);

- c. any debts owed to members which were not provable or on which no dividend was payable by reason of the application of the Alleged Equitable Rule; and
- d. to the extent that it is not provable, the contractually subordinated debt (on the terms of the Sub-Debt Agreements) (as to which see Issues 17 and 18 above)?

20. Is the order of priority for payment by a liquidator the same as for an administrator (as to which see Issue 19 above)?

### **Statutory interest**

21. Might interest be payable under rule 2.88(7) of the Rules and/or section 189(2) of the Act notwithstanding that, as a result of the application of the Alleged Equitable rule and/or contractual subordination, not all debts proved in the administration or liquidation have been paid in full or at all?

### **Currency conversion claims**

22. Is an unsecured creditor, with a contractual entitlement to payment in a currency other than sterling (the "Contractual Currency"), entitled, following payment in full of:

- a. all provable debts; and
- b. interest payable pursuant to rule 2.88(7) of the Rules,

to payment in a sum equal to the difference between: (i) the amount of its contractual entitlement to payment in the Contractual Currency; and (ii) the amount received by it in respect of its proved debt, converted into the Contractual Currency as at the date(s) of payment (such claim being referred to as a "Currency Conversion Claim")?



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