

WATERFALL APPLICATION

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

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

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

STATEMENT OF AGREED FACTS

The parties agree the facts set out in this document solely for the purposes of the issues to be determined at the hearing listed to be heard in November 2013, and not for any other purpose.

Parties

- 1 Lehman Brothers International (Europe) ("**LBIE**") was the principal trading company within the European Lehman Brothers group of companies.
- 2 Lehman Brothers Limited ("**LBL**") is a limited English company. As set out below it holds a single ordinary share in LBIE. It was the service company for the Lehman Group's operations in the UK, Europe and Middle East, holding most of the service contracts and employee contracts for UK companies within the Lehman Brothers group of companies (the "**UK Lehman Group**"). LBL also maintained IT systems and provided infrastructure support to the UK Lehman Group. Furthermore, it was the head lessee for the UK Lehman Group's headquarters at 25 Bank Street, London, as well as the Group Paying Agent for UK corporation tax, the Representative Member for the Lehman Group VAT registration, and the "Principal Employer" under the Lehman Brothers Pension Scheme.

- 3 LB Holdings Intermediate 2 Limited (“**LBHI2**”) is a limited English company, and holds shares in LBIE as set out below.
- 4 Lehman Brothers Holding Inc (“**LBHI**”) is the ultimate parent for the Lehman Brothers group of companies worldwide, and is incorporated in the State of Delaware, USA.
- 5 LBIE and LBL have been in administration since September 2008. LBHI2 has been in administration since January 2009.

LBIE Corporate Structure and History

- 6 LBIE is (and was, at the time of its entry into administration) an English unlimited company.
- 7 LBL and LBHI2 are the only shareholders of LBIE:
 - 7.1 LBL holds one ordinary LBIE share of \$1; and
 - 7.2 LBHI2 holds the following shares in LBIE:
 - (i) 6,273,113,999 ordinary shares of \$1 each;
 - (ii) 2 million 5% redeemable preference shares of \$1,000 each; and
 - (iii) 5.1 million 5% redeemable Class B preference shares of \$1,000 each.
- 8 LBIE was incorporated on 10 September 1990, as a limited company named “Lehman Brothers International Limited” (“**LBIL**”).
- 9 On 21 December 1992, LBIE was re-registered as an unlimited liability company and renamed as LBIE.
- 10 Statements made in interview by Ms Dolby (who was, prior to LBIE’s entry into administration, head of European Corporate Tax) were to the effect that the re-registration of LBIE as an unlimited company was undertaken for US tax reasons.
- 11 LBIE was incorporated with an issued share capital of \$2. The original subscribers were Alistair Francis Bird and Colleen Ann Harney (each holding a Single Dollar Share).
- 12 On 5 October 1990, the original subscribers transferred their shareholdings as follows:
 - 12.1 Mr Bird transferred his \$1 share to LBHPLC (which was, at that time, named Shearson Lehman Brothers Holdings PLC); and
 - 12.2 Ms Harney transferred her \$1 share to Martin William Cornish (a solicitor then employed within the Lehman Brothers group who was Chief Legal Officer and the LBIE Company Secretary until 2 October 1991).

- 13** On 30 November 1990, 59,999,998 LBIE ordinary shares of \$1 each were allotted to LBHPLC, making LBHPLC the majority shareholder of LBIE. From that point until the 2006 Restructuring, save for the period 22 September 1992 to 23 November 1994 when LBHPLC was the sole shareholder of LBIE, LBHPLC was LBIE's majority shareholder.
- 14** Mr Cornish held a \$1 share until 2 October 1991, when it was transferred to Peter Robert Sherratt (who was also a solicitor employed within the Lehman Brothers group and who succeeded Mr Cornish as Chief Legal Officer and LBIE's Company Secretary on 2 October 1991).
- 15** Mr Sherratt held a \$1 share until 22 September 1992, when it was transferred to LBHPLC.
- 16** On 10 December 1992, LBIE's memorandum and articles of association were amended and its authorised share capital increased by the creation of 50,000,000 ordinary shares of £1 each.
- 17** On 10 December 1992, 30,000,010 LBIE ordinary shares of £1 each were allotted to LBHPLC.
- 18** On 18 December 1992, LBIE adopted a written shareholder resolution amending its articles of association to, amongst other things, limit its number of shareholders to one unless otherwise determined by special resolution.
- 19** On 23 September 1994, 5,250,000 LBIE ordinary shares of £1 each were allotted to LBHPLC.
- 20** On 23 November 1994, LBIE adopted a written shareholder resolution amending its articles of association to, amongst other things, remove the restriction on LBIE having more than one shareholder which had been entered into its articles on 18 December 1992.
- 21** On 23 November 1994, LBL acquired from LBHPLC a £1 share to be held as nominee on behalf of LBHPLC.
- 22** On 1 May 1997:
 - 22.1** LBIE resolved to cancel and extinguish all sterling shares, including the £1 share held by LBL and the 35,250,009 £1 shares held by LBHPLC; and
 - 22.2** LBIE allotted a \$1 share to LBL and 59,999,999 \$1 shares to LBHPLC.
- 23** According to its year end financial statements, LBIE declared and paid the following dividends:
 - 23.1** \$130,000,000 during the year ended 30 November 1997;
 - 23.2** \$140,000,000 during the year ended 30 November 1998; and
 - 23.3** \$110,000,000 during the year ended 30 November 1999.

- 24 According to its year end financial statements, LBIE proposed the following dividends:
- 24.1 \$60,000,000 for the year ended 30 November 1999 (in addition to the \$110,000,000 declared and paid during the financial year); and
 - 24.2 \$85,000,000 for the year ended 30 November 2000.

The 2006 Restructuring

- 25 LBIE was the UK broker dealer of the Lehman Brothers group, providing a wide range of financial services including trading and broking fixed income and equity instruments, participation in the syndication and underwriting of new security issues and stock broking in relation to securities issued in many major and emerging markets around the world.
- 26 Statements made in interview by Ms Dolby and Mr Jackson (who was, prior to leaving Lehman Brothers in May 2008, European Financial Controller and a director of LBIE and LBHI2) were to the effect that during the 2000s, there was a significant expansion of Lehman Brothers' activities in Europe, resulting in an increase in business booked to LBIE.
- 27 Statements made in interview by Ms Dolby were to the effect that:
- 27.1 As a result of the Lehman Brothers group's growing European trading activities, by 2006 LBIE had accumulated a significant volume of foreign tax credits (the "**LBIE FTCs**").
 - 27.2 The global Lehman Brothers group wanted to be able to utilise the LBIE FTCs in the United States, to avoid double taxation and thereby reduce the Group's global effective tax rate.
 - 27.3 In order for the LBIE FTCs to be available to the Lehman Brothers group for the purposes of its financial reporting in the US, LBIE needed to be profitable.
 - 27.4 Her recollection was that at that time, however, LBIE was not profitable. One reason for this was that LBIE was paying interest on the amounts outstanding under certain subordinated debt agreements it had in place at that time with its then parent LBHPLC (the "**LBHPLC Sub-Debt Agreements**", and the debt issued under those agreements the "**LBHPLC Sub-Debt**") which formed part of its regulatory capital base.
- 28 The LBHPLC Sub-Debt Agreements were three subordinated debt agreements entered into between LBHPLC (as lender) and LBIE (as borrower):

- 28.1 a €3,000,000,000 Long Term Subordinated Loan Facility dated 19 July 2004 (the “**Long Term Euro LBHPLC Facility**”);
- 28.2 a \$4,500,000,000 Long Term Subordinated Loan Facility dated 19 July 2004 (the “**Long Term Dollar LBHPLC Facility**” and, together with the Long Term Euro LBHPLC Facility, the “**Long Term LBHPLC Facilities**”); and
- 28.3 a \$8,000,000,000 Short Term Subordinated Loan Facility dated 31 October 2005 (the “**Short Term LBHPLC Facility**”).
- 29 The LBHPLC Sub-Debt Agreements were the final link in a chain of subordinated debt arrangements that allowed for the flow of subordinated debt through the corporate chain between LBIE (the primary regulated trading entity in the European Lehman Group) and its ultimate US parent, LBHI.
- 30 Statements made in interview by Ms Dolby were to the effect that:
- 30.2 In order to improve LBIE’s profitability, it was decided that LBIE’s regulatory capital base should be restructured in such a way that it would no longer need to pay interest on all of the funding it received under the LBHPLC Sub-Debt Agreements.
- 30.3 Planning and implementing the 2006 Restructuring was a joint process among, principally, three functions in the European Lehman Group:
- (i) the Tax function, whose concern was to ensure that the restructuring achieved the aim of releasing the LBIE FTCs for use in the US without other adverse tax implications;
 - (ii) the Regulatory function, whose concern was to ensure that the restructuring was achieved without jeopardising LBIE’s ability to meet its regulatory capital requirements as an FSA-regulated entity; and
 - (iii) the Treasury function, whose concern was to ensure that the restructuring did not jeopardise LBIE’s (and, more broadly, the Lehman Brothers group’s) general funding requirements.
- 31 On 1 November 2006, LBIE replaced \$2 billion of its LBHPLC Sub-Debt with \$2 billion of non-cumulative preference shares (“**Preference Shares**”).
- 32 The Preference Shares were treated and reported to the FSA as comprising part of LBIE’s lower tier 2 capital for the purposes of the FSA’s regulatory capital requirements (with the excess over LBIE’s lower tier 2 capital limit reported as tier 3 capital).
- 33 A new intermediary holding company was inserted between LBHPLC and LBIE to hold the Preference Shares, being LBHI2.
- 34 Statements made in interview by Ms Dolby were to the effect that:

- 34.1 the purpose of doing so was, again, to realise a tax benefit. Since the intermediary company would be paying interest on that subordinated debt, but receiving no interest or dividends on the Preference Shares, it would make a significant loss in respect of its holding of the Preference Shares. This simple (or “clean”) loss was desirable for tax planning purposes.
- 34.2 The evidence of certain witnesses is that it it was considered desirable, as part of the 2006 Restructuring, to insert into the group structure a further intermediary company between LBHPLC and LBHI2, being LB Holdings Intermediate 1 Limited (“**LBHI1**”). LBHI1 was required simply to hold the share capital in LBHI2, and was otherwise dormant.
- 35 On 1 November 2006 LBIE entered into the following subordinated loan agreements with its new direct parent company, LBHI2:
- 35.1 a €3,000,000,000 Long Term Subordinated Loan Facility (the “**Long Term Euro Facility**”);
- 35.2 a \$4,500,000,000 Long Term Subordinated Loan Facility (the “**Long Term Dollar Facility**” and, together with the Long Term Euro Facility, the “**Long Term Facilities**”); and
- 35.3 a \$8,000,000,000 Short Term Subordinated Loan Facility (the “**Short Term Facility**” and, together with the Long Term Facilities, the “**LBHI2 Sub-Debt Agreements**”).
- 36 Statements made in interview by Ms Dolby and Mr Rushton (who was, prior to LBIE’s entry into administration, employed in its Treasury function) were to the effect that these LBHI2 Sub-Debt Agreements were entered into because the Treasury function wanted to retain the flexibility that having some subordinated debt as part of LBIE’s regulatory capital base allowed. The drawdown and repayment of subordinated debt under a subordinated debt facility could be conducted more quickly than preference shares could be issued and redeemed.
- 37 In respect of currency, amount and term, the LBHI2 Sub-Debt Agreements were direct replacements for the LBHPLC Sub-Debt Agreements.
- 38 One result of the 2006 Restructuring was that the LBHPLC Sub-Debt was replaced with new funding in the form of:
- (i) the \$2 billion of Preference Shares issued to LBHI2 on 1 November 2006; and
 - (ii) \$4.7 billion of LBHI2 Sub-Debt drawn down in November 2006.

The Terms of the LBHI2 Sub-Debt Agreement

- 39 The LBHI2 Sub-Debt Agreements all contain the same subordination provision.
- 40 Specifically, the LBHI2 Sub-Debt Agreements subordinate all present and future sums, liabilities and obligations, and all interest payable thereon, payable or owing by LBIE to the Lender under the agreements to all other sums, liabilities and obligations payable or owing by LBIE (apart from sums owed by LBIE which are expressed to be and, in the opinion of the administrators of LBIE do, rank junior to the subordinated liabilities).
- 41 The LBHI2 Sub-Debt Agreements were based on templates provided by the FSA and there are only minimal differences between the terms of the subordination provision in the LBHI2 Sub-Debt Agreements and the subordination provision in the FSA standard form subordinated debt agreement.

The Treatment of the LBHI2 Sub-Debt

- 42 The LBHI2 Sub-Debt formed part of LBIE's regulatory capital for the purposes of the FSA's capital adequacy requirements.
- 43 Statements made in interview by Ms Dolby and Mr Rushton were to the effect the LBHI2 Sub-Debt was a particularly flexible form of regulatory capital funding.
- 44 In the general ledger accounts in Dun and Bradstreet Software ("**DBS**"), the LBHI2 Sub-Debt was booked in the same DBS account as the Preference Shares into which any LBHI2 Sub-Debt (or, formerly, LBHPLC Sub-Debt) had been converted.
- 45 The relevant Lehman Brothers finance systems included the Lehman Treasury Workstation System ("**TWS**") which was used to book and manage trades and record draw downs and repayments relating to the LBHI2 Sub-Debt Agreements. Neither DBS nor TWS linked movements in LBHI2 Sub-Debt to specific LBHI2 Sub-Debt Agreements.
- 46 In LBIE's statutory accounts, which had been prepared in accordance with UK GAAP, all LBHI2 Sub-Debt (whether drawn down under the Short Term Facility or one of the Long Term Facilities) was treated in the same way. Specifically, all LBHI2 Sub-Debt was accounted for as "*Creditors: amounts falling due within one year*". 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".
- 47 The Preference Shares were accounted for in LBIE's audited accounts as "*Creditors: amounts falling due over one year*".

The 1 May 2007 Restructuring

- 48 As part of a further restructuring which took effect on 1 May 2007, the majority of the then-outstanding LBHI2 Sub-Debt was converted into Preference Shares. Specifically:
- 48.1 LBIE was discharged from the obligation to repay \$5.1 billion of LBHI2 Sub-Debt (being the majority of the balance of LBHI2 Sub-Debt outstanding as at 1 May 2007); and
- 48.2 LBIE allotted to LBHI2, as consideration for the discharge of the LBHI2 Sub-Debt, \$5.1 billion of Preference Shares.
- 49 Statements made in interview by Ms Dolby were to the effect that the May 2007 Restructuring was essentially a “refinancing” of the LBHI2 Sub-Debt. Converting the majority of the LBHI2 Sub-Debt into Preference Shares (as with the 2006 Restructuring) freed LBIE from the burden of paying interest on the LBHI2 Sub-Debt and created further losses in LBHI2.
- 50 LBIE was required to report regularly to the FSA on its regulatory capital position. As part of that reporting requirement, from January 2008 LBIE prepared monthly FSA003 reports. The FSA003 report for the month ending on 31 May 2008 contained the following information (reported in US Dollars):
- at row 42, “*Lower tier two capital [\$]3,382,413[,000]*”;
 - at row 43, “*Lower tier two capital instruments [\$]7,100,000[,000]*”;
 - at row 44, “*Excess on limits for lower tier two capital [\$]3,717,587[,000]*”;
 - at row 58, “*Total tier three capital [\$]7,332,618[,000]*”;
 - at row 59, “*Excess on limits for total tier two capital transferred to tier three capital [\$]3,717,587[,000]*”, and
 - at row 60, “*Short term subordinated debt [\$]3,475,000[,000]*”.
- 51 The FSA003 report for the month ending 30 June 2008 contained the same information contained at paragraph 50 (above) in respect of the 31 May 2008 FSA003 report, except that the information at row 58 stated “*Total tier three capital [\$]7,461,501[,000]*.”
- 52 The FSA003 report for the month ending 31 July 2008 contained the same information contained at paragraph 55 (above) in respect of the 31 May 2008 FSA003 report, except that the information at row 58 stated “*Total tier three capital [\$]7,350,546[,000]*.”
- 53 The draft FSA003 report for the month ending 31 August 2008 contained the same information contained at paragraph 55 (above) in respect of the 31 May 2008

FSA003 report, except that: (a) row 58 stated “*Total tier three capital [\$]6,040,268[,000]*”; and (b) row 60 stated “*Short term subordinated debt [\$]2,225,000[,000]*”.

- 54** At the date of Administration, \$2.225 billion of the LBHI2 Sub-Debt held by LBIE was outstanding.

Other issues

- 55** LBL has lodged an unsecured claim in the LBIE administration in the sum of £363 million. This figure is the subject of discussions between the joint administrators of LBL and the joint administrators of LBIE.
- 56** LBHI2 has lodged unsecured claims in the LBIE administration for: (i) approximately £38 million (in respect of the general intercompany unsecured balance); and (ii) £1,254,165,598.48 in respect of the outstanding LBHI2 Sub-Debt.
- 57** The £363 million and £38 million sums proved by LBL and LBHI2, respectively, in LBIE’s administration are not due from LBIE to LBL and LBHI2 in their character as members.
- 58** Lydian Overseas Partners Master Fund Ltd has lodged in the LBIE administration unsecured claims in respect of a contractual debt of \$218,539,783.61 and a contingent contractual debt of \$45,648,338.38 which have been converted for the purpose of proving to £122 million and £25 million respectively.
- 59** According to the LBIE Administrators’ latest progress report dated 12 April 2013, they have yet to determine the most appropriate exit from administration but the Administrators’ proposals made in October 2008 (as approved by creditors in November 2008) contemplated a scheme of arrangement, creditors’ voluntary liquidation, a company voluntary arrangement and distribution in the administration followed by dissolution as possible exit strategies.

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