CR-2008-000026

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
COMPANIES COURT (ChD)

IN THE MATTER OF LEHMAN BROTHERS HOLDINGS PLC (in administration)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN

THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS HOLDINGS PLC (in administration)

- and –

(1) LB GP NO 1 LIMITED (in liquidation)

(2) LEHMAN BROTHERS HOLDINGS INC.

(3) DEUTSCHE BANK A.G. (LONDON BRANCH)

REPLY POSITION PAPER OF DEUTSCHE BANK A.G. (LONDON BRANCH)

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1. This is the reply position paper of Deutsche Bank, which follows its position paper dated 30 June 2023 ("**DB PP**") and responds to LBHI's position paper also dated 30 June 2023 ("**LBHI PP**"). Capitalised terms used in the DB PP are adopted herein.

PLI 1

2. The DB PP sets out why LBHI's position on PLI 1 is precluded by the doctrine of *res judicata* and is in any event unsustainable (see: [7]-[16]). In short: (1) the ECAPS 1 Proceedings determined that Claim D ranks in priority to Claim C, and that is not now open to challenge; and (2) it follows necessarily from the decision of the Supreme Court in Waterfall 1 that Claim D includes statutory interest for these purposes (and this is correct in any event). Nothing in the LBHI PP changes these conclusions.

3. The Claim D subordination provisions (see Clause 3(a) of the Terms and Conditions of the Notes) provide for the subordination of Claim D to the Senior Liabilities. The subordination in terms extends to "*payment of any amount (whether principal, interest or otherwise) in respect of the Notes …*"

4. It is clear from the language used in Clause 3(a) that any amount payable "*in respect of"* the Notes, including "*interest or otherwise*", is subordinated to the same degree as the obligation to pay principal.

5. The Claim C subordination provisions are to similar effect. Clause 5(1) of the Subordinated

Loan Facility contains materially the same wording, providing that the subordination of Claim C extends to "*payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities …*". Subordinated Liabilities are defined in turn as:

> "*all Liabilities to the Lender in respect of each Advance made under this Agreement and all interest payable thereon*."

6. It was determined in Waterfall I (considering identical subordination provisions to those used in Claim C: see the judgment at [42]) that the payment of principal in respect of the Subordinated Liabilities was subordinated below the payment of statutory interest payable in respect of the Senior Liabilities: see [38] et seq. In so concluding, the Supreme Court rejected arguments (see [44]) that (a) statutory interest was not a Liability in the required sense because it was payable and owing by LBIE pursuant to rule 2.88(7) of the applicable insolvency rules (and in substance a direction to the officeholder) rather than under the relevant contract; and (b) that statutory interest was "*not payable or capable of being established or determined in the insolvency of LBIE*" within the meaning of the subordination agreement. Lord Neuberger concluded that there was no credible basis to treat the payment as being other than in the insolvency of the issuer ([46]-[50]) and (importantly) that statutory interest could be treated as "*payable or owing by*" the company concerned for the purpose of the definition of Liabilities, notwithstanding that it was paid pursuant to a statutory provision ([51]-[56]).

7. In this instance, the Court of Appeal has already determined that Claim D (including the statutory interest element of Claim D) is senior to Claim C. Statutory interest payable in respect of the PLC Sub-Notes is a Senior Liability for the purpose of the Claim C subordination provisions, because: (a) it is a Liability payable or owing by the Borrower (Waterfall I) and (b) it is not a Subordinated Liability or Excluded Liability (Re LB Holdings). In particular:

   (1) It is necessary to look to the Claim D definitions in order to determine whether the statutory interest element of Claim D has been expressed to be junior to the rights under Claim C (and therefore an Excluded Liability) (see Re LB Holdings at [86]-[88]);

   (2) If and to the extent that statutory interest element of Claim D is a" *Liabilit*[y] *to the Noteholders in respect of the Notes*" or another *"Liabilit*[y] *of the Issuer which rank*[s] *or* [is] *expressed to rank pari passu with the Notes*" (see the definition of Subordinated Liabilities), it is a Subordinated Liability for the purpose of the Claim D provisions and therefore not expressed to rank junior to Claim C for the purpose of the Claim C subordination provisions; and

(3) Statutory interest payable in respect of the PLC Sub-Notes is "*a Liabilit*[y] *to the Noteholders in respect of the Notes*" within the meaning of the definition of Subordinated Liabilities: see also the language of Clause 3(a), which plainly equates payments in respect of the Notes as including interest (or payments otherwise made).

8. In light of the above, the fundamental error in LBHI PP [3], in particular [3.6.3], is to disregard the language actually used in the Claim D subordination provisions and treat "*in respect of the Notes*" in the definition of Subordinated Liabilities as meaning "*a liability that arises under the Notes*". That is not what the language of the relevant provisions says and, to the extent it is suggested that a payment of statutory interest is not "*in respect of the Notes*" in the required sense, it is wrong. It clearly is in light of the language of Clause 3(a) and the reasoning of the Supreme Court in Waterfall I (see above).

9. Furthermore, there is no warrant (c/f LBHI PP at [3.6.3(ii)] and [3.6.4]) to suggest that the notion of liabilities "*in respect of the Notes*" as used in the definition of Subordinated Liabilities in Claim D should be limited by the subsequent language "*and all other Liabilities of the Issuer which rank or are expressed to rank pari passu with the Notes*". The first part of this phrase clearly identifies as Subordinated Liabilities all Liabilities in respect of the Notes. The second part (after "and") is a separate aspect of the definition which extends Subordinated Liabilities to all other Liabilities of the issuer which rank or are expressed to rank *pari passu.* It makes no difference that, absent subordination, statutory interest on a proved debt would be paid after the proved debts (i.e. principal claims) by reason of Rule 14.23(7)(a). Statutory interest payable in respect of the PLC Sub-Notes is a liability in respect of the Notes and is a Subordinated Liability as defined. Being a Subordinated Liability, statutory interest on the Notes cannot, by definition, be an Excluded Liability or Senior Liability as defined in the PLC Sub-Notes.

PLI 2

10. There is no scope to re-interpret Rule 14.23(7) in the manner that LBHI suggests in light of the language used in the Rule, irrespective of what LBHI asserts is the purpose of statutory interest (see LBHI PP [6.1] and DB PP [17]-[27]).

11. It is the debt proved on which statutory interest must be paid. There is no scope to interpret Rule 14.23(7) to refer to any amount other than that for which the debt (including a future debt) is admitted to proof. In particular:

(1) LBHI ignores the language used in the rule, and seeks to paraphrase it by reference to the amount paid in respect of the proved debt i.e. the dividend, or the "*calculation of the proved debts to be paid*", thus seeking to introduce the notion of discounting used in rule 14.44 (see LBHI PP at [6.4], [6.5] and [6.8]). There is no justification for such an

approach, which is contrary to the clear language used in the rule and contrary to the principles of construction identified in DB PP [18]-[24]; and

(2) LBHI ignores the fact that the surplus is identified following payment of the "*debts proved*" (i.e. there is no reference to the payment of the dividends referable to the debts proved or to rule 14.44), and it is by reference to "*those debts*" that statutory interest is paid. C/f LBHI PP [6.5.2], the method of payment (i.e. by way of dividend calculated by reference to a discounted amount of the proof under rule 14.44) is irrelevant when identifying the amount of the "*proved debt*" and does not lead to any inequality: all proved debts share statutory interest on a pro-rata basis for the periods between the commencement date (see PLI 3) and when they were paid.

12. In any event, LBHI misdescribes the purpose of statutory interest (LBHI PP at [6.1]):

(1) Statutory interest is paid by way of compensation for the delay since the commencement of the administration in the payment of a creditor's proved debt (i.e. for compensation for the delay between the notional simultaneous realisation and distribution of assets, and the date that the proved debt is in fact paid): see Waterfall II A/B [2016] Bus LR 17 at [207] per David Richards J; Waterfall II A/B [2018] Bus LR 508 at [51]; and Joint Administrators of Lehman Brothers International (Europe) (in administration) v Revenue and Customs [2019] UKSC 12 at [49];

(2) Insofar as any judicial comment has been made referring to the function of statutory interest being to compensate for a delay in payment of dividends rather than payment of the proved debt, it must be read in context as intended to refer to the same underlying function identified in the above quotations i.e. statutory interest is compensation for delayed payment of proved debts, and was not referring to or seeking to suggest a different rule applied to future debts (which is the only type of provable debt where the proved debt can be paid in full by way of dividends which do not total the same amount as the proved debt itself); and

(3) The proved debt for the purpose of statutory interest payable on future debts in rule 14.23(7) is (and can only be) the full amount of the future debt. It is the delayed payment of the future debt for which compensation is paid by way of statutory interest.

13. Nor (c/f LBHI PP at [6.6] and [6.7]) is there any basis to suggest that the result advocated by DB is commercially unreasonable, unfair or out of kilter with the purpose and statutory regime as a whole, or leads to an objectionable form of overpayment: see DB PP at [27] and [28].

14. LBHI's alternative reliance on the application of rule 14.44 by reason of statutory interest being a dividend is wrong for the reasons given at DB PP [25] and [26]. Whether a payment

of a *sui generis* kind, or a form of distribution, it cannot be a payment of a dividend within the meaning of Rule 14.44.

PLI 3

15. The argument advanced in the LBHI PP is not open to LBHI or any other party: DB PP at [35] and [36]. The PLC Administrators should be directed to proceed on the basis that the applicable period for the purpose of the calculation of statutory interest on Claim D begins on the date on which PLC entered administration.

16. Without prejudice to this position, and in any event, LBHI is plainly wrong to assert that the date that Claim D was entitled to prove in the administration is the relevant date from which statutory interest runs (see DB PP [37]). Further and in particular:

    (1) Once Claim D is capable of proof, it can be seen for the purpose of the Rules that it has been outstanding since the commencement of the administration and is therefore entitled to statutory interest on the same basis as all other proved debts;

    (2) There is no relevant concept of the date of "*entitlement*" to proof, which is an LBHI construct that is not found anywhere in the Rules;

    (3) It is not a requirement that, in order to be entitled to statutory interest, a creditor must have been in a position since the commencement of the administration to commence proceedings and seek a judgment against the company to which the Judgments Act rate would apply. That could not apply to all or many contingent and future debts. In the reference to Waterfall IIA at [207] at LBHI PP [9.6.2], David Richards J was simply explaining in general terms "*the rationale for the choice of judgment rate as the minimum rate of interest payable*" rather than a requirement (or rationale) for the payment of statutory interest at all, or the date from which it was payable;

    (4) There is no legal or commercial logic to the stance adopted by LBHI, c/f LBHI PP at [9.7]. See DB PP at [37(3)]. The subordinated creditor may have agreed to be subordinated to certain creditors unless and until particular conditions are met. But once the claim becomes provable, it can be seen that Claim D has been outstanding and unpaid since the commencement of the administration. There is no basis to suggest that the relevant subordination provisions applicable to Claim D were intended to reduce the amount of interest payable in the event of a surplus for the sole benefit of those who are subordinated below Claim D and/or for the holders of equity;

    (5) LBHI obtains no assistance from the decision in Re Park Air Services Plc [2000] 2 AC 172, which decision does not deal with a future subordinated debt but rather the statutory entitlement to damages which arises following disclaimer in a liquidation. The latter is a statutory entitlement to compensation to be assessed as at the date of disclaimer (i.e.

after the commencement of the liquidation), in respect of which the counterparty is not treated as being a creditor as at the date of the liquidation unless and until disclaimer occurs: see 180B-181C; 187B-C. Insofar as it addressed the date from which interest ran on that claim, the point was common ground between the parties and not subject to substantive consideration by the House of Lords.

PLI 4

Res Judicata

17. Although LBHI seeks to address the question of whether its position on PLI 4 is precluded by the doctrine of *res judicata* at LBHI PP [12], none of its points deal with the key reasons why that doctrine is engaged.

18. At LBHI PP [12.1]-[12.2], LBHI asserts that PLI 4 does not concern the relative priority of Claim C and Claim D such that there is *"no question of the Court of Appeal's declaration being subverted*". This may explain why there is no strict cause of action estoppel in relation to PLI 4, but ignores the fact that DB relies upon an issue estoppel (DB PP [42]).

19. In the ECAPS 1 Proceedings, all parties proceeded on the basis that, distributions on Claim D would benefit the holders of the ECAPS because Claim D would be paid in priority to Claim C. This was also the express basis on which the Court joined Deutsche Bank to the proceedings and was stated in terms in the first instance judgment of Marcus Smith J. This issue was also expressly relied on by the Court of Appeal in determining the priority dispute that was the subject of the ECAPS 1 Proceedings: the Court of Appeal held that prioritizing Claim D over Claim C was consistent with a commercial purpose of repaying external investors in the ECAPS in priority to the intra-group creditors. See Deutsche Bank PP at [41]. The issue that payments on Claim D would be for the economic benefit of the investors in the ECAPS, like Deutsche Bank, was therefore determined in the ECAPS 1 Proceedings, and it is not now open for LBHI to contend otherwise. For the same reason, the PLC Administrators are precluded from raising this issue under PLI 4.

20. LBHI's second point (which is relevant only if, contrary to Deutsche Bank's primary position, there is no issue estoppel) is that PLI 4 is not an issue that should have been raised in the ECAPS 1 Proceedings, "*having regard to the circumstances*" of those proceedings.[1] LBHI appears to identify three "*circumstances*":

    (1) The first is that at the time of the ECAPS 1 Proceedings it was not clear whether PLI 4 would be relevant (because its relevance depended on whether PLC would be able to

[1] LBHI PP, ¶¶ 12.3.

pay distributions on Claim D, which in turn depended on the outcome of other priority disputes in the ECAPS 1 Proceedings and related proceedings concerning LBHI2), and so it was not necessary (and even disproportionate) to investigate PLI 4.[2]

(2) The second "*circumstance*" is that the nature of the issues arising in the Lehman group estates require an iterative approach across multiple directions applications.[3]

(3) Both of these arguments fail to meet the key point that, if LBHI is correct about PLI 4, then all of the ranking issues in the ECAPS 1 Proceedings were necessarily irrelevant. This is not a question of an iterative process to work through successive issues (which may have occurred in some of the prior Lehman waterfall proceedings), but of whether an entire set of issues had any purpose at all. That is why it was both necessary and proportionate to raise PLI 4 – if it was to be raised at all – before LBHI and the PLC Administrators put the parties through proceedings lasting over four years, including a 5-day appeal in the Court of Appeal. This would amount to a staggering waste of the court's and the parties' resources. It is extraordinary (and wrong) to suggest that LBHI and the PLC Administrators were at liberty to hold back PLI 4 (and indeed in the case of LBHI, to run arguments directly contrary to the position on PLI 4 it now takes)[4] in order to wait and see how the ECAPS 1 Proceedings turned out. This conduct is a paradigm abuse of the court's process and should not be permitted.

(4) Deutsche Bank addressed LBHI's third point that the Court lacks jurisdiction to preclude the PLC Administrators from raising PLI 4 at DB PP [12]. It is obvious that the doctrine of *res judicata* must apply to an administrator's application for directions, and this is made clear by Rule 12.1 of the Insolvency Rules 2016, which applies the relevant provisions of the CPR. It cannot seriously be contended that an administrator is entitled repeatedly to seek directions on the same issue, over and over again, for so long as any one creditor objects to the way those issues were determined in the Courts.

Substantive merits

21. LBHI's interpretation of clause 2.11 fails to give any meaning to the express qualification that the clause is engaged only in relation to a "*payment or distribution of assets of the Guarantor*". But this qualification is fatal to its case because in order to succeed on PLI 4 LBHI must show that the clause is engaged in relation to payments by GP1, from the partnership assets of the ECAPS Issuers, of an unsecured contractual obligation to pay a Liquidation Distribution under

[2] LBHI PP, ¶¶ 12.3.2 – 12.3.3.

[3] LBHI PP, ¶¶ 12.3.4 – 12.3.5.

[4] Deutsche Bank PP, ¶¶47-48.

the terms of the ECAPS. This is simply untenable.

22. LBHI says that clause 2.11 "*includes within its scope an indirect receipt by the Holder of a payment or distribution of PLC's assets*". It is not clear what LBHI means by "*indirect*" here[5], but whatever it means it does not assist LBHI unless the payment is of PLC's assets. Since a payment by GP1 from the partnership assets is not a payment of PLC's assets, it cannot be caught by clause 2.11.

23. The fundamental flaw that underlies LBHI's case on PLI 4 is exposed by its description of how clause 2.11 is said to be engaged at LBHI [11.5.3]: "*the assets paid or distributed [by PLC in respect of Claim D] will be 'received' by the Holder … via GP1*" (emphasis added). This is legally incoherent: it ignores separate corporate personality and the actual chain of payments involved.

24. There is no transfer of PLC's assets "*via*" GP1. A distribution on Claim D will be paid to GP1, in its capacity as the general partner of the three ECAPS Issuers, whereupon those funds become the unencumbered partnership assets of the ECAPS Issuers, indistinguishable from their other assets. If and when GP1 comes to pay a Liquidation Distribution to the Holder of the ECAPS, it will do so from the partnership assets[6], and not the assets of PLC, irrespective of what proportion of those assets were ultimately derived from Claim D. In the same way, payment by GP1 of the liquidation expenses of the ECAPS Issuers is not a payment using PLC's assets, irrespective of whether the source some of the ECAPS Issuers' assets were payments made by PLC under Claim D.

25. LBHI seeks also to rely on what it says was the commercial purpose of "*the structure*" described in the ECAPS prospectus.[7] Specifically, LBHI asserts that the overall purpose of the "*ECAPS structure*" was to ensure that the ECAPS Holders receive no more than they would if they were holders of preference shares of PLC, and that this is achieved by clause 2.11 of the Subordinated Guarantee ensuring that any proceedings in excess of those sums are held on trust for PLC. This makes no sense and is in any event inconsistent with LBHI's own

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[5] LBHI says that an "*indirect*" payment is captured by the phrase in clause 2.11: "*including any such payment or distribution which may be payable or deliverable* ***by reason of the payment of any other indebtedness of the Guarantor*** *being subordinated to the payment of amounts owing under this Subordinated Guarantee*". The bold text is LBHI's emphasis, and it seems to be said that this is contemplating a payment of other indebtedness of the Guarantor ultimately making its way to the Holder. But this is not what this phrase means, and it ignores the words that immediately follow the bold text which LBHI emphasises – what is contemplated is a payment by the Guarantor to the Holder being made by reason of the payment of the other indebtedness "*being subordinated to the payment of amounts owing under this Subordinated Guarantee*". In other words, the class of payment being identified includes a payment or distribution by the Guarantor which is made because some other indebtedness of the Guarantor is subject to payment subordination. There is no suggestion that payments other than by the Guarantor (in its capacity as Guarantor, and of its assets) to the Holder are caught by any trust or turnover obligation in clause 2.11.

[6] In accordance with Condition 3.1 of the ECAPS.

[7] LBHI PP, ¶11.4.

construction of clause 2.11:

(1) If any overall commercial purpose can be attributed to the "*ECAPS structure*", it is inherently improbable that PLC is obliged pay the PLC Sub-Notes (Claim D) in priority to the PLC Sub-Debt (Claim C), but that when the proceeds of Claim D came to be distributed to the ECAPS Holders, those proceeds were to be paid back to PLC and used to discharge Claim C (to the exclusion of Claim D), all by virtue of a clause not in any of the principal debt instruments in the structure, but in a unilateral subordinated guarantee. This would be an absurd commercial structure if the intention was for Claim C ultimately to be paid in priority to Claim D, and simply exposes the tension of LBHI's new case on PLI 4 with the outcome of the ECAPS 1 proceedings.

(2) LBHI's position is in any case incoherent because the alleged commercial purpose for which it contends would not be achieved by its interpretation of clause 2.11. The effect of LBHI's construction of clause 2.11 is not that the ECAPS Holder would receive no more than they would if they were holders of preference shares of PLC, but instead that the ECAPS Holder would necessarily receive nothing at all. This is because a payment by PLC in respect of Claim D would discharge PLC's liability in respect of Claim D, so that when those monies are ultimately returned to PLC they can be used to discharge PLC's more junior ranking liability (Claim C) to LBHI: see LBHI PP at [14]. In other words, the ECAPS Holder would receive nothing, even if there is a surplus available that would be payable to a preference share holder of PLC.

26. The inherent improbability of LBHI's commercial purpose is borne out when one looks at the documents from which LBHI derives its alleged commercial purpose, and which do not support LBHI's case. LBHI's alleged commercial purpose seems to be based solely on a single phrase used in the "*Summary*" section of the ECAPS Prospectuses, and not in the terms of any of the relevant instruments. The phrase reads as follows:

"*The Preferred Securities together with the Subordinated Guarantee, are intended to provide Holders [, with respect to the Issuer,] with rights on liquidation [of the Issuer] equivalent to non-cumulative preference shares of the Guarantor, whether or not issued*."

27. The words that appear in square brackets above, and which are completely ignored by LBHI, are found only in the prospectus for the third series of the ECAPS, and not in the first two. However, the words in square brackets are clarificatory, and the meaning of the overall phrase must be the same across all three prospectuses (LBHI is not understood to contend (nor could it seriously be contended) that the commercial purpose of overall ECAPS structure it relies on

could have changed between different issuances of the ECAPS). It is therefore clear that the phrase is purporting to describe the rights of the Holder in a liquidation of the ECAPS Issuer, and not the rights of the Holder to the assets of PLC in a liquidation of PLC, as LBHI seems to contend. In any case, parsing the meaning of this opaque phrase in the summary of the ECAPS prospectuses is unlikely to assist the Court, and is certainly not an exercise capable of changing the meaning of the clear words used in clause 2.11.

28. Instead, the purpose of clause 2.11 is to be found by looking at that clause in the context of the ECAPS Guarantee as a whole. In that context, clause 2.11 is simply a trust-based mechanism of achieving the subordination of the Holders' rights against PLC as Guarantor, in the alternative to the contractual form of subordination set out in the preceding clause 2.9. Clause 2.9 (and clause 2 generally) is concerned with the subordination of the Holders' rights against PLC only in its capacity as Guarantor – clause 2.9 refers only to the subordination of the Guarantor's "obligations hereunder" – and has nothing to do with the subordination of the Holders' economic rights to a Liquidation Distribution on the ECAPS[8]. There is nothing surprising in the ECAPS Guarantee including such alternative forms of subordination, not least because at the time of the ECAPS Guarantee, it had not yet been established definitively that the contractual form of subordination in clause 2.9 was effective in an insolvency. This approach ensured that the Holders' rights under the Guarantee remained subordinated to the claims of the Senior Creditors even if the contractual subordination in clause 2.9 failed.

PLI 5

29. If PLC purported to make distributions on Claim D using funds that remained beneficially PLC's assets, then that distribution would not discharge PLC's liability in respect of Claim D: see (DB PP [58]). If, however, PLC makes a distribution on Claim D with funds that upon payment become beneficially owned by the ECAPS Issuers (as LBHI contends), then those funds cannot remain PLC's assets for the purpose of clause 2.11 when used to pay the ECAPS Issuers. In that situation, the payment by PLC would discharge PLC's liability under Claim D, as LBHI contends, but that result shows the absurdity of LBHI's position because, as explained above, it results in Claim D having no economic value and PLC's surplus ultimately being paid in respect of Claim C, which ranks for payment junior to Claim D.

28 July 2023

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[8] This is consistent with the limited scope of Guaranteed Payments, which do not include a Liquidation Distribution.