CR-2008-000026
CR-2009-000052

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 LB HOLDINGS INTERMEDIATE 2 LIMITED (in administration)
AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN

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

LEHMAN BROTHERS HOLDINGS INC.
THE JOINT LIQUIDATORS OF LB GP NO 1 LIMITED (in liquidation)
DEUTSCHE BANK A.G. (LONDON BRANCH)

AND

BETWEEN

THE JOINT ADMINISTRATORS OF LB HOLDINGS INTERMEDIATE 2 LIMITED (in administration)
and
LEHMAN BROTHERS HOLDINGS SCOTTISH LP 3
THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS HOLDINGS PLC (in administration)
(3) DEUTSCHE BANK A.G. (LONDON BRANCH)

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

Introduction

1. This is the position paper of Deutsche Bank A.G. (London Branch) ("**Deutsche Bank**") served in accordance with the order of Mr Justice Mann dated 24 July 2018 (the "**Order**") in relation to the applications dated 16 March 2018 for directions within the administration of LB Holdings Intermediate 2 Limited ("**LBHI2"** and the "**LBHI2 Application**") and for directions within the administration of Lehman Brothers Holdings plc ("**PLC**" and the "**PLC Application**").

2. In accordance with paragraph 8(b) of the Order, Deutsche Bank has coordinated with the Joint Administrators of PLC (the "**PLC Administrators**") to avoid duplication on the LBHI2 Application.

3. The abbreviations and defined terms used by LBHI and SLP3 in their position paper dated 11 January 2019 (the "**LBHI/SLP3 Position Paper**") are adopted below.

4. This position paper addresses the issues on the LBHI2 Application and the PLC Application in the following order:

   (1) First, Issue 1 of the LBHI2 Application (*the relative ranking of the LBHI2 Sub-Notes and the LBHI2 Sub-Debt)*;

   (2) Second, Issue 1 of the PLC Application (*release of the PLC Sub-Debt)*.

   (3) Third, Issue 2 of the PLC Application (*the relative ranking of the PLC Sub-Debt and the PLC Sub-Notes)*.

   (4) Fourth, Issue 4 of the PLC Application (*discounting the quantum of PLC's liability under the PLC Sub-Notes)*;

   (5) Fifth, Issue 3 of the PLC Application (*the status and ranking of the Subordinated Guarantee*).

5. This is the most logical and efficient order in which to address the issues because:

   (1) The issues on the PLC Application may not arise at all unless it is determined under Issue 1 of the LBHI2 Application that PLC's claims in the administration of LBHI2 rank ahead of the claims of Lehman Brothers Holdings Scottish LP 3 ("**SLP3**"); and

   (2) Issue 2 of the PLC Application will not arise if it is determined under Issue 1 of the PLC Application that the claims of Lehman Brothers Holdings Inc. ("**LBHI**") have been released in full.

The LBHI2 Application – Issue 1: relative ranking of the LBHI2 Sub-Notes and the LBHI2 Sub-Debt

6. Issue 1 on the LBHI2 Application raises the following question: "*Within the administration of LBHI2, whether the claims of [PLC] under … [the LBHI2 Sub-Debt] rank for distribution before, after or pari passu with the claims of [SLP3] under the LBHI2 Sub-Notes*."

7. **In common with the position of the PLC Administrators, Deutsche Bank's position is that the claims of PLC under the LBHI2 Sub-Debt rank for distribution before the claims of SLP3 under the LBHI2 Sub-Notes.**

8. In summary, Deutsche Bank's position is that the terms of the LBHI2 Sub-Notes (as amended by the 2008 Amendments) make clear that the LBHI2 Sub-Notes rank for distribution behind the LBHI2 Sub-Debt:

   (1) If, as the PLC Administrators and Deutsche Bank contend, LBHI2's distributing administration qualifies as a winding-up for these purposes, the amended conditions of the LBHI2 Sub-Notes clearly provide that no sums are payable under the LBHI2 Sub-Notes until the LBHI2 Sub-Debt has been paid in full;

   (2) There is no basis for rectifying the 2008 Amendments because no case for rectification is made out in fact or in law; and

   (3) Even if LBHI2 is not in a winding-up for the purposes of the LBHI2 Sub-Notes, the position is the same. The 2008 Amendments did not alter the ranking of the Sub-Notes and Sub-Debt outside a winding-up, but rather reflected the existing ranking that already pertained in such a scenario under the original unamended terms of the LBHI2 Sub-Notes.

9. In light of the position adopted by the PLC Administrators, and to avoid duplication, Deutsche Bank's position is set out below on limited additional points relevant to the following matters:

   (1) First, the position if LBHI2 is in a winding-up for the purposes of the LBHI2 Sub-Notes;

   (2) Second, the position if LBHI2 is not in a winding-up for the purposes of the LBHI2 Sub-Notes;

(3) Third, the question of whether the terms of the LBHI2 Sub-Notes should be rectified; and

(4) Fourth, the relevant factual matrix and the Lehman Group's commercial purpose.

The position if LBHI2 is in a winding-up for the purposes of the LBHI2 Sub-Notes

10. Deutsche Bank agrees with the PLC Administrators that by Condition 3(a), as amended by the 2008 Amendments, the LBHI2 Sub-Notes are expressed to rank for distribution behind the LBHI2 Sub-Debt in a winding-up.

11. This expression of junior ranking is achieved by specifying that the amount payable by LBHI2 under the LBHI2 Sub-Notes is "*the amount (if any)*" that LBHI2 would (notionally) have to pay to the holder of a preference share with a right of return of assets ahead of (only) other shares and other creditors whose rights are similarly quantified as if they were preference shareholders.

12. The right to payment under the terms of the LBHI2 Sub-Debt is subordinated only to other debt obligations comprising "*Liabilities*" under the terms of the LBHI2 Sub-Debt. The LBHI2 Sub-Debt is therefore not subordinated to, and ranks ahead of, shares, including preference shares: In re Nortel GmbH [2014] AC 209, [39].

13. Since the LBHI2 Sub-Debt ranks ahead of a holder of a preference share, it follows that the LBHI2 Sub-Debt must rank ahead of the LBHI2 Sub-Notes if LBHI2 is in a winding-up.

14. Put differently, if LBHI2 is in a winding-up, then the amount payable to SLP3 as holder of the LBHI2 Sub-Notes is zero until LBHI2 has paid in full all debt ranking above preference shares, including the LBHI2 Sub-Debt.

15. There is nothing in the terms of the LBHI2 Sub-Debt that can alter this conclusion because:

(1) As set out above, the LBHI2 Sub-Notes "*are expressed to be and [...] do, rank junior*" to the LBHI2 Sub-Debt and are therefore "*Excluded Liabilities*" under the terms of the LBHI2 Sub-Debt; or

(2) Alternatively, even if (contrary to Deutsche Bank's position) the LBHI2 Sub-Notes are not Excluded Liabilities under the terms of the LBHI2 Sub-Debt, and are

instead "*Senior Liabilities*" or rank *pari passu*, there is nothing in the terms of the LBHI2 Sub-Debt that prevents it being paid in full where the amount payable under the LBHI2 Sub-Notes is zero.

The position if LBHI2 is not in a winding-up for the purposes of the LBHI2 Sub-Notes

16. Even if LBHI2 is not in a winding-up for the purposes of the LBHI2 Sub-Notes, Deutsche Bank agrees with the PLC Administrators that the PLC Sub-Notes would still rank behind the LBHI2 Sub-Debt.

17. Deutsche Bank contends that there is an additional or alternative reason the LBHI2 Sub-Notes are Excluded Liabilities under the LBHI2 Sub-Debt (and therefore rank junior to the LBHI2 Sub-Debt) even if LBHI2 is not in a winding-up within the meaning of the LBHI2 Sub-Notes. This is because:

    (1) The definition of "*Excluded Liabilities*" in the LBHI2 Sub-Debt includes Liabilities that are "*expressed to be …. junior to the* [LBHI2 Sub-Debt] *... in any Insolvency of* [LBHI2]"

    (2) The 2008 Amendments make clear that the LBHI2 Sub-Notes are expressed to be junior to all subordinated debt ranking above equity, including the LBHI2 Sub-Debt, in any winding-up or dissolution of LBHI2;

    (3) A winding-up or dissolution of LBHI2 falls within the plain meaning of "*any*" insolvency of LBHI2; and

    (4) It follows that, whether or not LBHI2 is currently in a winding-up, the 2008 Amendments express the LBHI2 Sub-Notes as Excluded Liabilities ranking junior to the LBHI2 Sub-Debt.

18. There is also a further, or alternative, basis on which the LBHI2 Sub-Notes should be treated as ranking behind the LBHI2 Sub-Debt:

    (1) The opening paragraph of condition 3(a) of the LBHI2 Sub-Notes specifies that no sums are payable under the LBHI2 Sub-Notes unless LBHI2 is "*solvent at the time of, and immediately after, such payment*" and LBHI2 "*could make such payment and still be solvent immediately thereafter*";

(2) Condition 3(b) specifies that LBHI2 will be solvent for the purposes of condition 3(a) only if, among other things, "*it is able to pay its debts as they fall due*";

(3) There is no equivalent solvency condition in the LBHI2 Sub-Debt;

(4) The conditionality in the LBHI2 Sub-Notes is consistent with and reflects the fact that the LBHI2 Sub-Notes were intended to be the most deeply subordinated form of debt of LBHI2.

(5) LBHI2 is not able to pay its debts as they fall due, not least because it has insufficient funds to pay both the LBHI2 Sub-Notes and the LBHI2 Sub-Debt in full;

(6) The conditionality in the opening paragraph of condition 3(a) continues to apply unless LBHI2 is in winding-up or dissolution; and

(7) Therefore, if (as SLP3 contends[1]) LBHI2 is not in a winding-up or dissolution, then no sums are payable under the LBHI2 Sub-Notes, at least until LBHI2 has paid all of its other debts, including the LBHI2 Sub-Debt in full.

Rectification of the LBHI2 Sub-Notes

19. Deutsche Bank agrees with the PLC Administrators that there is no legal or factual basis for the terms of the LBHI2 Sub-Notes to be rectified as SLP3 suggests or otherwise. That there was no common mistake in the drafting of the terms of the 2008 Amendments is clear from, among other matters, the fact that the FSA approved the changes to the terms, and that LBHI2 registered the changes with the relevant Channel Islands stock exchange.

20. In any event, even if grounds for rectification were made out, Deutsche Bank's position is that the Court should not exercise its discretion to rectify the LBHI2 Sub-Notes in the form contended for by SLP3 because it would be inappropriate to do so having regard to the nature of the LBHI2 Sub-Notes as freely transferable debt securities listed on a stock exchange: compare, by analogy, *BNY Mellon Corporate Trustee Services v LBG Capital No 1 plc* [2016] UKSC 29; [2016] Bus LR 725, Lord Neuberger at [31].

[1] Deutsche Bank would also observe that the analysis of SLP3 (at for example, paragraph 24(4) of the LBHI / SLP3 Position Paper) starts from the wrong premise, because SLP3 assumes that the liabilities under the LBHI2 Sub-Notes and the LBHI2 Sub-Debt are provable debts to which Rule 14.12 of the Insolvency Rules apply. Consistent with its position set out in paragraphs 61 to 62 in relation the the subordinated debt of PLC, Deutsche Bank's position is that the subordinated debts of LBHI2 are non-provable debts.

The relevant factual matrix and the Lehman Group's commercial purpose

21. In common with the PLC Administrators, Deutsche Bank's position is that the terms of the LBHI2 Sub-Notes and the LBHI2 Sub-Debt make clear that the former rank junior to the latter without the need to refer to any extraneous evidence or the factual matrix of the relevant instruments, and that it is inappropriate and unnecessary for reference to be made to any such material.

22. However, Deutsche Bank's position is that, in so far as relevant, the wider commercial context of the LBHI2 Sub-Notes and the LBHI2 Sub-Debt supports its position on the junior ranking of the LBHI2 Sub-Notes. In particular:

    (1) Although the purpose of the subordinated debt issued by LBHI2 was to provide regulatory capital to LBHI2 and, ultimately, LBIE, the relevant regulatory requirements did not require any particular ranking as between the LBHI2 Sub-Notes and the LBHI2 Sub-Debt.

    (2) However, there were important commercial and tax reasons why the LBHI2 Sub-Debt should rank in priority to the LBHI2 Sub-Notes.

    (3) The Lehman Group and LBHI had powerful commercial reasons for ensuring that the issuers of the ECAPS at all times had sufficient funds to enable them to make scheduled distributions under the ECAPS because:

        (i) The ECAPS were listed and rated securities held by external (non-Lehman) investors, including both institutional and individual investors;

        (ii) the ECAPS were issued on terms that gave the Lehman Group, and, ultimately, LBHI significant flexibility and discretion to manage any funds paid to or held by the issuers of the ECAPS;

        (iii) in particular, LBHI had the power to cause the issuers either to apply any funds they held to make scheduled distributions under the ECAPS or to suspend

distributions under the ECAPS and distribute their funds, ultimately, back to LBHI[2];

(iv) LBHI was incentivised to ensure that scheduled distributions were paid under the ECAPS because it undertook[3] not to pay any dividends or repurchase any common stock payments if payments were suspended under the ECAPS and for one year after payments resumed (the "**Dividend Stopper**");

(v) however, if the issuers of the ECAPS were ever short of funds, this would have necessarily triggered the Dividend Stopper and would have had serious adverse consequences for LBHI; and

(vi) by contrast, there was no downside to funds flowing to the issuers of the ECAPS because LBHI could always exercise its discretion to retain those sums in the Lehman Group (albeit at the cost of triggering the Dividend Stopper).

(4) In order to ensure that the issuers of the ECAPS could be kept in sufficient funds, it was necessary to ensure that LBHI2 should be able to prioritise payments under the LBHI2 Sub-Debt over payments under the LBHI2 Sub-Notes because:

(i) sums paid by PLC under the PLC Sub-Notes were the only material funds available to the ECAPS issuers;

(ii) sums received by PLC under the LBHI2 Sub-Debt were a key source of funds for PLC, in turn, to be able to fund payments under the PLC Sub-Notes to the ECAPS issuers;

(iii) by contrast, any sums paid by LBHI2 to SLP3 under the LBHI2 Sub-Notes would not be available to PLC to make payments under the PLC Sub-Notes to the issuers of the ECAPS; and

[2] Pursuant to Condition 2 of the terms of the ECAPS, the General Partner of the issuers had full discretion to publish a "*No Payment Notice*" in relation to any "*Distributions*" payable to the holders of the ECAPS, with the effect that the holders would have no right to receive those Distributions. Since LBHI ultimately controlled the General Partner, the discretion under Condition 2.4 of the ECAPS could be exercised, in practical terms, by LBHI. Further, pursuant to Condition 2, any funds held by the issuers that were not required to pay Distributions (for example, if the General Partner issued a No Payment Notice), would be paid to the Preferential Limited Partner and, ultimately, to LBHI.

[3] By clause 18.1 of the limited partnership agreements constituting the issuers of the ECAPS.

(iv) if the LBHI2 Sub-Notes rank senior to or *pari passu* with LBHI2 Sub-Debt, then LBHI2 could not prioritise payments to PLC under LBHI2 Sub-Debt over payments to SLP3 without breaching the terms of the LBHI2 Sub-Notes.

(5) There were also important tax reasons that explain why the LBHI2 Sub-Notes would have been subordinated to rank below all other liabilities of LBHI2, including the LBHI2 Sub-Debt:

(i) In order to optimise the tax treatment of the Lehman Group's regulatory capital funding structure, it was necessary for the LBHI2 Sub-Notes to be treated as equity for US tax purposes and, at the same time, as debt for UK tax purposes;

(ii) From a US tax perspective, interest received by SLP3 from LBHI2 under the LBHI2 Sub-Notes would, in certain circumstances, be treated much more favourably if it was classified as dividend income rather than interest income;

(iii) For UK tax purposes, however, it was in LBHI2's interest that the LBHI2 Sub-Notes be treated as debt and not equity, so that interest payments would be treated as an expense;

(iv) In order to achieve the Lehman Group's tax planning objectives, the LBHI2 Sub-Notes had to be structured as debt instruments that were so deeply subordinated that they would be treated as equivalent to a form of equity under US tax rules;

(v) The 2008 Amendments were therefore intended to clarify and ensure that interest payments under the LBHI2 Sub-Notes would be classified as dividend income in the hands of SLP3, whilst ensuring that the LBHI2 Sub-Notes were still treated as debt for UK tax purposes; and

(vi) There was no equivalent reason for the LBHI2 Sub-Debt to be treated as equity for US tax purposes, and so no reason for it to be subordinated to the same extent as the LBHI2 Sub-Notes.

PLC Application – Issue 1: release of the PLC Sub-Debt

23. Issue 1 on the PLC Application is: "*Within the administration of [PLC], whether the claims of [LBHI] under the [PLC Sub-Debt] have been released pursuant to [the Settlement Agreement].*"

Deutsche Bank's position

24. **Deutsche Bank's primary position is that LBHI's claims under the PLC Sub-Debt were released in full pursuant to the Settlement Agreement.**

25. If, contrary to Deutsche Bank's primary position, LBHI's claims under the PLC Sub-Notes have not been released in full under the Settlement Agreement, then **Deutsche's position is that LBHI's claims are released, discharged or diminished by the amount paid or that will be paid by LBHI in its capacity as guarantor of PLC's obligations under the PLC Sub-Debt pursuant to claims allowed by the Settlement Agreement**.

The law applicable to the Settlement Agreement

26. The Settlement Agreement is governed by New York law pursuant to the parties' choice of law under section 12.02 thereof and Article 3(1) of Regulation (EC) No 593/2008 on the law applicable to contractual obligations (Rome I).

27. Deutsche Bank will rely on expert evidence to establish the principles of contractual interpretation under New York law relevant to the meaning and effect of the Settlement Agreement, which include the following principles:

    (1) Where the written terms of a contract are clear and unambiguous, the contract should be enforced according to its terms, and extrinsic evidence is not admissible to contradict or vary the unambiguous terms of the contract. See: *Quadrant Structured Prods. Co. v. Vertin*, 23 N.Y.3d 549, 559-60 (2014); *R/S Assocs. v. New York Job Dev. Auth.*, 98 N.Y.2d 29, 33 (2002); *1701 Rest. on Second, Inc. v. Armato Props., Inc.*, 83 A.D.3d 526, 526 (1st Dep't 2011); *British Am. Dev. Corp. v. Schodack Exit Ten, LLC*, 83 A.D.3d 1247, 1249 (3rd Dep't 2011);

    (2) Consistent with the principle set out above, where it is clear that the parties have agreed to a general release, New York law will give effect to that agreement to effect a release of all claims between the parties. See: *In re Mercer*, 141 A.D.3d 594, 597 (2d Dep't 2016); *Sparacio v. Sparacio*, 283 A.D.2d 481, 483 (2d Dep't 2001); *Delaney v. County of Westchester*, 90 A.D.2d 819, 820 (2d Dep't 1982); *Centro Empresarial Cempresa S.A. v. America Movil, S.A.B.*, 929 N.Y.S.2d 3, 8 (2011); *Worldcom, Inc.*, 296 B.R. 115, 122-123 (Bankr. S.D.N.Y. 2003); *Ortiz v. City of New York*, 127 A.D.3d 671, 672 (1st Dep't 2015);

(3) Where parties have agreed to a mutual general release of claims, New York law generally treats the release as applying to all claims that are not expressly excluded in enumerated exceptions. See*: Arrowgrass Master Fund Ltd. v. Bank of New York Mellon*, 106 A.D.3d 582, 583 (1st Dep't 2013); *Coppola v. WE Magazine, Inc.*, 268 A.D.2d 303, 304 (1st Dep't 2000); *Hack v. United Capital Corp.*, 247 A.D.2d 300, 302 (1st Dep't 1998);

(4) Under New York law, when the words of a release are of general effect the release is to be construed against the releasor and the burden rests upon the releasor to establish that general language of the release was not meant to be general. See: *Mt. Read Terminal, Inc. v. LeChase Const. Corp.*, 58 A.D.2d 1034, 1035 (4th Dep't 1977); *Consorcio Prodipe, S.A. de C.V. v. Vinci, S.A.*, 544 F. Supp. 2d 178, 189-90 (S.D.N.Y. 2008); *In re Marketxt Holdings Corp.*, 361 B.R. 369, 406 (Bankr. S.D.N.Y. 2007);

(5) Under New York law, the courts will generally give effect to parties' use of broad language in formulating a release, such as "including", "any claims and causes of action", "all claims that were or could have been made", "all matters", "whether known or not known", "all manner of actions", "of any kind whatsoever", and "all claims between the parties". See: *In re Mercer*, 141 A.D.3d 594, 597 (2d Dep't 2016); *Long v. O'Neill*, 126 A.D.3d 404, 406-407 (1st Dep't 2015); *Centro Empresarial Cempresa S.A. v. America Movil, S.A.B.*, 929 N.Y.S.2d 3, 8 (2011); *Innophos, Inc. v. Rhodia, S.A.*, 38 A.D.3d 368, 369 (1st Dep't 2007), *aff'd*, 10 N.Y.3d 25 (2008); *Tavoulareas v. Bell*, 292 A.D.2d 256, 257 (1st Dep't 2002); and

(6) Only if the court first determines that the contract is ambiguous in that, on its face, its written terms are reasonably susceptible to more than one interpretation, then extrinsic evidence, including evidence of the parties' course of performance, or what is sometimes referred to under New York law as the parties' "practical construction," is admissible for the purpose of resolving an ambiguity in the written terms of the contract. *See Karol v. Polsinello*, 8 N.Y.S.3d 447, 451 (3rd Dep't 2015); *Vision Dev. Grp. of Broward Cty., LLC v. Chelsey Funding, LLC*, 43 A.D.3d 373, 374 (1st Dep't 2007); *compare Schechter Assocs., Inc. v. Major League Baseball Players Ass'n*, 256 A.D.2d 97, 97 (1st Dep't 1998) (as to the relevance of the parties' course of performance); *31-32 Gourmet Corp. v. Cable Bldg. Assocs.*, 223 A.D.2d 387, 387 (1st Dep't 1996) (as to the relevance of negotiations); *67 Wall*

St. Co. v. Franklin Nat. Bank, 37 N.Y.2d 245, 248-49 (1975) (as to the relevance of prior or contemporaneous agreements and conversations); *Evans v. Famous Music Corp*., 1 N.Y.3d 452, 459-60 (2004) (as to the relevance of industry custom or practice).

Section 8.02 of the Settlement Agreement

28. The structure of section 8.02 is as follows:

(1) The underlined words in the phrase "*Upon the occurrence of the Effective Date ... each Debtor [....], hereby fully and forever releases, discharges and acquits each Debtor Released Party ...*" provide for a condition precedent to the release by reference to a point in time: the release is effective only "*upon* (and only upon) *the occurrence of the Effective Date*";

(2) The persons effecting releases under section 8.02 are "*each Debtor*". There is no dispute that LBHI was at all material times and is a "*Debtor*";[4]

(3) The persons being released under section 8.02 are "*each Debtor Released Party*". There is no dispute that PLC was at all material times and is a "*Debtor Released Party*";[5]

(4) Certain enumerated claims are expressly carved out from the scope of the release by the words:

> "*except with respect to (1) the Allowed Claims and the Admitted Claims and any rights and distribution entitlements in respect thereof, (2) the agreements, promise, settlements, representations and warranties set for in the Agreement, (3) the performance of the obligations set forth herein and (4) the Excluded Items*".

(5) There is no dispute that the PLC Sub-Debt does not fall within any of these four expressly enumerated exceptions;

[4] Compare paragraph 37 of the LBHI Position Paper.
[5] Compare paragraph 37 of the LBHI Position Paper.

(6) The substantive scope of the release – that which is being released by each Debtor – is stated in the broadest of terms, and is defined by the words "*all Causes of Action*". Section 8.02 then specifies that Causes of Action includes:

> "*all Causes of Action … whether … accrued or unaccrued, foreseen or unforeseen, foreseeable or unforeseeable, known or unknown, matured or unmatured, fixed or contingent, liquidated or unliquidated, certain or contingent, in each case, that arise from, are based on, connected with, alleged in or related to any facts or circumstances in existence prior to the date hereof*".

(7) "*Causes of Action*" is defined in section 1.01 of the Settlement Agreement to mean "*all manners of action, causes of action, judgments, executions, debts, liabilities, demands, rights, damages, costs, rights, expenses, and claims of every kind, nature, and character whatsoever*";

(8) The closing words of section 8.02 set out a non-exhaustive list of examples of the Causes of Action included within the substantive scope of the release:

> "*including (i) any Funding Claims, (ii) any Causes of Action under chapter 5 of the Bankruptcy Code or similar actions under applicable state law, (iii) except as explicitly set forth in Section 2.04, any claims based upon an asserted right of subrogation, indemnification (whether express or implied), contribution or reimbursement, including any such claims in connection with distributions to any of the UK Affiliates or any of their creditors based upon a guarantee or similar document by LBHI or any Lehman Entity and (iv) all Causes of Action against any Debtor Released Party, arising from, in connection with, or relating to any Causes of Action against any other entity (whether or not a Party) existing as of the date hereof. For the avoidance of doubt, this Section 8.02 is without prejudice to any of the Debtors' rights or Causes of Actions against any entity that is not a Debtor Released Party"*.

29. In the premises, by section 8.02, LBHI, as a Debtor, agreed to release all Causes of Action against PLC, as a Debtor Released Party, provided only that:

(1) The "*occurrence of the Effective Date*" had occurred; and

(2) The Cause of Action arose from, was based on, was connected, alleged in or related to any facts or circumstances in existence prior to the date of the Settlement Agreement.

Section 8.02 released the PLC Sub-Debt

30. LBHI's claims under the PLC Sub-Debt are among "*all manners of action, causes of action, judgments, executions, debts, liabilities, demands, rights, damages, costs, rights, expenses, and claims of every kind, nature, and character whatsoever*." Therefore, LBHI's claims under the PLC Sub-Debt are within the scope of the defined term "*Causes of Action*" in section 8.02.

31. LBHI's claims under the PLC Sub-Debt are Causes of Action released by section 8.02 of the Settlement Agreement because:

(1) The "*occurrence of the Effective Date*" took place on 6 March 2012. Therefore, the condition precedent to the release under section 8.02 has been satisfied;

(2) Any claim in respect of the PLC Sub-Debt arises from, is based on, connected with, alleged in or related to facts or circumstances in existence prior to the date of the Settlement Agreement because such claims arise from sums advanced to PLC prior to the Settlement Agreement under facility agreements entered into prior to the Settlement Agreement;

(3) There is no other temporal restriction on the Causes of Action released by section 8.02. In particular, there is nothing in section 8.02 or in the Settlement Agreement that restricts the term "*Cause of Action*" to a Cause of Action acquired by a Debtor prior to the date of the Settlement Agreement or to a Cause of Action held by a Debtor on the Effective Date;

(4) To the contrary, section 8.02 expressly provides for the release of certain Causes of Action that could be acquired by a Debtor only after the date of the Settlement Agreement and the Effective Date.

(i) By sub-section 8.02(iii) of the Settlement Agreement, LBHI expressly agreed that the Causes of Action released included "*claims based upon an asserted right of subrogation, indemnification (whether express or implied),*

contribution or reimbursement … in connection with distributions to any of the UK Affiliates… based upon a guarantee or similar document by LBHI".

(ii) As of the date of the Settlement Agreement, it was known to all parties that LBHI had not made any distributions to its UK Affiliates based upon a guarantee or similar document because LBHI's Chapter 11 Plan, by which such distributions could be made, had not yet been confirmed;

(iii) Sub-section 8.02(iii) therefore refers to Causes of Action that LBHI could acquire by subrogation, indemnification, contribution or reimbursement only after the date of the Settlement Agreement; and

(iv) Sub-section 8.02(iii) therefore shows that the release in section 8.02 is capable of and did encompass Causes of Action acquired by a Debtor after the date of the Settlement Agreement and after the Effective Date.

(5) In *Re Professional Satellite and Communication, LLC*, 2017 WL 4286995 (S.D. Cal. Sept. 27, 2017), *appeal dismissed,* No. 17-56489, 2018 WL 1586478 (9th Cir. Mar. 13, 2018) ("*ProSat*") a court applying Californian law, which does not differ materially from New York law, held that a release in analogous terms to section 8.02 had the effect of releasing a claim that was assigned to the releasing party after the date of the settlement agreement.

32. The terms of section 8.02 are clear and unambiguous and, accordingly, extrinsic evidence is not admissible under New York law in interpreting the meaning and effect of section 8.02. However, even if extrinsic evidence were admissible, Deutsche Bank's position on the meaning of section 8.02 is further supported by the following facts and matters:

(1) The parties entered into the Settlement Agreement in the context of, and in connection with, LBHI filing and seeking approval of its Chapter 11 Plan, a key purpose of which was the full reconciliation of all intercompany and non-trading balances among the Debtors on the one hand and the Foreign Affiliates, including PLC, on the other hand, all of which were in insolvency proceedings or otherwise winding-up their businesses;

(2) A construction of the Settlement Agreement that does not have the effect of releasing any claim of LBHI in respect of the PLC Sub-Debt would undermine this fundamental commercial purpose of the Settlement Agreement by leaving in place

a substantial intercompany liability between LBHI and PLC, one of its principal Foreign Affiliates;

(3) In so far as relevant and admissible, the parties' course of performance, or "practical construction" does not support the proposition that section 8.02 was not capable of releasing Causes of Action acquired or accrued by a Debtor after the date of the Settlement Agreement and the Effective Date. By way of example:

(i) In a settlement deed dated 10 October 2014 between, *inter alia*, LBIE and LBHI, Clause 5.1.1 provided that each "*Agreed Proof Creditor's Admitted Claim is assigned to LBHI*" subject to the proviso that "*any releases in the 2011 Settlement Agreement shall not apply to the Agreed Proof Creditors' Admitted Claims*". The proviso is consistent with LBHI practically construing section 8.02 of the Settlement Agreement as applying to Causes of Action assigned to it after the date of the Settlement Agreement and the Effective Date; and

(ii) A settlement agreement dated 11 October 2011 between Deutsche Bundesbank and, among other Lehman entities, LBHI and the same Lehman "*Debtors*" as under the Settlement Agreement, (the "**DBB Settlement Agreement**"), contained a release clause in analogous terms to section 8.02 of the Settlement Agreement. Not only did the DBB Settlement Agreement involve LBHI and the same Debtors as the Settlement Agreement, but it was negotiated by the same counsel for LBHI and the Debtors and both agreements were included in the same plan supplement, and incorporated into LBHI's Chapter 11 Plan. However, the DBB Settlement Agreement expressly excluded "*future assigned*" claims from the scope of the release. This exclusion shows that where LBHI intended that a release in analogous terms to section 8.02 of the Settlement Agreement did not apply to future assigned claims, that intention was expressly recorded in the agreement.

(iii) Further, under the DBB Settlement Agreement, although DBB excluded "*future assigned*" claims from the release in favour of LBHI, LBHI did not exclude future assigned claims from the scope of the release in DBB's favour. This is not surprising and reflects the fact that LBHI was in a terminal insolvency process, whereas DBB continued to operate as a central bank. The DBB Settlement Agreement demonstrates that LBHI expressly excluded

future assigned claims where that was intended, and suggests that future assigned claims would generally fall within the release, and that LBHI did not intend to exclude the release of such claims in the Settlement Agreement.

In any event, LBHI's claims under the PLC Sub-Debt are released by the amounts paid by LBHI as guarantor of PLC's obligations pursuant to claims allowed by the Settlement Agreement.

33. If, contrary to Deutsche Bank's primary position, LBHI's claims under the PLC Sub-Notes have not been released in full under the Settlement Agreement, then Deutsche's alternative position is that LBHI's claims under the PLC Sub-Debt in the administration of PLC are released, discharged or diminished in part, as follows:

(1) LBHI guaranteed the liabilities of PLC in respect of the PLC Sub-Debt by a resolution dated 9 June 2005 (the "**LBHI Guarantee**");

(2) By section 2.04 of the Settlement Agreement, LBHI allowed a claim under the LBHI Guarantee by Lehman Brothers UK Holdings Limited ("**LBUKH**"), as original lender of the PLC Sub-Debt, in respect of PLC's liability for the PLC Sub-Debt (the "**LBUKH Allowed Claim**");

(3) LBHI has made distributions of 35.568% on Class 4B guarantee claims to date, since the LBUKH Allowed Claim is a Class 4B guarantee claim, LBHI will so far have made distributions under the LBUKH's Allowed Claim in the sum of over $216 million;

(4) The effect of such payments was to release or otherwise diminish the amount of any primary claim that may be asserted by LBHI as assignee of LBUKH under the PLC Sub-Debt in the administration of PLC: Re Blakeley (1892) 9 Morr 173 and Re Amalgamated Investment and Property Co Ltd [1985] Ch 349;

(5) Any secondary claim that LBHI may have otherwise had against PLC by subrogation, indemnification, contribution or reimbursement by reason of its payments under the LBHI Guarantee were expressly released by section 8.02(iii) of the Settlement Agreement; and

(6) Alternatively, Clause 7(f) of the terms of the PLC Sub-Debt provides for the proceeds of enforcement of any guarantee of the PLC Sub-Debt to be held on trust

for PLC. LBHI's claims under the PLC Sub-Debt therefore fall to be reduced by the amount that are or should have been held on trust for PLC.

The PLC Application – Issue 2: relative ranking of the PLC Sub-Debt and the PLC Sub-Notes

34. Issue 2 on the PLC Application is Issue 2 is:

> *"...within the administration of [PLC], whether LBHI's claims in respect of the [PLC] Sub-Debt rank for distribution before, after or pari passu with any of the claims of LB GP No 1 Limited (In Liquidation) (as General Partner of, respectively, Lehman Brothers UK Capital Funding LP, Lehman Brothers UK Capital Funding II LP and Lehman Brothers UK Capital Funding III LP) under Fixed Rate Subordinated Notes issued by [PLC] pursuant to offering circulars dated 29 March 2005, 19 September 2005, 26 October 2005 and 20 February 2006".*

35. **Deutsche Bank's position is that the claims of LB GP No 1 Limited under the PLC Sub-Notes rank for distribution ahead of the claims of LBHI under the PLC Sub-Debt.**

The terms of the PLC Sub-Debt and the PLC Sub-Notes

36. The subordination provisions under the PLC Sub-Debt are set out in Clause 5 of the Standard Terms of each loan agreement comprising the PLC Sub-Debt, and are in the same form as the subordination provisions in the LBHI2 Sub-Debt. In particular:

    (1) Clause 5(1) provides that "*the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon [...] (b) the Borrower being "solvent" at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such a payment and still be "solvent"*".

    (2) Clause 5(2) provides:

> "*…the Borrower shall be 'solvent' if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding –*
>
> *(a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and*
>
> *(b) the Excluded Liabilities.*"

(3) The following definitions used in the Standard terms are relevant:

> "*Liabilities" means all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever);*
>
> *"Senior Liabilities" means all Liabilities except the Subordinated Liabilities and Excluded Liabilities;*
>
> *"Subordinated Liabilities" means all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon;*
>
> *"Excluded Liabilities" means Liabilities which are expressed to be and, in the opinion of the Insolvency Officer of the Borrower, do, rank junior to the Subordinated Liabilities in any Insolvency of the Borrower*.

37. The subordination provisions in Condition 3 of the PLC Sub-Notes are in similar form to the provisions of the PLC Sub-Debt set out above, save that:

(1) The definition of Subordinated Liabilities in the PLC Sub-Notes is different, and provides: "*"Subordinated Liabilities" means all Liabilities to the Noteholders in respect of the Notes and all other Liabilities of the Issuer which rank or are expressed to rank pari passu with the Notes."*.

(2) Condition 3(a) of the PLC Sub-Notes opens with the following words not found in the PLC Sub-Debt: "*The Notes constitute direct, unsecured and subordinated obligations of the Issuer and the rights and claims of the Noteholders against the Issuer rank pari passu without any preference among themselves*".

<u>*The PLC Sub-Debt cannot rank pari passu with the PLC Sub-Notes*</u>

38. The terms of the PLC Sub-Notes and the PLC Sub-Debt have in common that the definition of "*Senior Liabilities*" applies to all liabilities other than "*Excluded Liabilities*" and "*Subordinated Liabilities*" such that all liabilities of PLC must fall into one of these three defined categories.

39. However, there is a significant difference in the definition of "*Subordinated Liabilities*" between the PLC Sub-Notes and the PLC Sub-Debt. In the PLC Sub-Debt, unlike in the PLC Sub-Notes, the definition of Subordinated Liabilities applies only to liabilities under

the PLC Sub-Debt, and all other liabilities (that is, other than under the PLC Sub-Debt) must therefore be either Excluded Liabilities (which rank junior to the PLC Sub-Debt) or Senior Liabilities (which rank senior to the PLC Sub-Debt).

40. In other words, the terms of the PLC Sub-Debt allow no scope for any other liability to rank *pari passu* with the PLC Sub-Debt. By contrast, the PLC Sub-Notes may rank *pari passu* with other debts that are either expressed to rank or do rank *pari passu* with the PLC Sub-Notes.

41. The effect of the different definition of Subordinated Liabilities in the PLC Sub-Debt is that the PLC Sub-Debt cannot rank *pari passu* with the PLC Sub-Notes, as LBHI contends, because its terms preclude *pari passu* ranking with any other debt. Either the PLC Sub-Notes rank senior to the PLC Sub-Debt, as Deutsche Bank contends, or the PLC Sub-Debt ranks senior (a position for which no party contends).

The circularity on the face of the PLC Sub-Debt and the PLC Sub-Notes

42. Which of the PLC Sub-Notes and the PLC Sub-Debt ranks senior and which ranks junior is not immediately clear on the face of their terms.

43. On the face of the terms of the PLC Sub-Debt, the liabilities under the PLC Sub-Notes are "*Senior Liabilities*" and rank in priority for payment by PLC. This is because:

    (1) There is no basis to treat the liabilities in respect of the PLC Sub-Notes as "*Subordinated Liabilities"* because they are not *"Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon*"; and

    (2) There is no basis to treat the liabilities in respect of the PLC Sub-Notes as "*Excluded Liabilities*" because they are not Liabilities "*which are expressed to be and in the opinion of the Insolvency Officer of [LBH], do, rank junior to [the PLC Sub-Debt] in any insolvency of [LBH]*".

44. By the same reasoning, the liabilities under the PLC Sub-Debt are "*Senior Liabilities*" on the face of the terms of the PLC Sub-Notes because they are not "*Subordinated Liabilities"* or "*Excluded Liabilities*" thereunder.

45. A literal application of these provisions would, however, lead to circularity and the absurd result that no amounts are payable under either the PLC Sub-Debt or the PLC

Sub-Notes in an insolvency because the solvency test could never be satisfied unless PLC had sufficient sums to repay the sums due under both the PLC Sub-Debt and the PLC Sub-Notes. This cannot be the effect of the parties' agreement.

Breaking the circularity

46. In common with the position adopted by the Joint Liquidators of LB GP No 1 Limited, DB's position is that the PLC Sub-Notes rank senior to the PLC Sub-Debt. As set out below, Deutsche Bank contends that the circularity should broken by a different legal mechanism to the mechanism proposed the Joint Liquidators. However, the effect of the position adopted is the same.

47. Deutsche Bank's position is that the circularity should be broken by:

    (1) Construing the PLC Sub-Debt and/or the PLC Sub-Notes to give effect to what the parties would objectively have intended if they had contemplated the relative ranking of the PLC Sub-Debt and the PLC Sub-Notes, namely that the PLC Sub-Notes must rank senior to the PLC Sub-Debt so as to avoid the possibility that neither would ever be paid: Astor Management AG and ors v Atalaya Mining Plc and ors [2018] EWCA Civ 2407; Arnold v. Britton [2016] AC 1619; alternatively

    (2) Implying a term into one or both of the PLC Sub-Debt and the PLC Sub-Notes (on the basis that such a term is obvious, or necessary in order to make the contract work and give it commercial and practical coherence: Marks and Spencer Plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd [2016] AC 742, or on the basis that such a term must be implied to avoid the contract being incomplete in the absence of such a term: Liverpool City Council v Irwin [1977] A.C. 239).

48. To give effect to what the parties would objectively have intended, it is necessary to construe the terms of the PLC Sub-Debt and the PLC Sub-Notes such that the PLC Sub-Notes rank ahead of the PLC Sub-Debt. Alternatively, the term to be implied should be of like effect.

49. This would reflect objectively what would have been agreed on the issue of ranking by reasonable persons in the position of the parties to the PLC Sub-Debt and the PLC Sub-Notes, in light of (i) the absence of a provision providing for the PLC Sub-Debt to rank *pari passu* with other debt; (ii) the timing of the issuing of the PLC Sub-Debt and PLC

Sub-Notes; and/or (iii) the context of the Lehman Group as a whole, and its tax and commercial objectives.

50. As regards the absence of a provision providing for the PLC Sub-Debt to rank *pari passu* with other debt, see above at paragraphs 38 to 41.

51. As regards timing:

(1) The first two PLC Sub-Debt facility agreements were entered into on 30 July 2004 at a time before the PLC Sub-Notes were issued.

(2) In order to achieve Tier 2 or 3 status for regulatory capital, the FSA required the PLC Sub-Debt to be documented using their standard template and subordinated to all unsubordinated creditors of PLC. However, the FSA did not prescribe how the loans should rank as against other subordinated creditors;

(3) The PLC Sub-Notes were issued (between March 2005 and February 2006) after the date of the first two of the three PLC Sub-Debt facility agreements. The subordination language of the PLC Sub-Notes departed from the then applicable FSA standard template to allow it to rank senior, junior or *pari passu* with other indebtedness. However, no express reference was made to then existing PLC Sub-Debt as being debt that ranked *pari passu* with, or senior to, the PLC Sub-Notes. The only logical conclusion is that the PLC Sub-Debt was thought to be the most deeply subordinated debt issued, ranking junior to the PLC Sub-Notes; and

(4) The final PLC Sub-Debt facility agreement was entered into on 30 October 2005, being after the first two PLC Sub-Debt facilities agreements and the PLC Sub-Notes, and at a time when the parties were aware that language allowing subordinated debt to rank *pari passu* had been included in the PLC Sub-Notes and was permitted by the FSA. However, PLC and LBUKH chose not to include any language in the third PLC Sub-Debt facility agreement to allow it to rank pari passu with other subordinated debt. This choice is consistent only with an intention to maintain (and replicate) the deeply subordinated status of the existing PLC Sub-Debt, such that all of the PLC Sub-Notes rank senior to the PLC Sub-Debt.

52. As regards the tax and commercial objectives of the Lehman group:

(1) As set out at paragraph 22(3) above, the Lehman Group had strong commercial reasons to prioritise payments to the issuers of the ECAPS under the PLC Sub-Notes over payments under the PLC Sub-Debt to avoid the mandatory operation of the Dividend Stopper and to retain the flexibility and discretion on funding intended under the ECAPS;

(2) In addition, the Lehman Group received detailed tax advice that PLC should take all commercially reasonable steps to avoid the suspension of interest on the PLC Sub-Notes;

(3) The only way to enable PLC to prioritise payments under the PLC Sub-Notes was for the PLC Sub-Notes to rank in priority to the PLC Sub-Debt, and any other ranking would jeopardise the commercial and tax planning objectives of the Lehman Group;

(4) If the PLC Sub-Debt and PLC Sub-Notes ranked *pari passu*, as LBHI contends, then a shortage of funds at PLC would require PLC to default on both the PLC Sub-Notes and the PLC Sub-Debt, because both would be payable at the same time and could not be paid in full;

(5) If the PLC Sub-Debt ranked senior, the Dividend Stopper would be triggered, and the tax status of the PLC Sub-Notes would be jeopardised in a cash constrained scenario because PLC could not make payments under the PLC Sub-Notes unless sums payable under the PLC Sub-Debt could be paid in full; and

(6) In all the circumstances, the only commercially reasonable structure is that the PLC Sub-Notes rank in priority to the PLC Sub-Debt, and that is what reasonable parties to the LBHI2 Sub-Debt and the LBHI2 Sub-Notes would have agreed.

The PLC Application – Issue 4: discounting the quantum of PLC's liability under the PLC Sub-Notes

53. Issue 4 on the PLC Application is: *"Within the administration of [PLC], whether or not the quantum of [PLC's] liability under the [PLC] Sub-Notes for distribution purposes falls to be discounted under Rule 14.44 of the Insolvency (England and Wales) Rules 2016, or by reference to some other method and if so which method."*

Deutsche Bank's position

54. **Deutsche Bank's primary position is that the quantum of PLC's liability under the PLC Sub-Notes for distribution purposes does not fall to be discounted under Rule 14.44 of the Insolvency (England Wales) Rules 2016 (*the "Rules"*) or otherwise because PLC's liability is not, or should not be treated, as a future debt.**

55. **Alternatively, Deutsche Bank's position is that:**

    (1) **In any event, PLC's liability under the PLC Sub-Notes, even if a future debt, is a non-provable debt and therefore Rule 14.44 of the Rules is of no application;**

    (2) **To the extent that PLC's liability under the PLC Sub-Notes is non-provable, it is either incapable of being subjected to a discount, alternatively can only be discounted at an appropriate commercial rate (being the Fixed/Floating 15 year Swap Rate , currently 1.0016% p.a.); and**

    (3) **If PLC's liability under the PLC Sub-Notes is treated as a future debt or liability for distribution purposes and subject to discounting (whether as a provable or non-provable debt or liability), PLC's liability for future interest in respect of the PLC Sub-Notes should also be admitted or accepted for distribution purposes, and subject to discounting in the same way (whether as a provable or non-provable debt or liability).**

Deutsche Bank's primary position: the liability under the PLC Sub-Notes is not a future debt

56. On the true construction of the PLC Sub-Notes, and subject at all times to the subordination provisions in Condition 3, any claim for principal against the Issuer should be admitted or accepted for its full face amount as a form of current debt or liability of the Issuer (whether provable or non-provable), and should not be discounted for the purpose of dividend or payment. In particular:

    (1) The Conditions of the PLC Sub-Notes anticipate either redemption at term or immediate redemption at the full face amount of the Notes:

        (i) Condition 6(a): "*Scheduled Redemption: Unless previously redeemed, or purchased or cancelled, the Notes will be redeemed at their principal amount*

on 30th March (the "Maturity Date") subject as provided in Condition 3 (Status and Subordination) and Condition 7 (Payments)";

(ii) Condition 6(c): "*Redemption at the option of the Issuer: The Notes may be redeemed at the option of the Issuer in whole, but not in part, at any time on or after 30th March 2010 (the date of redemption being the "Call Settlement Date") at a redemption price equal to 100 per cent. of their principal amount plus accrued interest (if any) up to but excluding the Call Settlement Date on the Issuer's giving not less than 15 nor more than 30 days' notice to the Noteholders (which notice shall be irrevocable and shall oblige the Issuer to redeem the Notes on the Call Settlement Date at such price plus accrued interest to such date)*";

(2) No other form of redemption was contemplated as possible. Condition 6(d) provides "*No other redemption: the Issuer shall not be entitled to redeem the Notes otherwise than as provided in paragraphs (a) (Scheduled Redemption) to (c) Redemption at the option of the Issuer) above."* (Condition 6(b) being concerned with redemption for tax reasons);

(3) If and to the extent that there is to be redemption or payment of the Sub-Notes in a distributing insolvency of the Issuer otherwise than at term, such redemption or payment amounts to redemption at the option of the Issuer for the purpose of Condition 6(c) on its true construction (being the contractual construction that is most consistent with commercial common sense): Wood v Capita Insurance Services Ltd [2017] AC 1173; Rainy Sky SA v Kookmin Bank [2011] 1 WLR 2900; In re Sigma Finance Corporation (in administrative receivership) [2010] 1 All ER 571;

(4) Alternatively, a distributing insolvency process in respect of the Issuer was neither intended nor contemplated in the drafting of Condition 6. It is clear from the terms of the PLC Sub-Notes on their true construction that the parties would have intended that the Sub-Notes could only be treated as currently payable for the full face amount of principal payable in such circumstances: Arnold v Britton [2016] AC 1619; Astor Management AG and ors v Atalaya Mining Plc and ors [2018] EWCA Civ 2407;

(5) In the further alternative, it is an obvious implied term of the Notes, alternatively necessary in order to make the contract work and give it commercial and practical coherence, that the amounts payable thereunder become immediately due and payable in their full face value amount in circumstances where PLC has entered a distributing administration, subject at all times to the subordination provisions in Condition 3: Marks and Spencer Plc v BNP Paribas Securities Services Trust Co (Jersey) Ltd [2016] AC 742;

(6) In the further alternative, any attempt to redeem or pay the PLC Sub-Notes other than in accordance with Conditions 6(a)-(c) is a repudiatory breach of Condition 6(d) and the Conditions generally, such that the holder of the Sub-Notes is entitled to accept the repudiation and prove for damages in an amount equivalent to the full face value amount of the PLC Sub-Notes.

57. All of the above alternative constructions of the PLC Sub-Notes are consistent with the regulatory regime existing at the time that the PLC Sub-Notes were issued, and the requirements for subordinated loan capital as set out in Chapter 10, Rule 10-63 of the FSA Interim Prudential Sourcebook: Investment Business ("**IPRU Inv**"). In particular, no part of the regulatory regime or IPRU Inv necessitated that the PLC Sub-Notes be treated as outstanding as future debts, and be capable of satisfaction by the Issuer on a discounted basis, in a distributing insolvency once the subordination provisions were otherwise satisfied.

58. Furthermore, the above constructions of the PLC Sub-Notes also avoid a form of one way bet, which is the outcome for which LBHI in substance contends. On LBHI's case, the PLC Sub-Noteholders are prevented from accelerating their notes in a winding-up or distributing process. Any claim therefore remains a long-dated future debt that PLC is entitled to satisfy on a discounted basis in a distributing winding-up once the subordination provisions are otherwise satisfied, and irrespective of whether or not there are sufficient funds to discharge the full principal amounts of such debts. In a solvent scenario, such an interpretation of the PLC Sub-Notes would, notwithstanding the clear intention that early redemption would be at full face value (see Condition 6, above), enable all of the surplus monies remaining after payment of the PLC Sub-Noteholders on a discounted basis to be paid over to the equity holders, even if winding-up (including on a voluntary basis) intervened shortly after the PLC Sub-Notes had been issued. The requirements of regulatory subordination did not require such an uncommercial outcome.

59. If the PLC liability under the PLC Sub-Notes is presently due, it is irrelevant whether or not the debt is provable or non-provable. No discounting for futurity can be applied and it must be paid in full prior to any payment being made to lower ranking liabilities or *pari passu* with equal ranking liabilities.

60. Alternatively, in order to avoid unfair harm and unfairness generally to the holders of the PLC Sub-Notes, the Joint Administrators should act (and be directed to act) so as to make the PLC Sub-Notes currently due in their full face amount. A failure to do so would lead to enforcement of legal rights in a manner contrary to natural justice; less favourable treatment of, or discrimination against the interests of, the holders of the PLC Sub-Notes; and conduct which is obviously unjust, unconscionable, dishonourable, perverse or lacking sufficient commercial justification for causing harm to the creditors as a whole by subverting the intended ranking and treatment of the holder of the PLC Sub-Notes: paragraph 74 of Schedule B1 to the Insolvency Act 1986; Re Meem SL Ltd [2018] Bus LR 393; Hockin v Marsden [2014] Bus LR 441; Re LBIE (Waterfall IIB) [2015] BPIR 1162; Re Nortel GmbH [2014] AC 209; Ex parte James (1873-74) LR 9 Ch App 609.

PLC's liability under the PLC Sub-Notes, even if a future debt, is a non-provable debt

61. PLC's liability under the PLC Sub-Notes can only be paid after all provable debts and statutory interest have been paid. Because statutory interest can only be calculated and paid after payment of all provable debts, PLC's liability under the PLC Sub-Notes is necessarily classified as a non-provable debt or liability in respect of which Rule 14.44 is inapplicable: see In re Nortel GmbH [2014] AC 209; In re Lehman Bros (Europe) (No 4) ("Waterfall I") [2018] AC 465. In particular:

    (1) The subordination provisions in Condition 3 mandate payment in respect of the Notes after all Senior Liabilities, being all Liabilities other than the Subordinated Liabilities and Excluded Liabilities;

    (2) Other Liabilities will therefore include any Statutory Interest, postponed debts, and other non-provable claims;

    (3) Effective subordination may include provisions which provide for a "*different distribution*" in insolvency provided that the creditor in question ranks lower in the waterfall than the law otherwise provides: Waterfall I at [66];

(4) Conditions 3 and 9 operate to preclude any claim being made in respect of the Notes until all statutory interest and non-provable liabilities have been paid in full (or it is clear that they will be paid in full): see, by analogy, Waterfall I at [69] and [70]);

(5) The effect of the subordination provisions set out in the Notes is that, on the proper construction of the Notes, any claim in respect thereof is non-provable in the insolvency of PLC: see, by analogy, the comments of Lord Neuberger in Waterfall I at [71] ("*On the face of it at any rate, it seems a little strange that a proof can be, or has to be, lodged for a debt which ranks after statutory interest (which can only be paid out of a "surplus") and non-provable liabilities. It may be that the proper analysis is that the subordinated debt is a non-provable debt which ranks after all other non-provable liabilities. It is unnecessary to decide that point, and, as it was not argued, I say no more about it.*");

(6) The comments made by Lord Neuberger in both [70] and [72] of Waterfall I, to the effect that the subordinated debt in question was provable, were premised on an assumption, which assumption it was not necessary for the Supreme Court to resolve: Waterfall I at [71] (above), [70] ("… *subject to what I say in the next paragraph"), and [72] ("assuming that they can prove*"). It was not necessary to resolve the issue in Waterfall I because, provided that the subordinated debt was treated as not payable until after statutory interest and any non-provable liabilities of LBIE had been paid in full, it made no difference whether the subordinated debt was treated as a provable or non-provable debt for the purpose of the Rules; and

(7) If, as Deutsche Bank contends, the liability under the PLC Sub-Notes is a non-provable debt or liability, Rule 14.44 of the Rules can be of no application (because the claim is not a provable debt to which Rule 14.44 applies).

62. Treating any liability under the PLC Sub-Notes as a non-provable debt or liability is equally consistent with the regulatory regime and provisions of IPRU Inv existing at the time that the PLC Sub-Notes were issued, and the intended treatment of any such liability as subordinated loan capital equivalent to a form of equity, that can only be dealt with in a winding-down of the regulated entity after all other debts, including non-provable debts have been paid in full..

Discounting of a non-provable debt

63. There is no mechanism for subjecting future non-provable debts or liabilities to discounting. Any claim in respect of the PLC Sub-Notes is not therefore subject to discounting, and (absent disclaimer or agreement with the creditor) should, insofar as assets are available, be reserved for in full so as to enable debt or the liability to be discharged in due course: see, by analogy, Gooch v London Banking Association [1985] 32 Ch 41, Oppenheimer v British and Foreign Exchange and Investment Bank (1877) 6 ChD 744 and Midland Coal, Coke and Iron Company [1895] 1 Ch 267.

64. If, contrary to Deutsche Bank's position set out at paragraph 63, the amount of any claim in respect of the PLC Sub-Notes is to be subject to discounting in respect of the amount of any future element of the claim referable to principal (for any period after the date of anticipated distribution in respect of the Notes until the contractual term of the Notes), such discounting should be at an appropriate commercial rate and not the rate provided for by Rule 14.44 of the Rules: see, by analogy, Moschi v Lep Air Services [1973] AC 331; Re Park Air Services [2000] 2 AC 172 and the Cork Report 1982 (Cmnd 8558) at [1390]. The appropriate commercial rate would be the Fixed/Floating 15 year Swap Rate, currently 1.0016% p.a.

Admitting PLC's liability for future interest in respect of the PLC Sub-Notes for distribution

65. A claim reflecting the liability for such future interest should be admitted or accepted for distribution purposes to reflect the contractual right to interest payable prior to the date at which the debt would otherwise have fallen due: Re Browne and Wingrove Ex parte Ador [1891] 2 QB 574, Re Theo Garvin [1969] 1 Ch 624, Re Amalgamated Investment & Property Co Ltd [1985] Ch 349, McPherson's Law of Company Liquidation at [12-019] and Palmer's Company Law at [14.313].

66. If, contrary to Deutsche's primary case above, PLC's liability to pay principal under the PLC Sub-Notes is treated as a future provable debt, then PLC's liability to pay interest under the PLC Sub-Notes is also a provable debt, and is not to be treated as interest bearing on a debt proved for the purpose of Rule 14.23 on its true construction. Interest bearing on a debt proved is limited to interest payable on the debt proved once it has fallen due. Any other construction of the Rules, or approach to non-provable debts, is commercially nonsensical. It equates the position of the holder of an interest bearing debt with the position of the holder of a non-interest bearing debt, and deprives the holder of

the Notes of the ability to prove and be compensated for its full range of contractual rights.

The PLC Application – Issue 3: the subordinated guarantees

67. Issue 3 on the PLC Application is: "Within the administration of [PLC], whether any liability of [PLC] which might be established under guarantees given by [PLC] by Deeds of Guarantee in favour of "Holders" (as defined in each Deed of Guarantee) (the "**PLC Guarantees**") of certain preferred securities issued by each of [the Partnerships] in the context of the… [LBH Sub-Notes]… [(the "**[PLC] Guarantee Liabilities**")] rank for distribution before, after or pari passu with each of the [PLC Sub-Debt] and [PLC Sub-Notes]"

Deutsche Bank's position

68. **Deutsche Bank's position is that the PLC Guarantees have not been terminated and remain in effect, but are subordinated to both the PLC Sub-Notes and the PLC Sub-Debt.**

The Deeds of Guarantee

69. The PLC Guarantees guarantee, under Clause 2.1, the "Guaranteed Payments" as and when due which includes, *inter alia*, the "Optional Redemption Price". The Optional Redemption Price is the Liquidation Preference as defined by the relevant Preferred Securities. Consistent with DB's position with respect to Issue 4 on the PLC Application, which is that any claim for principal in respect of the PLC Sub-Notes should be admitted or accepted for its full face amount as a form of current debt or liability of the Issuer, the PLC Sub-Notes are or will be "*redeemed at the option of the Guarantor… at the Optional Redemption Price*" (see Clause 4.2 of the relevant Limited Partnership Agreements).

70. The PLC Guarantees remain in effect because:

    (1) Termination under Clause 4.3 of the PLC Guarantees does not refer to accrued liabilities or require that accrued liabilities fall away. This is the only possible construction of Clause 4.3 as Clause 2.4(d) states that the obligations of the Guarantor are not affected or impaired by the "*voluntary or involuntary winding-up, dissolution… or other similar proceedings affecting, the Issuer or any of the assets of the Issuer*." This is further supported by the proviso in Clause 4.3, which states that the guarantee "*will continue to be effective or will be reinstated, as the*

case may be, if at any time payment of any sums paid in respect of the Preferred Securities or under this [PLC Guarantee] must be restored to a Holder for any reason whatsoever".

(2) Further, the reference in Clause 4.3 to dissolution can only mean the completion of the dissolution, not the commencement of dissolution, as this is the only possible reading of Clause 4.3 that is consistent with the wording of Clause 2.4(d) referenced above.

71. The PLC Guarantees are subordinated to both the PLC Sub-Notes and the PLC Sub-Debt by the plain wording of the PLC Guarantees:

(1) Clause 2.9(a) of the PLC Guarantees provides that the PLC Guarantee Liabilities rank "*junior to all liabilities of the Guarantor including subordinated liabilities (… other than…Tier 1 Capital or [any liability] which is referred to in [Clause 2.9(b) or (c)] and any other liability expressed to rank pari passu with or junior)*".

(2) Neither of the PLC Sub-Notes or PLC Sub-Debt are Tier 1 Capital. Clause 2.9(c) refers to share capital of PLC, which ranks behind the PLC Guarantees. Clause 2.9(b) of the PLC Guarantees provides that the PLC Guarantee Liabilities rank *pari passu* with Parity Securities, and Parity Securities include guarantees in respect of other Preferred Securities. Accordingly, the PLC Guarantees are junior to the subordinated debt under the PLC Sub-Notes and PLC Sub-Debt.

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