Case No: CR-2008-000026

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

IN THE MATTER OF LEHMAN BROTHERS HOLDINGS PLC (IN ADMINISTRATION)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

B E T W E E N:

THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS HOLDINGS PLC (IN ADMINISTRATION)

Applicants

-and-

(1) LB GP NO 1 LIMITED (IN LIQUIDATION)
(2) LEHMAN BROTHERS HOLDINGS INC.
(3) DEUTSCHE BANK A.G. (LONDON BRANCH)

Respondents

POSITION PAPER OF THE JOINT LIQUIDATORS OF LB GP NO 1 LIMITED (IN LIQUIDATION)

Introduction

1. This Position Paper is filed on behalf of the Joint Liquidators ("the **JLs**") of LB GP No. 1 Limited (in liquidation) ("**GP1**"), in accordance with paragraph 2 of the 4 May 2023 Order of Mr Justice Hildyard, to outline GP1's position on:

   1.1 the application brought by the Joint Administrators ("**JAs**") of Lehman Brothers Holdings plc ("**PLC**") dated 14 March 2023 ("the **Directions Application**");

   1.2 PLC's further application dated 25 April 2023 ("the **Distribution Application**"); and

   1.3 the application brought by the Third Respondent, Deutsche Bank ("**DB**") dated 27 April 2023 ("the **Strike-Out Application**"). (Together, "the **Applications**").

2. The Applications arise in consequence of the Court of Appeal's judgment in these proceedings in *Lehman Brothers Holdings Scottish LP 3 v Lehman Brothers Holdings Plc (In Administration)* [2021] EWCA Civ 2523; [2022] Bus. L.R. 10, following an earlier application for directions by PLC ("**ECAPS 1**"). That was an appeal from the first instance decision of Marcus Smith J ([2020] EWHC 1681 (Ch)).

3. The Court of Appeal:

   3.1 Held that GP1's claims against PLC on the PLC Sub-Notes ("**Claim D**") take priority over the claim against PLC on the PLC Sub-Debts ("**Claim C**") held by Lehman Brothers Holding Inc. ("**LBHI**").

   3.2 Did not upset the decision of Marcus Smith J at first instance (at [122(2)]) that effective subordination clauses (as contained in both Claim C and Claim D) *"must render the creditor unable to prove at least until the obligations prior to that debt have been satisfied in full"* (emphasis in original).

4. In addition, and as declared by consent by Marcus Smith J at first instance, any liability of PLC under ECAPS Guarantees for the benefit of ECAPS holders ("**Claim E**") ranked for distribution after Claim D and Claim C.

Directions Application

5. There are five issues to be determined in this application (referred to as the "**Priority Legal Issues**"). In outline, GP1's position on those issues (which is expanded upon below) is:

   (1) **Issue 1**: Statutory interest payable on the claim in respect of Claim D falls to be paid in priority to the payment of the principal amount of Claim C.

   (2) **Issue 2**: Statutory interest payable on the claim in respect of Claim D falls to be calculated by reference to the face value amount of the PLC Sub-Notes.

   (3) **Issue 3**: Statutory interest on the claim in respect of Claim D begins on the date on which PLC entered into administration.

   (4) **Issue 4**: On its true construction, clause 2.11 of the ECAPS Guarantees does not impose on the Holder (as defined) a trust in respect of any proceeds which have been distributed by PLC to GP1, or distributed onwards by GP1.

   (5) **Issue 5**: To the extent that proceeds are turned over to PLC by the Holder pursuant to clause 2.11 of the ECAPS Guarantees, this does not alter the priority as between Claim D and Claim C.

6. By the Strike-Out Application, DB contends that it is not open to LBHI to advance a contrary position on Issues 1, 3, 4 and 5, on the basis that it is estopped or otherwise prevented by the doctrine of *res judicata* from doing so or, alternatively, would be an abuse of process for it to do so now, given the issues argued and the judgments of Marcus Smith J and the Court of Appeal in

ECAPS 1, which are final after the Supreme Court denied permission for a second appeal. GP1 agrees with and supports DB's position on that Strike-Out Application. In the interests of avoiding duplication, however, GP1 leaves it to DB to advance those arguments. Logically, the Strike-Out Application falls to be determined before the substance of those four issues.

7. GP1 recognises, however, that the Court is likely to want to determine all issues on their merits in any case – even if (in the event that the Strike Out Application is successful) only in the alternative.

<u>ISSUE 1</u>: Whether the principal amount of the PLC Sub-Debt (Claim C) falls to be paid in priority to statutory interest payable on the claim in respect of the PLC Sub-Notes (Claim D), or vice versa.

8. GP1's position is that statutory interest payable in relation to the PLC Sub-Notes (Claim D) is to be paid in priority to the principal amount of the PLC Sub-Debt (Claim C).

9. The starting point is the wording of r.14.23(7) of the Insolvency Rules 2016 ("**IR 2016**"), which provides that:

> *"In an administration—*
>
> *(a) any surplus remaining after payment of the debts proved must, before being applied for any other purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the relevant date;*
>
> *(b) all interest payable under sub-paragraph (a) ranks equally whether or not the debts on which it is payable rank equally; and*
>
> *(c) the rate of interest payable under sub-paragraph (a) is whichever is the greater of the rate specified under paragraph (6)* [i.e. that specified under section 17 of the Judgments Act 1838] *and the rate applicable to the debt apart from the administration."*

10. The reference to "*interest*" in r.14.23(7)(a) is to statutory interest.

11. LBHI's position is that the effect of r.14.23(7)(b) is that all statutory interest must be paid at the same time, such that statutory interest is paid at the same time on all subordinated debts regardless of how they rank relative to each other. LBHI's case is that the principal of all the subordinated debts must be paid prior to the payment of statutory interest.

12. LBHI's position is wrong. Just as a subordinated creditor may contractually agree to demote its ranking relative to the *pari passu* principle in Rule 14.12 of the statutory "waterfall", a subordinated creditor may likewise demote its ranking relative to the *pari passu* entitlement to statutory interest in Rule 14.23(7)(b), notwithstanding that statutory interest is a purely statutory entitlement:

12.1 In *Waterfall I*, Lord Neuberger held that statutory interest on unsubordinated liabilities was a liability falling within the definition of "*Senior Liabilities*" in the subordinated instruments there under consideration. *Waterfall I* was a decision reached by Lord Neuberger on the basis of the language of the standard FSA form subordination provision which is identical to the relevant subordination terms in the PLC Sub-Debts giving rise to Claim C. Lord Neuberger concluded that statutory interest on an unsecured debt was a "*Liability*" capable of being established in the insolvency of the borrower such that the solvency condition in the terms of the debt subordinated to such Senior Liabilities could not be met until the statutory interest on the Senior Liability had been discharged (see [56] & [65]-[66]). Accordingly, statutory interest on unsubordinated provable debts ranked in priority over the repayment of the principal amount of subordinated debt.

12.2 By parity of reasoning, that finding on the relative priority of statutory interest in relation to unsubordinated debts also applies *within* subordinated debts of different relative priority.

12.3 The effect of subordination is to prevent subordinated debts from being proved until senior liabilities have been paid in full (*Waterfall I* ([2017] UKSC 38) at [68] to [72], considered by Marcus Smith J in *ECAPS 1* at first instance at [122]). The subordinated debt remains a provable debt, but the proof of debt cannot be lodged until debts with priority and statutory interest on them have been paid. Similarly, more deeply subordinated debts that stand even further back in the queue cannot prove until subordinated liabilities senior to them have been satisfied in full, including payment of statutory interest. In *ECAPS I*, the Court of Appeal found that Claim D falls within the definition of "*Senior Liabilities*" from the perspective of Claim C's subordination provision, and Claim C has therefore agreed to stand even further back in the queue relative to Claim D.

12.4 Just as it is possible to create debts that are subordinated to unsubordinated liabilities, it is also possible to create subordinated debts that are subordinated to other subordinated debts (i.e. subordination both between and *within* categories of obligation; see Marcus Smith J at [123]). Put another way, it is possible for subordinated debts to have relatively different priorities as between themselves: Claim C is in exactly the same position *vis-à-vis* Claim D as Claim D is *vis-à-vis* the unsubordinated creditors.

12.5 In exactly the same way as Claim D cannot prove or be paid until statutory interest on unsubordinated debts has been satisfied in full, Claim C should not be entitled to prove or be paid until statutory interest on Claim D has been satisfied in full.

12.6 The definition of "*Subordinated Liabilities*" in Claim D includes "all Liabilities to the Noteholders in respect of the Notes". The broad definition of "*Liabilities*" in Claim D includes statutory interest, consistent with the determination in *Waterfall I*. The Court of Appeal has already held that *"Claim D must be paid in priority to Claim C"* (*ECAPS I* at [92]). Since Claim D includes statutory interest, the inquiry is over.

13. Further:

13.1 Even if the definition of "*Subordinated Liabilities*" in Claim D somehow excludes statutory interest on Claim D (and it does not) the operative subordination provision in Claim C still demotes its ranking and entitlement to prove behind the priority payment of statutory interest on Claim D. Since the definition of "*Subordinated Liabilities*" in Claim C references only the PLC Sub-Debt (i.e. Claim C itself) and cannot tolerate *pari passu* liabilities, Claim C can only have priority over "*Excluded Liabilities*", defined as liabilities which are *"expressed to be and, in the opinion of the Insolvency Officer, do rank junior to the Subordinated Liabilities in an Insolvency"*.

13.2 As the Court of Appeal explained, *"Unless the rights under Claim D are 'expressed to be junior' to the rights under Claim C, they will not be Excluded Liabilities"* (*ECAPS I* at [86]). Nowhere in Claim C's contractual subordination provision is statutory interest *"expressed to be"* junior to Claim C. On the contrary, the Court of Appeal held that Claim D is a "*Senior Liability*" from the perspective of Claim C's subordination provision, and statutory interest is included within Claim C's definition of "*Liabilities*". LBHI improperly seeks to read into the contract an implied term of expression by referencing the default statutory rule in 14.23(7)(b). This argument fails.

14. Further, the mechanism of contractual subordination is not inconsistent with a proper construction of r.14.23(7)(b), based on when subordinated provable debts are entitled to prove:

14.1 The surplus referred to in r.14.23(7)(a) is from funds remaining after the payment of debts which have been proved: "*any surplus remaining after payment of the debts proved"*.

14.2 It follows that the remainder of r.14.23(7)(a), which relates to the payment of interest on "*those debts*" before the surplus can be otherwise used, must refer to debts which have already been proved.

14.3 The effect of subordination is to prevent subordinated debts from lodging a proof until senior liabilities have been paid in full.

14.4 It follows that Claim C is not a "*debt proved*" within the meaning of 14.23(7)(a), and the surplus which remains once Claim D has been paid must be applied first to paying statutory interest on Claim D. Only after that interest has been satisfied in full will Claim C be entitled to prove.

ISSUE 2: Whether statutory interest payable on the claim in respect of the PLC Sub-Notes falls to be calculated by reference to the face amount, or the discounted amount pursuant to Rule 14.44 of the IR 2016, of the PLC Sub-Notes.

15. The JLs' position is that statutory interest payable on Claim D falls to be calculated by reference to the face amount of the PLC Sub-Notes.

Limited application of Rule 14.44 does not apply to statutory interest

16. R.14.44(2) IR 2016 provides that:

> *"For the purpose of dividend (and no other purpose) the amount of the creditor's admitted proof must be discounted by applying the following formula…"*

17. The wording of r.14.44(2) clearly and unambiguously provides that that rule applies only for the *"purpose of dividend"* on a creditor's admitted proof of debt. The application of a surplus under r.14.23(7), however, is a distribution not a "*dividend*", and so payment is not made by reference to the discounted amount of the proof:

17.1 There is no use of the term "*dividend*" in rule r.14.23(7).

17.2 The Insolvency Act 1986 ("**IA 86**") and IR 2016 distinguish between "*dividends*" and "*distributions*": see, for example, IA 86, Sched. B1, paragraph 65(1), r.14.28(1) IR 2016, r.14.29(1) IR 2016, r.14.30(a) IR 2016, r.14.35(4). As such, there is a difference between dividends, which are paid on proved debts, and distributions, which are made in other circumstances such as making a distribution of a fixed settlement sum to a creditor as opposed to a payment of a dividend: *Re HPJ UK Ltd (in administration)* [2007] BCC 284 at [11]; or, as in this case, a payment from the surplus of an estate after dividends have been paid in full.

17.3 In *Waterfall IIA* (*Re Lehman Brothers International (Europe) (In Administration)* [2015] EWHC 2269 (Ch)), David Richards J drew a distinction between the *"final dividend"* and *"Statutory Interest"* (at [185], emphasis added), implying that statutory interest is something other than a dividend. Rather, statutory interest is a *"purely statutory entitlement arising once there is a surplus and payable only out of that surplus."* (*Waterfall IIA* at [149]).

R.14.44 is self-contained

18. Further and alternatively, even if the payment of statutory interest is considered a "*dividend*", the discounting exercise in r.14.44(2) IR 2016 applies only to the principal debt proved in accordance with r.14.44(1), not to the payment of statutory interest on that proved debt:

    18.1 R.14.44(1) sets out a creditor's entitlement to a dividend on a proven debt payable at a future time. Pursuant to the rule, a creditor is entitled to the dividend, but "*subject as follows*" to the remaining provisions of rule 14.44.

    18.2 R.14.44(2) then sets out the limitations imposed on the dividend envisaged by r.14.44(1), which is the only other provision of r.14.44. R.14.44(2) provides the discounting formula by which the admitted proof of debt must be modified for payment of the dividend. As such, r.14.44(1) is "*subject*" to the qualification in r.14.44(2).

    18.3 Thus r.14.44(2) must be read in the context of the dividend provided for in r.14.44(1), which is the dividend on the admitted proof. That is made clear by the terms of r.14.44(2) itself, which specifies that the application of the discounting formula is for dividends on the admitted proof "*and no other purpose*".

    18.4 The discounting formula therefore has no broader application and, specifically, does not apply to the payment of statutory interest from the surplus under r.14.23(7) IR 2016.

The effect of r.14.23(7)

19. R.14.23(7)(a) IR 2016 provides that:

> "*(a) any surplus remaining after payment of the debts proved must, before being applied for any other purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the relevant date."*

20. The JLs' position is that the "*outstanding*" debts referred to in that rule are the full face-value, undiscounted debts which are admitted to proof:

    20.1 In *Waterfall IIA* David Richards J held that debts admitted to proof are treated as being "*outstanding*" from the relevant date. On that basis, he concluded that statutory interest was payable from the relevant date on the total amount of future and contingent debts that had fallen due between the relevant date and the date of declaration of the dividend. The same reasoning must apply to future debts which have not fallen due by the date of the declaration of the dividend.

20.2 *Waterfall IIA* supports the view that "*the debts proved*" and "*those debts*" in r.14.23(7) refer to the full face-value of the future sum, not the discounted sum. That is because the debt that is proved is the full, undiscounted, sum. It is that undiscounted sum that is admitted to proof, but then discounted under r.14.44 solely for the purpose of dividend.

20.3 Statutory interest compensates creditors for the *"delay since the commencement of the administration in the payment of their admitted 'debts'"*. (*Waterfall IIA* at [207]). David Richards J determined that *"can only be, in my view, a reference to the debts as admitted to proof"* (*Waterfall IIA* at [208]), which refers to the full, undiscounted, sum.

21. In addition, regard must be had to 14.23(7)(c) IR 2016, which provides that:

> *"(c) the rate of interest payable under sub-paragraph (a) is whichever is the greater of the rate specified under paragraph (6)* [section 17 of the Judgments Act 1838] *and the rate applicable to the debt apart from the administration."*

21.1 In that provision the "*rate applicable to the debt apart from the administration"* is the interest rate which would have been applicable to the debt on the undiscounted principal amount.

21.2 If a debt due at the relevant date bore interest (for example) at 10%, that creditor would be entitled to claim interest at that full 10% rate, applied to the full face-value of the debt, out of the surplus as if there had been no administration.

21.3 It is implausible that a creditor with a future provable debt, who would have received the same 10% interest payments *but for* the administration, and who can prove for the full 10% interest accrued on the undiscounted principal amount of debt down to the commencement of the administration, should not be entitled to recover in the same manner.

ISSUE 3: Whether the applicable period for the purposes of the calculation of statutory interest on the claim in respect of the PLC Sub-Notes begins on the date on which PLC entered administration, or the date on which the holder of the PLC Sub-Notes became entitled to submit proofs of debt in PLC's administration.

22. Issue 3 rests on the interpretation of the words "*in respect of the periods during which they have been outstanding since the relevant date*" in r.14.23(7)(a) IR 2016. LBHI contends that subordinated debts can only be treated as "*outstanding*" from the date at which they were entitled to prove.

23. The JLs' position is that the applicable period for the calculation of statutory interest on Claim D begins on the date on which PLC entered administration.

Preliminary point: ECAPS 1 determined the issue

24. Before Marcus Smith J in ECAPS 1 it was common ground that, in relation to the PLC Sub-Notes, statutory interest would be payable from the relevant date to the actual payment of a dividend (see the judgment of Marcus Smith J at [309]). It was open to LBHI to take an alternative view at that stage, but it did not. It cannot now be raised by LBHI at this later stage. The following points are raised by GP1 without prejudice to that position.

Interpretation of 14.23(7)(a) IR 2016

25. The meaning of "*outstanding*" in r.14.23(7)(a) is derived from, and is relative to, the date of the administration. The rule applies to those debts which have been outstanding "*since the relevant date*". Thus, the "*relevant date*" is the starting point for the calculation period; the period during which a debt is "*outstanding*" is the period between the relevant date and payment in full of the proved debt from the estate. It is therefore possible for there to be different "*periods*" as contemplated by r14.23(7)(a), depending on the date at which each debt is paid in full.

26. That interpretation of r.14.23(7)(a) was determined by the Court of Appeal's decision in *Waterfall IIC* [2017] EWCA Civ 1462; [2018] Bus LR 508 at [53]:

> *"All the "periods" in respect of which statutory interest is payable start on the date of administration, and end on each dividend date (in respect of the part of the provable debt then paid). This is of course the case for a debt due at that date, but it is also true of a future debt, as the judge determined, and as to which there is no appeal."* (emphasis added)

27. That interpretation is also consistent with the *"principle of insolvency law that the realisation of assets and the distribution of the proceeds among creditors are treated as notionally taking place simultaneously on the date of the commencement of the liquidation or administration."* (*Waterfall IIA* at [202], citing *MS Fashions Ltd v Bank of Credit and Commerce International SA* [1993] Ch 425, 432G per Hoffman LJ (sitting at first instance)).

28. Moreover, if, as LBHI contends, the level of a subordinated creditor's recovery depends on the timing of distributions made to unsubordinated creditors, that interpretation of r.14.23(7)(a) makes little practical sense:

    28.1 The subordinated creditor cannot prove until the unsubordinated creditors have been paid in full.

    28.2 The point at which those payments to unsubordinated creditors are made, in turn, depends upon the speed at which the administrators can realise the assets of the estate and pay creditors further up the waterfall.

28.3 Those are matters over which the subordinated creditor has no control.

28.4 Thus, the longer the delay in paying dividends to unsubordinated creditors, the longer the period in which subordinated creditors receive no interest.

28.5 In solvent estates, therefore, delays in the payment of unsubordinated creditors will leave subordinated creditors worse-off relative to shareholders, who do not have to prove and who will receive any remaining surplus after the subordinated creditors have been paid.

28.6 That is a result which prejudices subordinated creditors when compared to equity holders, who are paid last. That cannot have been the intended effect of r.14.23(7)(a).

28.7 LBHI's interpretation would be especially prejudicial to subordinated creditors with *future* provable debts subject to discounting under Rule 14.44, such as Claim D. On the one hand, applying a discount to reflect that the future debt has not yet fallen due for payment but, on the other hand, receiving no interest until the subordinated future debt is entitled to prove *"would appear to involve a double loss for the creditor. This would be an unjustified result even in the case of a future debt which did not carry interest but, as earlier observed, it would produce an extraordinary result in the case of interest-bearing future debts."* (*Waterfall IIA* at [213]).

ISSUE 4: Whether clause 2.11 of the ECAPS Guarantees imposes upon the Holder a trust in respect of any proceeds which have been distributed by PLC, which takes effect on receipt and requires proceeds to be turned over to PLC.

29. The JLs' position is that clause 2.11 of the ECAPS Guarantees does not impose upon the Holder a trust in respect of proceeds distributed from PLC to the Holder, through GP1.

30. By way of a preliminary point, before Marcus Smith J in ECAPS 1 it was common ground that, should GP1's claims (i.e. Claim D) rank ahead of other unsecured subordinated creditors of PLC (i.e Claim C), then DB (as well as any other holder of ECAPS) would benefit accordingly (see the judgment of Marcus Smith J at [19]).[1] It was open to LBHI to take an alternative view at that stage, but it did not. It cannot now be raised by LBHI at this later stage. The following points are raised by GP1 without prejudice to that position.

[1] The Court of Appeal judgment also included a flow of funds diagram in an appendix illustrating that payment of Claim D to GP1 was to be distributed onward to the ECAPS Holders.

Terms of the ECAPS Guarantees

31. Clause 2.11 of the ECAPS Guarantees ("**Clause 2.11**") states:

> *"In the event of the winding-up of the Guarantor if any payment or distribution of assets of the Guarantor of any kind or character, whether in cash, property or securities, 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, shall be received by any Holders, before the claims of Senior Creditors have been paid in full, such payment or distribution shall be held in trust by the Holder, as applicable, and shall be immediately returned by it to the liquidator of the Guarantor and in that event the receipt by the liquidator shall be a good discharge to the relevant Holder. Thereupon, such payment or distribution will be deemed not to have been made or received."*

32. The Guarantor was stated to be PLC.

33. "*Holder*" was defined to mean:

> *"[I]n respect of each Preferred Security, each person registered on the Register as the limited partner holding such Preferred Security at the relevant time, save that for as long as the Preferred Securities are registered in the name of a common depository (or a nominee for a common depository) for Euroclear and Clearstream, Luxembourg, each person (other than Euroclear and Clearstream, Luxembourg) who is for the time being shown in the records of Euroclear and Clearstream, Luxembourg as the holder of an interest in any Preferred Securities (in which regard any certificate or other document issued by Euroclear or Clearstream, Luxembourg as to the number of Preferred Securities standing to the account of any person shall be conclusive and binding for all purposes) shall be treated by the Issuer, the Guarantor and any Paying and Transfer Agent as the holder of the Preferred Securities in a nominal amount equal to such interest for all purposes other than with respect to payments, the right to which shall be vested in the name of the person appearing as the relative limited partner in the Register."*

Representation of interested parties in these proceedings

34. GP1 does not take a position as to who is the current "*Holder*" of the relevant securities under the ECAPS Guarantees as defined. GP1 understands, and proceeds on the assumption that the Holder is either (i) the Bank of New York Mellon, London Branch (as the "common depository") for Euroclear and Clearstream, or (ii) the Bank of New York Depository (Nominees) Limited (as the common depository's nominee) (referred to together and in the alternative as "**BONY**"). On no view is GP1 the "Holder", nor (on the language of that definition) is DB a "Holder". (And, even if DB is *a* "Holder", it is not the only Holder as there are other ECAPS investors).

35. These proceedings were therefore improperly constituted to make a determination binding on the Holders as to the effect of Clause 2.11. That fact was recognised by PLC at the hearing before Mr Justice Hildyard on 4 May 2023. BONY has since confirmed (in a letter of 18 May 2023) that

it agrees to be bound by the outcome of the Directions Application without needing to be joined as a party.

36. Nevertheless (and as implicitly recognised by PLC in joining GP1 as a respondent to the Directions Application, including Priority Legal Issues 4 & 5), GP1 is interested in the outcome of these issues. That is because, now that LBHI has raised these arguments (even though they are bad arguments), the reality is that any assets of the PLC estate distributed to GP1 will effectively be frozen in GP1's hands pending resolution of these issues. GP1 anticipates that the Holder(s) will not accept distributions from GP1's estate for onward distribution to the ultimate investors in the ECAPS (such as DB) in circumstances where it might be contended by LBHI that the Holder(s) hold those assets back on trust for PLC.

37. It is for those reasons, and in the absence of BONY taking an active role in these proceedings, that GP1 advances arguments on Priority Legal Issues 4 & 5.

38. That reality also forms an important context for the Distribution Application, returned to below.

Interpretation of Clause 2.11

39. Clause 2.11 is found within Section 2 entitled "Guarantee" of the Subordinated Guarantees provided by PLC as Guarantor for the benefit of the Holders of ECAPS (the "**ECAPS Guarantees**"). Each ECAPS Guarantee was executed as a unilateral deed by PLC under a stand-alone Deed of Guarantee. The entirety of Section 2 relates to PLC's obligations as Guarantor under the ECAPS Guarantee, which obligations are several and independent of PLC's obligations as debtor to GP1 under Claim D, and the ECAPS partnerships' obligations as Issuer to Holders of ECAPS. There are no payments in issue under the ECAPS Guarantees (Claim E), which was declared by consent at first instance in ECAPS 1 to rank for distribution after Claim D and Claim C. For example:

    39.1 Clause 2.8 of the ECAPS Guarantees acknowledge that PLC's obligations as Guarantor "*hereunder are several and independent of the obligations of the Issuer with respect to the [ECAPS].*"

    39.2 Further, the ECAPS prospectuses states that the ECAPS Guarantees "*will not cover payments on liquidation of the Issuer.*" Rather, rights upon liquidation of the Issuer are governed by Section 16.5 of the Limited Partnership Agreements (the "ECAPS LPAs") creating the Limited Partnerships which issued the ECAPS, in which GP1 acts as general partner. Section 16.5 of each ECAPS LPA applies a distribution waterfall of "Partnership

Assets" to be paid "*first, in payment of the Liquidation Distributions… in respect of each [ECAP security]".*

40. On its true construction, Clause 2.11 does not apply to sums received by the Holder (as described in paragraph 33 above) from GP1.

40.1 Clause 2.11 applies to *"any payment or distribution of assets of the Guarantor"*. While any payments that the Holder ultimately receives as a consequence of payments made on Claim D will in practice originate from PLC, those payments are not "*distributions*" from or "*assets*" of PLC.

40.2 The payments are first made to GP1, who receives these payments in its capacity as the general partner of the three limited partnerships, whereupon they become partnership assets legally and beneficially owned as such. It follows that a subsequent distribution from GP1 to the Holder is not a "*payment or distribution of assets of the Guarantor*". Clause 2.11 does not apply. Such onward distributions are payments or distributions of partnership assets, held by GP1 in its capacity as general partner.

40.3 The definition of "Senior Creditors" is found in Clause 2.9 of the ECAPS Guarantees. The definition is by reference to the obligations of PLC as Guarantor *"hereunder"*, i.e. under the Guarantee itself (i.e, Claim E). Any payment received by the Holders via GP1 is not, however, by reference to any obligation of PLC under the Guarantee. Rather, PLC has a primary obligation as debtor to pay (senior) Claim D to GP1, and GP1 in turn distributes Partnership Assets to the Holders. Whilst Claim C is senior to Claim E, Claim C is subordinated to Claim D such that Clause 2.11 is of no application.

41. The phrase "*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"* is of no assistance to LBHI's interpretation of Clause 2.11:

41.1 The commercial purpose of Clause 2.11 (objectively assessed) is to protect the ECAPS Guarantees, and those creditors of PLC whose claims are more senior to the Holders' claims *under the ECAPS Guarantees* (i.e. Claim E). It is simply a trust mechanism seeking to ensure that any more deeply subordinated claims to the claim under the ECAPS Guarantees which happen also to be held by the Holders do not get paid ahead of the claims under the ECAPS Guarantees. It was accepted in ECAPS 1 that Claims C and D are not subordinated to, and rank ahead of, claims under the ECAPS Guarantees (Claim E) with Claim D in turn ranking ahead of Claim C.

41.2 Thus, the quoted phrase encompasses payments made to the Holder in respect of liabilities which are subordinated to the obligations contained within the ECAPS Guarantees.

41.3 Whilst the phrase envisages that claims under the ECAPS Guarantees might not be the lowest ranking debt in the waterfall held by the Holder, it does not overcome the fact that for Clause 2.11 even potentially to bite on the assets distributed to the Holder, LBHI would first need to overcome the construction obstacles set out in paragraph 40 above. The payment to be made by PLC in respect of Claim D would be from PLC to GP1 (as general partner of the limited partnerships and the payment would be received as assets of the limited partnerships). The payment to the Holder would in turn be from GP1 (paying away partnership assets) and on that basis alone Clause 2.11 would not be engaged as those payments are not "*distributions*" from or "*assets*" of PLC.

42. Finally, the ECAPS Guarantees cannot as a matter of law have the effect that LBHI contends they do. LBHI has not articulated any (and there is no) means by which a deed executed *only* by PLC can impose upon non-parties (i.e. GP1 and/or the Holder(s)) trust obligations in respect of assets acquired pursuant to separate legal arrangements.

43. Without prejudice to the generality of that position, Clause 2.11 of each ECAPS LPA (to which: (i) PLC as Guarantor under the ECAPS Guarantee; and (ii) Chase Nominees Limited as the "Initial Limited Partner"; and (iii) GP1 as general partner of the partnerships are parties) expressly provides that the *"the relationship between them does not constitute, and is not intended to constitute… any form of trust under any applicable law or any form of trust relationship or equitable relationship under any applicable law."* It is therefore unarguable that any distribution by PLC to GP1 under Claim D can become impressed with any trust in PLC's favour; and there is no mechanism by which such trust can therefore arise upon any onwards distributions of those funds from GP1 to the Holder(s).

<u>ISSUE 5</u>: If PLC makes distributions on the PLC Sub-Notes but proceeds are thereafter turned over to PLC, what is the resultant priority as between the PLC Sub-Debt and the PLC Sub-Notes, in respect of such sums received by PLC?

44. Issue 5 does not arise once Issue 4 is determined correctly.

45. Issue 5 does, however, lay bare LBHI's attempt to circumvent the relative priority of the PLC Sub-Notes and the PLC Sub-Debt determined by the Court of Appeal, which is a final judgment no longer subject to appeal. In expressly asking the court to reconsider the relative priority between the PLC-Sub-Debt and the PLC Sub-Notes, Issue 5 runs roughshod over the Court of Appeal's previous finding. The answer to Issue 5 hinges on the concluding words of Clause 2.11.

Where (on this hypothesis) a distribution occurs of assets to the Holders which are immediately returned to PLC pursuant to the trust arrangement, Clause 2.11 treats such round-trip transaction as if *"such payment or distribution will be deemed not to have been made or received"*.

46. LBHI, in effect, argues that the only distribution to be ignored is that from GP1 to the Holder(s).

47. It is, however, not possible (on any view) to construe Clause 2.11 in that manner. The reference to *"such payment or distribution"* in the final sentence of Clause 2.11 is to a singular distribution, being the *"payment or distribution of assets of the Guarantor… received by any Holders"*. If it were possible (and it is not) to treat the 'distribution' of PLC's assets to GP1 and their onward distribution to the Holder(s) as a single distribution, then the entirety of that 'distribution' is to be deemed as not having been made or received. There is no reading of Clause 2.11 that allows LBHI to seek to uphold the distribution from PLC to GP1, but then upset the onwards distribution from GP1 to the Holder(s).

48. As already set out under Priority Legal Issue 4, it is wrong in principle to treat the payment of Claim D to GP1 and then onwards distribution of Partnership Assets to the Holder as being collapsed into a singular *"payment or distribution of assets of the Guarantor… received by any Holders"*. But if that is wrong, and Clause 2.11 applies to that course of dealing, then the whole chain of distributions is to be deemed not to have occurred upon the return of assets to PLC by operation of clause 2.11.

49. If so, Claim D is to be deemed as not having been discharged. Claim C therefore cannot be paid. The effect of LBHI's approach is therefore to seek to impose a further circularity problem or impasse: the effect of payment of Claim D in every case, would be that payment would need to be undone – but ECAPS 1 has already established that Claim C ranks behind Claim D. It is therefore not open to LBHI now to advance a position which leads to a different conclusion.

50. The true answer here, however, is that the absurdity of the conclusion which LBHI now seeks to engineer does not arise because Issue 4 should be determined against it.

The Distribution Application

51. The Distribution Application arose against the following background:

    51.1 The claims of unsubordinated creditors of PLC (as to their entitlement to statutory interest) have not yet been paid in full. PLC believes, however, that there are sufficient assets now to pay all such claims in full. Those claims rank before Claim D for distribution.

51.2 The extent of those unsubordinated claims remains uncertain, including because of: (i) the impact of the Court of Appeal's decision in ECAPS 1 on (what has been described as) the "Partial Discharge Issue", and the application of that principle to claims of unsubordinated creditors whose claims raise the same legal issue; and (ii) the other uncertainties about the extent of properly admitted debts of unsubordinated creditors, most recently raised in DB's letter to PLC of 30 May 2023.

51.3 Notwithstanding those uncertainties, on 31 March 2023, PLC indicated an intention to make an eighth interim distribution, including in respect of (at least in part) Claim D.

51.4 The effect of that payment would have been to stop time running on Claim D's entitlement to statutory interest (on any part of the principal of Claim D that was discharged). In circumstances where Claim C ranks behind Claim D, the cessation of statutory interest on Claim D is in LBHI's interests.

51.5 On the other hand, pending resolution of Priority Legal Issues 4 and 5, the reality is likely to be that the Claim D proceeds would be frozen in GP1's hands, as it would not be safe or practicable for it (or in turn, BONY) to distribute the funds to the ultimate ECAPS investors (such as DB) for so long as LBHI are asserting that such funds are or would be impressed with a trust in favour of PLC so as to be paid to Claim C. LBHI's position seems intended to achieve that result: in particular its letter dated 30 March 2023 from Weil, Gotshal & Manges (for LBHI) to BONY sought confirmation from the bank that it would not distribute the proceeds of any distribution made by GP1 until the final determination of Priority Legal Issues 4 and 5 in ECAPS 2.

51.6 In support of the JAs' position that it was appropriate to make such a distribution (notwithstanding the lack of payment of unsubordinated debts in full), they relied upon an agreement that they/PLC reached with LBHI on 22 March 2023 ("the **LBHI Waiver Agreement**") by which LBHI waived a right to payment of a further distribution on its unsubordinated proof of debt before the making of a distribution under Claim D. The waiver continues only as long as there is a distribution on Claim D before the "Longstop Date" of 30 June 2023. By the time of the 4 May 2023 hearing, the JAs/PLC envisaged entering into a similar agreement with another unsubordinated creditor, Lehman Brothers Limited. It is unclear whether that has occurred.

52. The Distribution Application is of considerably lower importance now, in circumstances where: (i) GP1 has lodged a proof of debt on Claim D (though without prejudice to its position that it should not have been required to, and that no dividend should yet be paid in respect of it); and

(ii) the JAs accepted before and at the 4 May 2023 hearing before Mr Justice Hildyard that they were not, in the event, pressing ahead with an intention to make any payment of a dividend in respect of Claim D.

53. GP1's understanding is that the JAs will not, now, pay *any* dividend on Claim D pending determination of Priority Legal Issues 4 & 5. If that is not the JAs' position, then it is incumbent upon them immediately to correct GP1's understanding.

54. If so, no dividend can be paid before the 30 June 2023 longstop date in the LBHI Waiver Agreement. It is therefore unclear whether it would be *possible* for PLC now to pay a dividend in respect of Claim D after that date. Until the unsubordinated claims have been satisfied in full, no dividend can be paid on Claim D.

55. Delaying payment of a dividend on Claim D until the final resolution of Priority Legal Issues 4 & 5 (i.e. at the first hearing of the Directions Application, or the resolution of any appeal on those issues) is the only proper and reasonable course for the JAs of PLC to take, in accordance with their duties (applying principles in *Ex p. James; Re Condon* (1873-74) L.R. 9 Ch. App. 609 & *Cadbury Schweppes Plc v Somji* [2001] 1 WLR 615). That is because, in outline:

    55.1 The dividend being envisaged is not a true dividend in any real sense: it is a dividend with reservations.

    55.2 The JAs cannot reasonably say (on the one hand) that the payment of a dividend on Claim D is simply a matter of the account between PLC and GP1 (with matters of onward distribution from GP1 to BONY / the underlying ECAPS investors being a matter for those parties) whilst also bringing the Directions Application (including Priority Legal Issues 4 & 5) against GP1. In proceeding in the way they have, the JAs must be taken to accept that GP1 has a real practical interest in the outcome of these issues.

    55.3 It is apparent that the JAs do not consider Priority Legal Issues 4 & 5 to have merit. Their view (expressed in Hogan Lovell LLP's letter of 22 November 2022) was that LBHI's arguments under this head were *"not correct"*.

    55.4 If the JAs are not sufficiently clear in their view of the merits that they require the Court's direction, then it would be irrational for the JAs at the same time to press ahead with distributing money out of the PLC estate where they consider that there is a real prospect that they will then have to recoup that money (if LBHI is correct on Priority Legal Issues 4 & 5) to be redistributed on Claim C.

55.5 Alternatively, if the JAs consider that Priority Legal Issues 4 & 5 are so without merit that they can safely distribute, then they should not have brought the Directions Application in this form. To have brought the application in this form means that the JAs are effectively acting as a conduit through which LBHI can advance its (in the JAs' view, unmeritorious) arguments. Having done so, however, the only fair and rational way for the JAs to act is for them *not* then to advance LBHI's interests further by paying a premature dividend on Claim D to prevent statutory interest from running to the benefit of Claim C and LBHI. That would not be to act in a fair and even-handed manner between the two competing classes of creditors.

56. In the circumstances, and absent confirmation from the JAs that they will not pay a dividend on Claim D without GP1's consent prior to the final resolution of Priority Legal Issues 4 & 5 (including any appeal), the JAs should be directed *not* to make such distribution.

30 June 2023

LEXA HILLIARD KC

TOM ROSCOE