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

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

Introduction

1. This Reply Position Paper is filed on behalf of the JLs of GP1, in accordance with paragraph 3 of the 4 May 2023 Order of Mr Justice Hildyard. It:

   1.1 responds to the 30 June 2023 Position Paper of LBHI ("the **LBHI PP**") and (to a limited extent) the Position Paper of PLC ("the **PLC PP**");

   1.2 does so on an issue-by-issue basis;

   1.3 continues to leave the arguments raised by DB on its Strike Out Application to DB to develop; and

   1.4 adopts the defined terms used in GP1's Position Paper of the same date ("the **GP1 PP**").

2. GP1 does not attempt to set out its arguments exhaustively in response to the points made in the LBHI PP. Such arguments will be a matter for written and oral argument in due course. Instead, the purpose of this Reply Position Paper (in conjunction with the GP1 PP) is to ensure that the points of disagreement between the parties are as clearly defined and delineated as possible. Where, therefore, an argument in the LBHI PP (or PLC PP) is not responded to in terms, it should not be taken as admitted.

3. GP1 also does not here respond to the recent developments concerning the Partial Discharge Issue, as set out in the 20 July 2023 letter of Hogan Lovells (for the PLC JAs).

ISSUE 1: 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.

4. LBHI's approach to this issue embarks on an exercise of comparing and seeking to construe the subordination provisions of both Claim D and Claim C. That is not the correct exercise. The subordination provisions of Claim D are irrelevant for present purposes:

4.1 The Court of Appeal has already determined that Claim C is subordinated to Claim D. In other words, for the purposes of the Claim C subordination provision, the principal of Claim D is undoubtedly a "Senior Liability" for the purposes of Claim C (as LBHI accepts at §3.7.2).

4.2 It follows that Claim C cannot prove until Claim D *and the statutory interest on it* has been paid in full. This point is beyond argument, having been decided by the Supreme Court in *In re Lehman Bros International (Europe) (in administration) (No 4) [2018] A.C. 465* (**Waterfall I**) at [68]-[72].

4.3 That this is the case (as relates to statutory interest) is also clear from the language of IR r.14.23(7)(a):

> *"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…."*

4.4 Claim D is the only debt that stands at its level in the waterfall. Once the principal of Claim D has been paid there will (at least on this hypothesis) be a surplus. That surplus *"must, before being applied for any other purpose, be applied in paying interest"* on Claim D. It cannot therefore be used to pay even the *principal* on Claim C, let alone statutory interest on Claim C, until statutory interest on Claim D's proved debt has been paid.

4.5 Further, Waterfall I also determined that on a proper construction of subordination clauses such as that found in Claim C, statutory interest on higher-ranking claims falls within the definition of "Senior Liability" of the more heavily subordinated debt: *Waterfall I* at [40] and [51]-[56] (*per* Lord Neuberger PSC).

4.6 The exercise carried out by LBHI at §§3.6 and 3.7 serves (at best) to demonstrate that (from the perspective of Claim D) it has not subordinated the principal on Claim D behind statutory interest on Claim D. That is trivially true. But Claim D contains no expression of juniority of statutory interest on Claim D against the principal of Claim C (let alone the statutory interest on Claim C). Absent such expression of juniority, statutory interest on Claim D is not an "Excluded Liability" and is therefore a "Senior Liability" from Claim C's perspective.

4.7 Para 3.7.4 of the LBHI PP is therefore wrong. Statutory interest on Claim D is not an Excluded Liability for Claim C.

5. Further, the glaring problem with LBHI's position under this head is that – if it is right – then Waterfall I must be wrong (a conclusion for which LBHI cannot contend). The position as between the statutory interest on Claim D and the principal on Claim C is exactly the same as the position as between the statutory interest on PLC's unsubordinated debts and the principal on Claim D.

5.1 LBHI is right to say (at §3.6.1) that *"Claim D subordinates itself to Senior Liabilities, namely unsubordinated proved debts and statutory interest on those proved debts"*. That is the effect of the subordination provisions of Claim D. But the language of the subordination provisions of Claim D expressly states that *"the rights of the Noteholders in respect of the Notes are subordinated to the Senior Liabilities"* with *"Senior Liabilities"* meaning *"all Liabilities except the Subordinated Liabilities and Excluded Liabilities"*.

5.2 The reason that Claim D is subordinated to statutory interest on unsubordinated debts is precisely because such statutory interest is within the definition of *"Liabilities" ("all present and future sums, liabilities and obligations payable or owing by the issuer"*). That is so, following Waterfall I, notwithstanding that statutory interest is a purely statutory entitlement.

5.3 So, if the statutory interest on unsubordinated debts is a "Liability" from Claim D's perspective (which is not an Excluded Liability or a Subordinated Liability), there is no reason not to treat statutory interest on Claim D in exactly the same way from Claim C's perspective. Claim C, in materially the same way for present purposes, is *"subordinated to the Senior Liabilities,"* which again are *"all Liabilities except the Subordinated Liabilities and the Excluded Liabilities."* And, as relevant, the definition of "Liabilities" is identical.

5.4 Nowhere has LBHI explained a coherent basis for treating the position as between Claim C and Claim D differently from the position as between Claim D and PLC's unsubordinated creditors. If (as LBHI argues at §3.8) *"it is therefore irrelevant that Claim D as to its proved debt ranks above Claim C as to its proved debt,"* why is it not equally irrelevant that the unsubordinated claims as to their proved debts as against PLC rank above Claim D? The mere assertion at §4.3 that it makes a difference is devoid of analysis which might lead to the conclusion for which LBHI contends.

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.

6. The issues between the parties on this issue are already well defined.

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.

7. The issues between the parties on this issue are already well defined.

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.

8. Contrary to LBHI's assertion in §11, Clause 2.9 of the ECAPS Guarantee is not part of the "factual matrix" (in respect of which no details are given) but rather appears on the face of the ECAPS Guarantee. Further, the point LBHI seeks to make in §11.1 is irrelevant to Issue 4 because the definition concerns obligations of PLC as Guarantor *"hereunder"* (i.e. under the ECAPS Guarantees themselves). Issue 4 is not concerned with any claim by the ECAPS Holders under the ECAPS Guarantees (that being Claim E, the ranking of which is now uncontroversial). This point is further emphasised by Clause 2.1 of the ECAPS Guarantees, which makes plain that *"the rights and claims of the Holders against the Guarantor under this Guarantee are subordinated as described in paragraph 2.9"* (emphasis added).

9. In relation to §11.3.2, LBHI glosses over the fact that Clause 2.11 bites only on a *"payment or distribution of assets of the Guarantor."* A payment or distribution of assets of GP1 to the ECAPS Holders is not a payment or distribution of assets of PLC *"of any kind or character."* If GP1 has assets available for distribution, they are GP1's assets, not assets of PLC, as LBHI, itself,

acknowledges at the end of §11.5.3. Such assets are (at the point of payment or distribution by GP1) beneficially and legally held by GP1 in its capacity as the general partner of the three limited partnerships. The rights and obligations as between GP1 and the ECAPS Holders (via the Initial Limited Partner) are set out in the Limited Partnership Agreements and are several and independent of the rights and obligations as between the ECAPS Holders and PLC as Guarantor under the ECAPS Guarantee. Indeed, the Limited Partnership Agreements make no reference to the ECAPS Guarantee.

10. Whilst it is therefore right that the payment of assets by PLC to GP1 on Claim D is a distribution of PLC's assets (§11.5.2 of the LBHI PP): (i) it is not a payment or distribution caught by Clause 2.11; and (ii) LBHI's position that an onwards distribution of those assets is also caught (§§11.3.3 & 11.5.3) is wrong. The words *"of any kind or character"* in Clause 2.11 do not serve to capture indirect payments to ECAPS Holders outside the ECAPS Guarantees. They serve to give an expansive meaning to the words *"cash, property or securities* [of the Guarantor]*."* They do not expand the concept of *"assets of the Guarantor"* to assets of other entities (such as GP1).

11. The point at §11.4 as to the *"commercial purpose of the structure, as described in the ECAPS prospectus materials"* is similarly irrelevant. The explanation concerning the *"Ranking of the Preferred Securities"* (in the "Summary of the Preferred Securities and Subordinated Guarantee" at p.10 of the offering circular) states that *"the Preferred Securities, together with the Subordinated Guarantee, are intended to provide Holders with rights on liquidation equivalent to non-cumulative preference shares of the Guarantor,"* however:

    11.1 Claim D is not a claim on the Preferred Securities, nor the Subordinated Guarantee.

    11.2 Claim D is not an exercise in the Holders enforcing their rights. It is an exercise of GP1's rights.

    11.3 The relevant "liquidation" there being referred to (as is clear in the context of the remaining text under the heading of *"Ranking of the Preferred Securities"*) is not the liquidation of PLC, but rather the liquidation of the Issuer (i.e. the relevant Limited Partnership, acting by GP1). This is obvious from the description of the ranking of Liquidation Distributions in the remaining part of the text. *"Liquidation Distribution"* is defined in paragraph 1 of the "Description of the Preferred Securities". Taken together with the definitions in the same paragraph 1 of "*Distribution,"* "*Liquidation Preference,"* and *"Additional Amounts,"* it is clear beyond argument that what is there being described is a Holder's rights on the liquidation of the Limited Partnership, not PLC. Accordingly, LBHI's vague

appeal to the "*commercial purpose of the structure,"* which is nowhere precisely articulated, is not supported by the selective use by LBHI of words, taken out of context.

11.4 Further and in any case, anything that is said in the ECAPS offering circular (and more particularly, in the Summary *"which is qualified in its entirety by the more detailed information included elsewhere in this Offering Circular")* about the Holders' direct rights against PLC is not relevant, let alone determinative, of the ultimate economic priority that the Holders might enjoy via other routes.

11.5 If the ECAPS Holders end up in a position which is better than the holder of non-cumulative preference shares might have enjoyed because: (i) the subordination provisions in Claim D did not adopt a subordination provision based on the concept of hypothetical preference shares; and (ii) Claim C subordinated itself more deeply than Claim D, there should be nothing surprising about that result.

11.6 The ECAPS Holders made no enforceable promise *vis-à-vis* LBHI (or PLC, or anyone else) that they would *not* ultimately by some route other than the ECAPS Guarantees benefit to a greater extent than the holder of non-cumulative preference shares might.

11.7 The fact of the matter is that LBHI, by the terms of the PLC Sub-Debts (Claim C) subordinated its claims more deeply than GP1's claims under Claim D. LBHI cannot now, having done so, look to the terms of a unilateral deed not made for its benefit and to which it was not party (the ECAPS Guarantee) or the ECAPS prospectuses to seek to elevate its own claim above that of GP1 against PLC. This point is further emphasised by Section 5.4 of the ECAPS Guarantee, which makes plain that the ECAPS Guarantee is "solely for the benefit of the [ECAPS] Holders".

11.8 The position between the partners of the relevant Limited Partnership and GP1 has, on a proper analysis, nothing to do with LBHI or PLC.

12. It is agreed that PLC's distributing administration qualifies as a *"winding-up of the Guarantor"* within the meaning of Clause 2.11 (§§11.3.1 and 11.5.1 of the LBHI PP).

<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?

13. LBHI's stance on Issue 5 is seriously defective and misguided in failing to have any regard to the concluding words of Clause 2.11. Those words provide that, on an application of the 'turnover

trust' (as LBHI describe it): *"Thereupon, such payment or distribution will be deemed not to have been made or received"*.

14. Clause 2.11 refers to a *"payment or distribution of assets"* singular. Yet, on LBHI's approach, the distribution is split into two parts: (1) from PLC to GP1; and (2) from GP1 to the Holders. LBHI then seeks, seemingly, *not* to treat (1) as not having been *"made or received"* (instead, it continues to treat the distribution on Claim D as having been made, so that Claim D is treated as having been, and remaining, discharged). It is unclear whether LBHI is suggesting that (2) should or should not also be treated as having been made or received.

15. There are therefore three options, all of which lead to impossible or absurd outcomes (thereby serving to demonstrate LBHI's error on Issues 4 and 5):

    15.1 It is impossible to treat the distribution in both (1) and (2) as having been made. That is ignoring the clear language of Clause 2.11

    15.2 If both (1) and (2) are deemed as not having been made, then Claim D has not been discharged. Claim C cannot be paid. Claim D must be paid first, and LBHI's approach re-introduces much the same circularity as it sought (wrongly) to suggest existed as between Claim D and Claim C in ECAPS 1. It has already been determined that there is no such circularity, because Claim D ranks ahead of Claim C.

    15.3 If (1) is deemed to have been made, but (2) is deemed not to have been made then:

        (i) That requires the singular language of Clause 2.11 (i.e. a single *"payment or distribution of assets"*) to be disregarded.

        (ii) And, more objectionably from the perspective of GP1, it means that GP1 will: (a) be treated as not having discharged its own liabilities to the ECAPS Holders; (b) already have called upon (and, on LBHI's logic, therefore be unable to call upon again) Claim D, being its only asset from which it can meet its liabilities; and (c) be in this position by reason of a deed (the ECAPS Guarantee) not made for its benefit and to which it is not party.

The Distribution Application

16. GP1 notes and endorses the PLC JA's position in the PLC PP at §39 that the determination Priority Legal Issue 4 *"materially affects the conduct of the JAs in respect of such distributions and the ultimate rights of the parties"*.

17. The PLC JAs go on to say in the same paragraph, however that, *"If (as LBHI contends) the effect of clause 2.11 is to require the ECAPS Holder to turn over to PLC any payments received as a result of a distribution by PLC to GP1 in respect of the PLC Sub-Notes, those funds would be returned to the estate and become available for distribution."*

18. That is an illogical way for the PLC JAs to approach matters. On the assumption (which GP1 rejects) that Issue 4 could even arguably be answered in the way that LBHI contends it should such as to justify an application to Court for directions, reasonable office holders in the JAs' position faced with this prospect would not countenance making a distribution on Claim D, only then to seek to claw-back the proceeds of that distribution from the ECAPS Holders (once an onwards distribution was made from the GP1 estate). Instead, the office holder would not make any distribution on Claim D pending determination of this question.

19. In large part, such criticism of the JAs' approach has been rendered academic in circumstances where the JAs (seemingly in response to GP1's stance in relation to the Distribution Application) have postponed the proposed dividend in respect of Claim D (i.e. part of the eighth proposed intended distribution). The JAs' position at §§59 and 60 of the PLC PP suggests (though does not quite make express) that the JAs will not make any distribution in respect of Claim D until the determination of ECAPS 2 at first instance. It is certainly proper that there should be no distribution until at least that point.

20. In the event that Priority Legal Issue 4 is resolved in GP1's favour at first instance, however, the JLs reserve the right to contend at that juncture that the PLC JAs should still delay any distribution on Claim D until the earlier of: (i) LBHI confirming it will not bring an appeal; (ii) the deadline for any appeal expiring; or (iii) the final determination of any such appeal.

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