Appeal Nos: A3/2020/1810 & 1811

IN THE COURT OF APPEAL

ON APPEAL FROM HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
COMPANIES COURT (ChD)
Marcus Smith J

IN THE MATTER OF LEHMAN BROTHERS HOLDINGS PLC (IN ADMINISTRATION)
AND LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)
AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN (in the "LBHI2 Proceedings"):

THE JOINT ADMINISTRATORS OF LB HOLDINGS INTERMEDIATE 2 LIMITED (IN ADMINISTRATION)

LBHI2 Applicants

-and-

(1) LEHMAN BROTHERS HOLDINGS SCOTTISH LP 3

(2) THE JOINT ADMINISTRATIORS OF LEHMAN BROTHERS HOLDINGS PLC (IN ADMINISTRATION)

(3) DEUTSCHE BANK AG (LONDON BRANCH)

LBHI2 Respondents

AND BETWEEN (in the "PLC Proceedings"):

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

PLC Applicants / **First Respondent to GP1's Appeal**

-and-

(1) LEHMAN BROTHERS HOLDINGS INC

First PLC Respondent / **Second Respondent to GP1's Appeal**

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

Second PLC Respondent / **Appellant**

(3) DEUTSCHE BANK AG (LONDON BRANCH)

Third PLC Respondent / **Third Respondent to GP1's Appeal**

APPEAL SKELETON ARGUMENT OF THE JOINT LIQUIDATORS OF LB GP NO 1 LIMITED (IN LIQUIDATION) ON THE CONSTRUCTION ISSUES IN THE PLC PROCEEDINGS

Introduction

1. This skeleton argument is filed by the joint liquidators of "**GP1**", who were the Second Respondents (at first instance) in the proceedings concerning the "**PLC Estate**" with Claim No. CR-2009-00026 ("the **PLC Proceedings**"). These submissions are filed in support of GP1's appeal against paragraph 7 of the order made by Mr Justice Marcus Smith dated 24 July 2020 ("the **July Order**").

2. The July Order was made consequent upon the lengthy judgment of 3 July 2020 ("the **Judgment**") concerning, *inter alia*, the relative ranking of "Claim C" and "Claim D" (as designated in the Judgment) as a matter of construction of the subordination clauses in the instruments which gave rise to those claims.

3. The learned Judge held, as a matter of construction, that neither Claim C nor Claim D had effectively subordinated itself to the other and that the provisions gave rise to a circularity, with the result that in law they ranked *pari passu* in the PLC Estate.

4. Permission to appeal against paragraph 7, which contained declarations recording that conclusion, was granted by paragraph 17 of the July Order.

5. GP1 contends that the learned Judge should have concluded that Claim D ranks ahead of Claim C. These submissions focus on the narrow construction arguments (or the 'textual analysis') which GP1 advanced below in support of that position and, which GP1 contends, the learned Judge erred in not accepting. In a nutshell, GP1's argument is this:

    5.1 There is no true 'circularity' between the subordination terms in Claim C and Claim D: the subordination terms in Claim C are unequivocal that Claim C ranks last, whereas the same is not true in the case of Claim D. In a 'race to the bottom', Claim C will always 'win' and defer to Claim D being paid first. That is the correct approach to these competing terms as a matter of construction.

    5.2 The point can be illustrated by positing a hypothetical subordinated Claim F: it could validly express itself to be *pari passu* to Claim D, and at the same time express itself to rank ahead of Claim C. Because that is possible, it must follow that Claim D ranks ahead of Claim C.

6. GP1's two grounds are set out in the Grounds of Appeal appended to its Appellant's

Notice. It is the first ground that is the focus of these submissions, and it (via its four sub-grounds) focusses on where the learned Judge went wrong in his analysis. Those four sub-grounds are returned to in the second half of this skeleton argument. But, given the nature of the narrow construction questions involved, it is likely to be more useful to the Court for GP1 to set out – first - its positive case of how the construction exercise *should* be approached, before going on to explain how the learned Judge erred in his approach to construction. Ground 2 is not a determinative point in itself (and is somewhat academic if Ground 1 is successful), and so is addressed briefly at the end.

Background

7. The relevant background facts are set out at §§1-23 of the Judgment, which paragraphs also designate the competing claims arising in the PLC Estate and the LBHI2 Estate by letters A to E. That background is not repeated.

8. For present purposes, and for ease of exposition, the following simplified summary should suffice:

   8.1 In the LBHI2 Estate, the insolvent applicant ("**LBHI2**") has sufficient funds to pay some, but not all, of its subordinated liabilities. There are two subordinated claims, Claim A and Claim B:

      (i) **Claim A** is a claim by the second respondent in those proceedings, "**PLC**", and arises under three subordinated debt agreements known as the "**LBHI2 Sub-Debts**". The learned Judge's analysis needed, in part, to refer to each individually: under the designation Claims A(i), A(ii) & A(iii).

      (ii) **Claim B** is a claim by the first respondent in those proceedings "**SLP3**", and arises under a series of subordinated notes, known as the "**LBHI2 Sub-Notes**". The subordination provisions of the LBHI2 Sub-Notes were amended significantly in 2008: and are therefore referred to as "pre-" and "post-" amendment.

   8.2 In the event that Claim A ranks ahead of Claim B (as the learned Judge held that it did, post-amendment), then PLC will – in turn - have funds to meet some, but not all, of its own subordinated liabilities. Again, there are two relevant subordinated

claims (the third, Claim E, is no longer of any relevance in these proceedings):

(i) **Claim C** is a claim by the first respondent in these proceedings ("**LBHI**") pursuant to a series of subordinated debt agreements known as the "**PLC Sub-Debts**". The subordination terms of the PLC Sub-Debts are materially the same as those in the LBHI2 Sub-Debts.

(ii) **Claim D** is the claim by GP1 under a series of subordinated notes, known as the "**PLC Sub-Notes**".

9. The above summary is shown graphically in the "flow of funds" diagram at Annex 3 to the Judgment.

The need for a textual analysis

10. There is much of the learned Judge's analysis in the Judgment with which GP1, respectfully, entirely agrees and endorses. In particular, the learned Judge (correctly) held that:

10.1 In situations, such as the present, where standard form contracts (or variants thereon) are being considered, background evidence has a more limited role to play: §61(2).

10.2 Relying on the evidence of the individual witnesses on questions of construction was *"dangerous"* for the reasons set out at §61(3), namely that: (i) it related to matters which largely did not 'cross the line'; (ii) was unlikely to be relevant to the extent that it went beyond what the market generally knew about the role of subordinated debt in regulatory capital; (iii) how subordinated debts ranked between themselves was not something which either the regulators or the Lehman Group itself had ever considered; and (iv) debt subordination is a technical area, where it is necessary to have primary focus on the words used in the various instruments.

10.3 *"[T]he regulatory regime did not consider priorities between subordinated obligations, being mainly concerned with the fact that subordinated obligations were properly subordinated to unsubordinated obligations. No-one appears to have considered relative priority between instruments where those instruments all*

contained subordination provisions." (at §161)

10.4 *"[T]he rules regarding regulatory capital, and their potential breach, have no bearing on the questions of subordination that I must address."* (at §327)

11. A narrow, and careful, textual analysis of how the subordination terms operate according to their language is therefore the requisite exercise.

The logical rules to apply

12. GP1 also, respectfully, agrees with the learned Judge's:

12.1 exposition of the efficacy of and mechanism by which simple contractual subordination works (at §§97-105); and

12.2 conclusion, as a matter of logic (and, in the absence of other authority or law), that where claim X[1] expresses itself to be subordinated to claim Y, and claim Y says nothing about its degree of subordination to claim X, then claim Y will rank ahead of claim X (being the effect of the conclusion at §198).

13. Further, in the event that a true 'symmetrical' circularity does arise (i.e. where two (or more) claims express themselves to be subordinated to the other), and there is no other means of breaking that circularity (for example, by recourse to the presumed commercial intention in the manner proposed by Deutsche Bank), then GP1 can see the force of the learned Judge's conclusion that a *pari passu* approach should be adopted (e.g. at §288).

The Textual Analysis

14. The textual analysis, of course, starts with the relevant clauses of the competing instruments which give rise to Claims C and D. As already noted, the instruments which comprise Claim C are in materially the same form as those which comprise Claim A (as the learned Judge also noted at §322).

<u>The PLC Sub-Debts (Claim C)</u>

15. The relevant terms of the PLC Sub-Debts are set out at §§329 to 335 of the Judgment.

[1] To use abstract labels for the purposes of illustrating the logical point.

Focussing, for present purposes, on what the Judge describes as "Phrase [1]" or the "simple contractual subordination" provision:

15.1 The PLC Sub-Debts are *"subordinated to the Senior Liabilities"* (clause 5(1) of the Standard Terms), which means (via the definition of "Senior Liabilities") that they are subordinated to *"all Liabilities except the Subordinated Liabilities and Excluded Liabilities"*.

15.2 The *"Subordinated Liabilities"* are other advances under the same sub-debt agreement (*"all Liabilities to the Lender in respect of each Advance made under this Agreement and all interest payable thereon")*, and so can be disregarded in a consideration of ranking vis-à-vis other instruments.

15.3 So far as material, the PLC Sub-Debts are therefore subordinated to all liabilities other than "Excluded Liabilities", that is: *"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."*

15.4 It is common ground that the Insolvency Officer will be guided by what the Court determines the proper ranking to be (see §181 of the Judgment).

15.5 The simple contractual subordination term therefore boils down to a provision that the PLC Sub-Debts are each subordinated to all liabilities save for those which *"are expressed to be… junior"* to the PLC Sub-Debt.

16. The terms of the PLC Sub-Debts do not admit of the possibility of a *pari passu* ranking with them: they express themselves to be more junior to all other claims *save for* those which express themselves to be more junior still – the Excluded Liabilities.

17. As between the PLC Sub-Debts themselves, GP1 accepts the terms lead to a circularity: each of the three sub-debts expresses itself to be junior to the other two, and none is in any different position to the other. This is precisely the same position that arises between the three LBHI2 Sub-Debts (i.e. as between Claims A(i), A(ii) and A(iii)) and the logic of the learned Judge's conclusion (at §§248 to 251) that, in that eventuality, none has effectively subordinated itself to the other such that they must rank *pari passu* is difficult to fault. GP1 accepts that is a logical means of breaking a true circularity.

18. That conclusion does not, however, apply to the relative rankings of Claims C and D – for the reasons set out below.

The PLC Sub-Notes (Claim D)

19. The subordination terms of the PLC Sub-Notes are materially different (even if similar) to those of the PLC Sub-Debts. Those terms are at §§337 to 343 of the Judgment. Focussing, again, on the "simple contractual subordination" term (clause [3] of this instrument):

    19.1 The PLC Sub-Notes are also *"subordinated to the Senior Liabilities"* (condition 3(a) of the offering circulars).

    19.2 The "Senior Liabilities" for the purposes of the PLC Sub-Notes are – again – *"all Liabilities except the Subordinated Liabilities and Excluded Liabilities"*.

    19.3 The definition of *"Excluded Liabilities"* is the same as under the PLC Sub-Debt.

    19.4 The definition of *"Subordinated Liabilities"* is materially – and critically – different. The definition is not restricted to liabilities under the PLC Sub-Notes themselves, but *"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."*

    19.5 The simple contractual subordination term therefore provides that the PLC Sub-Notes are each subordinated to all liabilities except for those which: (i) *"are expressed to be… junior"* – "Excluded Liabilities"; or (ii) *"are expressed to rank* pari passu *with the Notes"* or; (iii) which, *actually*, rank *pari passu* with the Notes irrespective of what they express.

    19.6 The *pari passu* ranking of claims irrespective of what (if anything) they express is a familiar concept to insolvency law, as a result of *"default rules"* determining the ranking of claims (to adopt the learned Judge's expression from §72 of the Judgment).

Discussion

20. The difference in the definition of "Subordinated Liabilities" is a subtle, but key, distinction between the terms of the PLC Sub-Notes and the PLC Sub-Debts. The difference in definition means that:

20.1 As a matter of ordinary language, the PLC Sub-Notes can accommodate other debts (for example, they *could* accommodate the PLC Sub-Debts) at the same ranking. The converse is not true, because the PLC Sub-Debts insist on being *junior* to everything else, not *pari passu*.

20.2 If one is forced (as the Court is here) to decide where the PLC Sub-Debts rank relative to the PLC Sub-Notes, given that the former cannot rank at the same level on their terms, the answer must be "below". The PLC Sub-Notes could have tolerated the PLC Sub-Debts at the same level, but the PLC Sub-Debts cannot tolerate such a ranking and must yield and drop below the PLC Sub-Notes.

20.3 The point is made clear by positing the example of a hypothetical third subordinated debt instrument. That third instrument could readily, as a matter of contract: (i) express itself to be subordinated to the same level as the PLC Sub-Notes; but (ii) express itself to rank ahead of the PLC Sub-Debts. This is returned to in the context of Ground 1.4 below. Ranking the PLC Sub-Notes at the same level as the PLC Sub-Debts would ignore entirely the terms of the third subordinated debt instrument which expressly agreed with the Issuer that it should rank ahead of the PLC Sub-Debts.

21. To set out the arguments slightly more fully:

21.1 Starting from the perspective of the PLC Sub-Debts, they are *prima facie* subordinated to the PLC Sub-Notes. That is because the PLC Sub-Notes are not *"expressed to be junior"* to the PLC Sub-Debts (indeed, they make no reference to the PLC Sub-Debts at all).

21.2 From the perspective of the PLC Sub-Notes, it is not immediately apparent whether they purport to subordinate themselves to the PLC Sub-Debts. However, it is immediately apparent that they are not purporting to be as deeply subordinated as

the PLC Sub-Debts for the following reasons:

(i) The PLC Sub-Debts are not *"expressed to be junior"* to the PLC Sub-Notes – in the sense of the former expressly making reference to the latter. If that was the end of the story, the same circularity problem which arises internally to the PLC Sub-Debts would apply as between the PLC Sub-Notes and Sub-Debts, in that each would be expressed to be subordinated to the other.

(ii) But that is not the end of the analysis, because it does not follow (for the PLC Sub-Notes) from the fact that another instrument is not expressed to be junior that the PLC Sub-Notes must be subordinated to it. That is because there is another option according to the terms of the PLC Sub-Notes: a *pari passu* ranking. That option is imported from the definition of "Subordinated Liabilities" which, in addition to the PLC Sub-Notes, includes Liabilities of the Issuer which rank or are expressed to rank *pari passu* with the PLC Sub-Notes.

(iii) From the perspective of the PLC Sub-Notes, therefore, it could accommodate the PLC Sub-Debts on a *pari passu* ranking. The fact that the PLC Sub-Debts are not expressed to be junior to the PLC Sub-Notes does not (from the PLC Sub-Note's perspective) automatically cause the PLC Sub-Notes to treat the PLC Sub-Debts as a senior liability – the possibility of a *pari passu* ranking can be entertained.

(iv) However, the PLC Sub-Debts cannot (on their terms) endure a *pari passu* ranking with any other instrument. Because the other instrument – on a tentative *pari passu* ranking – would not be expressed to be junior to the PLC Sub-Debts, the PLC Sub-Debts must fall to be more junior still.

21.3 One approach to the analysis is an iterative thought process (perhaps analogous to an iterative approach to solving mathematical problems), which hinges on the device of recognising that – according to their terms – the PLC Sub-Notes *could* tolerate other instruments on a *pari passu* basis, whereas the PLC Sub-Debts cannot and must (so they say) be paid last:

(i) That difference between the instruments provides a compelling and logical

basis for concluding – in order to break what would otherwise be a 'race to the bottom' – that the PLC Sub-Notes must rank ahead of the PLC Sub-Debts.

(ii) In the race to the 'bottom of the pile', the terms of the PLC Sub-Debts anchor those instruments more firmly to the bottom than the PLC Sub-Notes are anchored. The PLC Sub-Notes, which can tolerlate other *pari passu* subordinated debt instruments, must float on a level above the PLC Sub-Debts.

21.4 To make a similar argument in a slightly different way:

(i) The subordination clause in the PLC Sub-Notes refers to *pari passu* subordination and therefore indicates an objective intention by the PLC Sub-Notes that they were not to be subordinated below all other instruments, and that the extent of the agreement to subordinate was only to the same level as those who agreed to rank *pari passu* with the PLC Sub-Notes, or impliedly already did (i.e. the other PLC Sub-Note issues).

(ii) As the PLC Sub-Debts did not agree a *pari passu* ranking with the PLC Sub-Notes, and the PLC Sub-Notes did not agree to subordinate to the PLC Sub-Debts, the PLC Sub-Debts must rank lower.

The Judge's Errors

22. GP1 contends that the learned judge erred in not adopting the above textual analysis.

23. Unpicking particular errors in the learned Judge's analysis on the route to that conclusion – identified in Grounds 1.1 to 1.4 of GP1's Grounds of Appeal - provides further support for the correctness of GP1's approach.

Ground 1.1: *In holding (at §356) that the difference in the definition of "Subordinated Liabilities" between Claim D and Claim C made "no difference" to the outcome, the learned Judge overlooked, or failed to have due regard to the fact, that Claim D (but not Claim C) could accommodate other liabilities which **in fact** ranked pari passu, irrespective of how those other liabilities were expressed to rank.*

24. The learned Judge treated the interrelation between Claims C and D as being effectively the same problem as he had solved in relation to the interrelation between Claims A(i),

A(ii) and A(iii): i.e. that each simply expressed itself to be subordinated to the other, in a way that led to a circularity.

25. The learned Judge reached that decision because he dismissed the significance of the additional words in the definition of "Subordinated Liabilities" in the PLC Sub-Notes (i.e. that the PLC Sub-Notes were not subordinated to liabilities which *"rank or are expressed to rank* pari passu *with the Notes"*). He concluded that those words made *"no difference"* as the PLC Sub-Debts were not *expressed* to rank *pari passu* with the PLC Sub-Notes (see §356).

26. That conclusion overlooked, or at least did not address in terms, the fact that the PLC Sub-Notes could tolerate the PLC Sub-Debts on a *pari passu* basis, irrespective of what the PLC Sub-Debts *expressed*. It may be that the learned Judge had in mind the earlier portion of his Judgment, where he expressed the view that the distinction between a debt *in fact* ranking *pari passu* as opposed to *expressed to rank pari passu* as being an "elusive one" (§166(2)(e)(i)).

27. In reality, there is nothing elusive about it: indeed, as the learned Judge held in respect of Claims A(i), A(ii) and A(iii), for example, claims may end up ranking *pari passu* by operation of law (and the *"default rules"*) irrespective of what they express. Had that possibility been applied to the actual exercise which the learned Judge carried out in relation to the PLC Sub-Notes and PLC Sub-Debts, he ought to have reached the result for which GP1 contends. That is set out further below.

Ground 1.2: *The learned Judge erred in not reconsidering his decision that this definitional distinction made "no difference" in circumstances where he concluded (at §364) that Claims C and D did in fact rank* pari passu *by operation of law.*

28. Having decided that the definitional difference between the PLC Sub-Debts and PLC Sub-Notes made *"no difference"*, the learned Judge considered that a circularity arose between the subordination terms of the PLC Sub-Debts and PLC Sub-Notes, and therefore Claims C and D. In short, he concluded that each expressed itself to be subordinated to the other.

29. The learned Judge proposed to solve that problem in the same manner as he had solved the circularity between Claims A(i), A(ii) and A(iii), by deciding that – as between

Claims C and D – neither had effectively subordinated itself to the other, such that they ranked *pari passu* by operation of law: see §§363-364.

30. The learned Judge did not, however, go one step further and consider the oddity that arose as a result of that decision: the effect of that decision was that that two claims ranked *pari passu* whereas only one of the instruments expressly admitted of that possibility.

31. A step further still is that the conclusion that Claims C and D ranked *pari passu* contradicts the premise that *"Each – viewed through the prism of the other's subordination provisions – ranks as a Senior Liability"* (at §357). If Claim C was proposed to rank *pari passu* with Claim D, then Claim C would not be a *"Senior Liability"* from the perspective of Claim D (but the converse would not be true) because of the definitional difference.

32. Applying an iterative thought process, the learned Judge ought to have recognised that the effect of this oddity was to demonstrate that the symmetrical circularity that existed between Claims A(i), A(ii) and A(iii) (where no one of the claims could accommodate the other two on a *pari passu* basis according to its terms) did not exist when applied to Claims C and D.

Ground 1.3: *The application of the definitional distinction to the same exercise that the learned Judge carried out for Claim A and Claim B (pre-amendment) (as presented diagrammatically in Tables 2 and 6 of the Judgment) would have compelled the conclusion that Claim D ranked ahead of Claim C, on the basis that the expressions of subordination between the two claims are not consistent and no true circularity arises.*

33. The learned Judge performed a detailed analysis of the interaction between the subordination provisions of Claim A and Claim B (pre-amendment) in Tables 2 and 6 of the Judgment. The purpose of the exercise was to ascertain what each said about its relative subordination to the other from its own perspective. The following rules logically apply to the outcome of that exercise:

    33.1 **Rule 1:** If the answers from both perspectives were consistent with one another (i.e. if the outcomes 'agreed'), then that would provide the ranking answer.

    33.2 **Rule 2:** As noted above, if X subordinated itself to Y (from X's perspective) – but Y said nothing meaningful about ranking with X (from Y's perspective), then X

would rank behind Y.

33.3 **Rule 3:** If the answers were flatly inconsistent (i.e. each expressed itself to rank behind the other), then there is no meaningful subordination at all and, absent any other means of resolving the circularity, a *pari passu* ranking results – i.e. the conclusion reached between Claims A(i)-(iii).

34. The learned Judge, because he dismissed the significance of the definitional difference between Claims C and D, thought Claims C and D fell into that Rule 3. Had he applied the exercise he applied to Claims A and B (pre-amendment), he would have recognised that these claims fell into either Rule 1 or Rule 2 – with Claim C ranking behind Claim D.

35. That exercise is set out in a tabular form in Annex 1 to these submissions. Annex 1.i considers the position from the perspective of Claim C. Annex 1.ii carries out the same exercise from the perspective of Claim D.

36. The key point to recognise is that the expressions of subordination between the PLC Sub-Debts on the one hand and PLC Sub-Notes on the other are either consistent (with Claim D above Claim C), or asymmetric – with Rule 2 applying to cause Claim C to rank behind Claim D:

36.1 Claim C ranks behind everything save for that expressed to rank more junior still. From Claim C's perspective, Claim D is not expressed to rank more junior, and so Claim C ranks junior.

36.2 Claim D ranks behind everything save for that: (i) expressed to rank more junior still; and (ii) expressed to rank *or which does rank* pari passu. From Claim D's perspective, Claim C is either expressed to rank junior (so Rule 1 applies), or there is an equivocal answer to the ranking question from D's perspective: the possibility of a *pari passu* ranking remains. If so, Claim D says nothing meaningful about its subordination to Claim C (so Rule 2 applies). It certainly does not say that it is subordinated to Claim C (which it would need to for Rule 3 to apply).

37. Had the learned Judge applied the same exercise to Claims C and D as he applied to Claims A and B (pre-amendment) he would have recognised that the logical rule to apply

to Claims C and D was either Rule 1, or Rule 2 (as he had already applied to Claims A and B (pre-amendment) at §198 of the Judgment), not Rule 3 which he identified at §250 to deal with the Claim A(i), A(ii) and A(iii) circularity problem.

Ground 1.4: *The learned Judge failed to recognise the significance of the logical tool suggested by GP1 of a third category of debt which ranked ahead of Claim C but* pari passu *with Claim D.*

38. GP1 had suggested at §62.3 of its opening skeleton argument (and its oral closing submissions) the logical device of imagining a third category of claim in the PLC Estate which ranked ahead of Claim C but *pari passu* with Claim D. The fact that such a category may exist without offending the terms of Claims C and D or principles of subordination must compel the conclusion that Claim D ranks ahead of Claim C: a logical inconsistency would otherwise arise. It was not an argument that the learned Judge gave any express consideration to in the Judgment.

39. Such a claim, GP1 submits, is possible – say, "**Claim F**":

    39.1 If Claim F expressed itself to be subordinated to all unsubordinated creditors of PLC and to rank *pari passu* with Claim D: (i) that would not offend principles of insolvency law as relate to subordination because Claim F would simply be relegating itself down the order of priority it would have enjoyed *but for* such a term (see the discussion of *Re Maxwell* and *Re SSSL* at §§101-105 of the Judgment); (ii) nor would it cause any problems with the terms of Claim D: the PLC Sub-Notes expressly accommodate other debts expressed to rank *pari passu* at that level.

    39.2 If Claim F, at the same time, expressed a 'floor' to its degree of subordination, namely that it would not be subordinated to the same degree as Claim C, such a term would again: (i) not offend principles of insolvency law, as Claim F would not be seeking to achieve a *better* outcome in an insolvency than it would have achieved but for the existence of subordination provisions – *prima facie* Claim C is already more junior to Claim F as Claim C is expressed to be junior to *everything*; (ii) not contradict the terms of Claim C, because Claim C on its terms always falls to the 'bottom of the pile', save in respect of debts which are expressed to be more junior still (which Claim F is expressly not).

40. GP1 submits that the fact that there is this 'gap' into which the hypothetical Claim F might slot is a logical means of demonstrating how Claims C and D must rank.

Ground 2: *The learned Judge further erred in concluding (at §§147-149, §172 and §335) that each of Claims C and D (as with Claims A and B) contained both a simple contractual subordination provision and a contingent debt subordination provision. On a proper construction of the subordination terms in those instruments, they comprised a single contractual subordination term and the word "accordingly" should have been construed consistently with such a construction.*

41. The above analysis of the subordination terms of Claims C and D focusses on what the learned Judge described as the "simple contractual subordination" provision in the respective instruments.

42. The subordination terms in each of the PLC Sub-Notes and the PLC Sub-Debts (as in the case of the instruments in the LBHI2 proceedings) continued – following the word *"accordingly"* – to set out various conditions (in particular "solvency conditions") that needed to be fulfilled before payments under the instruments could be made.

43. The learned Judge concluded that the conditions following the word *"accordingly"* in each case gave rise to a quite independent means of subordination of the instruments to the preceding simple contractual subordination terms; namely a *"contingent debt subordination mechanism"* (as explained at §§94-96). The learned Judge further concluded, in the paragraphs cited in this ground of appeal, that both the simple contractual subordination provision and contingent debt subordination mechanism needed to be given independent effect – and therefore met - in order that payments could be made.

44. Given the (GP1 contends, erroneous) approach that the learned Judge took to the simple contractual subordination terms, the learned Judge's 'independent effect' approach to the second half of the subordination terms presented a further logical conundrum.

45. The problem the learned Judge's approach generated was that, having concluded that Claims A(i), A(ii) and A(iii) ranked *pari passu* as a matter of law (given the ineffective contractual subordination provisions), none of the "solvency conditions" in any of those instruments could be met either – such that, on their terms, none of the claims could be paid even on a *pari passu* basis. The learned judge concluded at §253 that that issue was

to be solved – as a matter of law – on a *pari passu* basis, so as to get around a 'non-functioning' mechanism.

46. The same solution was applied by parity of reasoning to Claims C and D: §364.

47. GP1 submits that a conclusion on construction which leads to separate 'contingent debt subordination' and 'simple contractual subordination' mechanisms in the same clause, linked by the word *"accordingly"*, which do not permit payment of claims at the same time is a surprising, and wrong, one. GP1 submits, instead, that the clause should be read as one – with both sides of the clause leading to the same result.

48. In truth, there is nothing 'contingent' about the debt: the solvency condition is intended merely as a means of illustrating the consequence and effect of the application of the simple contractual subordination clause.

49. The point need not, however, be addressed in any significant detail in these submissions: if Claim D ranks ahead of Claim C on the analysis of the contractual subordination terms set out above, then the 'contingent debt provision' should not lead to any impasse when it comes to paying Claim D ahead of Claim C:

    49.1 The relevant solvency condition in the PLC Sub-Notes is that the Issuer should be "solvent", by which is meant ***"****the Issuer shall be "solvent" if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding (i) obligations which are not payable or capable of being established or determined in the Insolvency of the Issuer, and (ii) the Excluded Liabilities."*

    49.2 For these purposes, for the reasons already canvassed, Claim C is either an "Excluded Liability" (as being expressed to rank more junior) or a "Subordinated Liability" (as in fact *pari passu*) and in either case can be disregarded from the solvency condition.

    49.3 The instruments which comprise Claim D each rank *pari passu* with each other, and are therefore within the definition of "Subordinated Liabilities", and so can also be ignored.

    49.4 Therefore, once the liabilities that rank ahead of the Subordinated Liabilities have been met, there is no impediment to Claim D being paid.

50. GP1 makes the point under this ground, therefore, in order to demonstrate that its preferred construction of the subordination terms in these instruments allows the whole of the subordination clause to be read as one, without the artificial and incongruous result of a solvency condition of separate effect preventing payment of debt which falls due for payment in the waterfall.

51. In the alternative, if: (i) the 'simple contractual subordination' and 'contingent debt subordination' mechanisms are to be given separate effect; and (ii) the learned Judge's conclusion that Claims C and D rank *pari passu* as a matter of simple contractual subordination is correct, then the operation of the 'contingent debt subordination' mechanism would still prevent Claim C being paid before Claim D. That is, again, a consequence of Claim D catering for its payment alongside other liabilities on a *pari passu* basis, whereas Claim C does not admit that possibility. That observation, GP1 suggests, serves primarily to reinforce the logic and sense of the outcome of its textual analysis.

LBHI's Respondent's Notice: Rule 14.16

52. LBHI contends in its Respondent's Notice that *"The Judge ought to have held that the PLC Sub-Debt and the PLC Sub-Notes rank after the same senior liabilities, such that they are entitled to prove at the same time and rank pari passu pursuant to rule 14.16 of IR16"*.

53. GP1 may wish to respond to this argument further once LBHI has set it out in its skeleton argument. However, for now:

    53.1 It follows from the textual analysis that the PLC Sub-Debt and the PLC Sub-Notes do not rank after the same senior liabilities, because the PLC Sub-Debt ranks behind the PLC Sub-Notes as a matter of construction of the instruments: so there is no need to look to rule 14.16 for a solution, and no room for that rule to operate.

    53.2 Even if the textual analysis is wrong, however, rule 14.16 is still of no application: Claims C and D do not on their terms rank behind the same senior liabilities, because each (if the textual analysis is wrong) views the other as a senior liability and so the class of senior liabilities from the perspective from each is different.

53.3 LBHI's recourse to rule 14.16 therefore begs the question: because it presupposes that Claims C and D have been subordinated to the same senior creditors and therefore rank *pari passu* as a matter of construction. LBHI does not, however, offer a construction of the subordination provisions which leads to that result.

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Annex 1.i – Effect of Subordination Provisions in Claim C

Stage	Provisions of the PLC Sub-Debt Agreements (Claim C)	Provisions of the PLC Sub-Notes (Claim D) (Relevant only when called into play by the provisions of Claim C)
1	Under Claim C, PLC's obligations to LBHI under the PLC Sub-Debt Agreements are "Subordinated Liabilities".	
2	Subordinated Liabilities are subordinated to Senior Liabilities.	
3	Senior Liabilities are <u>all</u> Liabilities <u>except</u> Subordinated Liabilities and Excluded Liabilities.	
4	Is Claim D a Senior Liability?	
4(a)	Claim D is <u>not</u> a Subordinated Liability, because it is not a liability under any of the PLC Sub-Debt Agreements.	
4(b)	An Excluded Liability is one expressed to rank <u>**and** which does rank junior</u> to a Subordinated Liability. ***This requires reference to the provisions of Claim D, to see how it is expressed to rank.***	
4(c)		According to its terms, are GP1's rights (as defined under Claim D) expressed to rank junior to a Subordinated Liability (as defined in Claim C)?
4(d)		According to Claim D, GP1's rights are subordinated to "Senior Liabilities". Senior Liabilities are relevantly defined as <u>all</u> Liabilities <u>except</u> Subordinated Liabilities and Excluded Liabilities. Subordinated Liabilities include <u>all other liabilities of PLC ranking **or** expressed to rank *pari passu*</u> with Claim D An Excluded Liability is one expressed to rank <u>**and** which does rank junior</u> to a Subordinated Liability. In other words, excluded from this definition of Senior Liabilities are those whose claims rank or are expressed to rank *pari passu* with GP1's rights, and those whose claims are expressed to and do rank junior. This, in turn, requires reference back to the provisions in Claim C to see how LBHI's claims rank. - Claim C contains a qualified expression of juniority, subject to the terms of Claim D. - If Claim C has failed effectively via that expression of juniority to subordinate itself to Claim D, Claim C will rank *pari passu* with Claim D by operation of law, applying the default rules. There is no mechanism whereby Claim C can rank ahead. - LBHI's claims under Claim C are therefore expressed to rank junior to Claim D or will rank *pari passu* with Claim D by operation of law. LBHI's claims under Claim C therefore do not fall within this definition of "Senior Liabilities" under Claim D. They are (on their own terms) subordinated and are either expressed to rank junior to GP1's rights, or will rank *pari passu* with GP1's rights by operation of law. Claim C is not, therefore, a Senior Liability (as defined uncer Claim D). GP1's rights under Claim D are not subordinated to Claim C.
	GP1's rights under Claim D are <u>not</u> expressed to rank junior to a Subordinated Liability.	
5	Claim D is a Senior Liability, being neither a Subordinated Liability nor an Excluded Liability. Claim C is therefore subordinated to Claim D.	

Annex 1.ii – Effect of Subordination Provisions in Claim D

Stage	Provisions of the PLC Sub-Note Agreements (Claim D)	Provisions of the PLC Sub-Debts (Claim C) (Relevant only when called into play by the provisions of Claim D)
1	Under Claim D, PLC's obligations to GP1 under the PLC Sub-Notes are "Subordinated Liabilities".	
2	Subordinated Liabilities are subordinated to Senior Liabilities.	
3	Senior Liabilities are <u>all</u> Liabilities <u>except</u> Subordinated Liabilities and Excluded Liabilities.	
4	Is Claim C a Senior Liability?	
4(a)	Subordinated Liabilities include <u>all other liabilities of PLC ranking</u> **<u>or</u>** <u>expressed to rank *pari passu*</u> with Claim D.	
4(b)	An Excluded Liability is one expressed to rank **<u>and</u>** <u>which does rank junior</u> to a Subordinated Liability.	
4(c)	Claim C will therefore <u>not</u> be a Senior Liability if it is: (i) a liability with <u>ranks or is expressed to rank *pari passu*</u> with Claim D; or (ii) a liability which <u>is expressed to rank junior</u> to claim D. ***This requires reference to the provisions of Claim C, to see how it is expressed to rank.***	
5		The analysis that must be followed is that set out in Annex 1.i: - Claim C's rights are expressed to rank junior to Claim D on a proper construction of Claim C. - Alternatively, if there was no meaningful expression of subordination in Claim C, such that it would have failed effectively to subordinate itself to Claim D, then Claim C would therefore *prima facie* rank pari passu with Claim D.)
6	Claim C is not therefore a Senior Liability, because: (i) Claim C is expressed to be junior to Claim D; and/or (ii) alternatively, if it has not done so, it ranks pari passu by operation of law, applying the default rules.	
7.	Claim D is not subordinated to Claim C.	