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

LBHI'S POSITION PAPER

---

1. This position paper is filed on behalf of Lehman Brothers Holdings Inc. (**LBHI**) in accordance with paragraph 2 of the Order of Mr Justice Hildyard dated 4 May 2023 (**Order**). It sets out LBHI's position in relation to the five issues raised in the application notice (the **Application**) issued by the joint administrators of Lehman Brothers Holdings Plc on 14 March 2023 (**PLC** and the **PLC JAs**). The purpose of this position paper is to set out LBHI's headline points on the five issues raised by the Application. LBHI's detailed arguments on the five issues will be set out in its skeleton argument.

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 whether statutory interest payable on Claim D falls to be paid in priority to the principal amount of Claim C.

2. **LBHI's position is that the proved debt in respect of Claim C[1] falls to be paid in priority to statutory interest payable on the proved debt paid in respect of Claim D.**

---

[1] Save except where expressly defined below, the abbreviated terms used in this position paper are the same as those used in the Application.

3. LBHI's position follows from the wording of the subordination provisions in Claims D and C and from the wording of Rule 14.23 of the Insolvency Rule 2016 (the **Rules**). In summary:

3.1. The Court of Appeal in Re LB Holdings Intermediate 2 Ltd [2022] 2 BCLC 513 (**Sub-Debt1**) held that Claim D ranked in priority to Claim C as regards the provable amount of those debts. The Court of Appeal said nothing about statutory interest on those debts.

3.2. In Sub-Debt1, Lewison LJ accepted the submission (recorded at [78]-[79] of his judgment) that Marcus Smith J had erred in concluding that there was no significant difference between the subordination language in Claims C and D. He analysed that language, in turn, at [81]-[83] (Claim D) and [84]-[89] (Claim C), and he expressed his conclusion at [90]:

> '[90] This is, perhaps, a convoluted way of arriving at a conclusion which can be more shortly expressed. There are three possible categories of claim by unsecured creditors: senior claims, *pari passu* claims and junior claims. Claim D subordinates itself to claims which are senior to it. It does not subordinate itself to claims which rank *pari passu* with it. It takes its place in the queue alongside other creditors whose claims rank *pari passu* with it. Claim C on the other hand has agreed to stand even further back in the queue. It has agreed to subordinate itself to claims other than those that are junior to it. In other words, it has agreed to stand in the queue behind creditors whose claims would otherwise rank *pari passu* with Claim C.'

3.3. On this basis, Lewison LJ held that Claim D ranks in priority to Claim C. It is said by Deutsche Bank AG (London Branch) (**DB**) that this conclusion resolved Issue 1 because statutory interest is also a Liability for the purpose of the subordination language in Claims C and D, as held by the Supreme Court (as to the meaning of Liabilities) in respect of similarly worded subordination language In re Lehman Bros International (Europe) (in administration) (No 4) [2018] A.C. 465 (**Waterfall1**). See, in particular, Waterfall1 at [40] and [51]-[56] (Lord Neuberger PSC).

3.4. It is correct, as far as the point goes, that statutory interest is a Liability for the purpose of the subordination language in Claims C and D, in particular, for the reason given by Lord Neuberger PSC in Waterfall1 at [52]:

> 'It is true that the company in liquidation cannot be sued for the purpose of enforcing section 189, and indeed that no claim can be made against the

company if section 189 is infringed, because the relevant claim should be made against the liquidator: see the discussion in In re HIH Casualty and General Insurance Ltd [2006] All ER 671, paras 115—121. However, in my judgment, that does not mean that statutory interest is not "payable or owing by" the company concerned, at least so far as the meaning of the contractual definition of "Liabilities" in clause 1 is concerned.'

3.5. However, merely pointing out that statutory interest is a Liability does not resolve the question of whether statutory interest on Claim D ranks above or below the principal amount owed in respect of Claim C. That is the pertinent question that must be answered to resolve Issue 1, and it was not addressed directly by the Court of Appeal in Sub-Debt1 (see further below). Nevertheless, it is apparent from Lewison LJ's analysis in Sub-Debt1 of the subordination language in Claims D and C that statutory interest on Claim D ranks *below* the debt proved in respect of Claim C.

3.6. Starting with the subordination provision of Claim D:

3.6.1. Claim D subordinates itself to Senior Liabilities, namely unsubordinated proved debts and statutory interest on those unsubordinated proved debts.

3.6.2. Claim D has not subordinated itself to Subordinated Liabilities, being:

> 'all Liabilities to 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.'

3.6.3. The obligation to pay statutory interest is not a Liability to the Noteholders '*in respect of the Notes*' because it is not a liability that arises under the Notes' terms and conditions but rather arises by statute in respect of '*the debts proved*' that are paid (see Rule 14.23(7)(a)):

(i) As explained in Waterfall1, it is a statutory direction to a liquidator or administrator in respect of a surplus against proved debts, and it is by reason of that direction that a right arises, albeit one not enforceable by suit against the issuer. See, in addition to the paragraphs of Lord Neuberger's judgment in Waterfall1 referred to above, the first instance judgment of David Richards J (as he then was) in Waterfall1 ([2015] Ch 1), at [70]-[71]. Moreover, the obligation to pay statutory interest applies irrespective of whether the underlying debt is interest-bearing, and forms

part of the statutory process for proof and dividend which replaces and extinguishes creditors' contractual rights, including as to interest (as Gloster LJ held in Waterfall2A [2018] Bus LR 508 at [77]).

(ii) As a matter of language, the built-in assumption to the subordination provision in Claim D is that the relevant Liabilities '*in respect of*' the Notes rank *pari passu* with each other. See in this regard (with emphases added): (a) the opening words to Condition 3(a) ('*The Notes constitute direct, unsecured and subordinated obligations of the Issuer* ***and the rights and claims of the Noteholders against the Issuer rank pari passu without any preference among themselves***'); (b) the second part of the definition of 'Subordinated Liabilities', which assumes that the relevant Liabilities in respect of the Notes rank *pari passu* with each other ('*all* ***other*** *Liabilities of the Issuer which rank or are expressed to rank pari passu with the Notes*'); and (c) Lewison LJ's identification of the purpose of the Subordinated Liabilities definition as being that '*Claim D has not agreed to stand further back in the queue than claims which rank pari passu with it*' (Sub-Debt1 at [82]). Thus, the first part of the Subordinated Liabilities definition is not apt to encompass *junior* Liabilities, such as statutory interest (see immediately below), which is the province of the Excluded Liabilities definition.

3.6.4. The obligation to pay statutory interest is also not a Liability '*which rank or are expressed to rank pari passu with the Notes*'. By the terms of Rule 14.23(7)(a) the liability to pay statutory interest arises *after* the payment of the proved debts. See Waterfall2A ([2016] Bus LR 17), at [134]-[135] and [144]-[149], in which David Richards J so held in the context of rejecting the submission that dividends were first to be appropriated to 'accrued' statutory interest; and Waterfall2A, at [27], where Gloster LJ noted that the Rules '*contain a built-in assumption that the whole of the principal of the relevant debts will already have been paid by dividend since, otherwise, there will be no relevant surplus*'. The obligation to pay statutory interest arises after the payment of proved debts only and it does not 'accrue' in the meantime from

the date of the administration.[2] By reason of this statutory definition, the obligation to pay statutory interest in relation to Claim D arises *after* the payment of the proved debt that is Claim D. Indeed, if Claim D were not a proved debt that was paid, LB GP No.1 Limited (**GP1**) would not enjoy any right to statutory interest at all.

3.6.5. As such, and following from the definition of Excluded Liability itself, statutory interest in relation to Claim D is an Excluded Liability for the purposes of the subordination terms appliable to Claim D:

> 'Excluded Liabilities' are 'Liabilities which are expressed to be and, in the opinion of the Insolvency Officer do, rank junior to the Subordinated Liabilities in any Insolvency of the Issuer'.

3.6.6. Put in positive terms, the obligation to pay statutory interest in relation to Claim D ranks below the proved debt that is Claim D pursuant to the terms of Rule 14.23(7)(a). See also in this respect Waterfall1, at [75] *per* David Richards J ('*Statutory interest is…expressed to rank junior…to the debts proved.*'); and Waterfall1, at [51] *per* Lord Neuberger PSC ('*Statutory interest cannot give rise to a provable debt, as it is only payable out of a surplus after payment of proven claims in full*.'). The subordination language applicable to Claim D is engaged by that statutory expression of subordination in relation to statutory interest, and so statutory interest is an Excluded Liability relative to the proved debt in respect of Claim D, which is a Subordinated Liability.

3.7. The same process can be applied in reverse to Claim C:

3.7.1. Claim C subordinates itself to Senior Liabilities, including unsubordinated proved debts and statutory interest on those unsubordinated proved debts. The proved debt that is Claim C is not, however, subordinated to the obligation to pay statutory interest referable to Claim C. As Lewison LJ held in Sub-Debt1

---

[2] In Waterfall1, at [75] David Richards J held that statutory interest was expressed to rank junior to the proved debts which, in that case, were senior unsubordinated debts. David Richards J had also held, at [69], that the subordinated debt in that case was barred from proof until the senior debt was paid. Lord Neuberger in Waterfall1 expressly left open (at [69]-[71]) what the position would be after the senior debts and statutory interest on those debts were paid. This open question was resolved by Marcus Smith J in Sub-Debt1 ([2020] EWHC 1681 (Ch)) at [122]. He held that Claim D was a provable debt. This aspect of his decision was not appealed or the subject of any adverse comment by the Court of Appeal.

at [83], Claim C 'ex*presses itself to be junior to all claims except those which are themselves junior to Claim C*'. The subordination language applicable to Claim C is engaged by the statutory expression of subordination in relation to statutory interest, and so statutory interest is an Excluded Liability relative to the proved debt in respect of Claim C.

3.7.2. Claim C also subordinates itself to Claim D. This is because, as Lewison LJ held in Sub-Debt1, Claim D did *not* express itself to be subordinated to Claim C because Claim D expressed itself to be subordinated to Senior Liabilities only. Claim D did not express itself to be subordinated to Subordinated Liabilities which included liabilities in respect of the Notes, or other liabilities which were expressed to rank *pari passu* with the Notes, being other forms of subordinated debt that rank *equally* with Claim D. Lewison LJ said, at [88]:

> '[88] The clear thrust of this definition is that Claim D is not subordinated to claims which have an *equal* ranking with Claim D. It must follow that the reasonable reader of that provision would understand that Claim D was not to be subordinated to a claim that had a *junior* ranking. Whatever else may be said about the clarity of the drafting, it is not possible to regard Claim D as 'expressing' itself to be 'junior' to Claim C.' (Lewison LJ's italics.)

3.7.3. Unlike Claim D, which did *not* express itself to rank below Claim C, statutory interest referable to Claim D does so express itself because it is a right subordinated to the payment of the debts proved. Claim C is a provable debt and it is entitled to be proved because the proved debt that comprises Claim D has been paid in full. Put another way, Lewison LJ's rationale for concluding (at [83] and [90]) that Claim C ranks below Claim D is inapplicable to statutory interest referable to Claim D, which is *not* a claim that would otherwise rank *pari passu* with Claim C.

3.7.4. Statutory interest referable to Claim D is, accordingly, an Excluded Liability when viewed from the perspective of the subordination language applicable to Claim C. As a consequence, Claim C does *not* express itself to be junior to statutory interest referable to Claim D.

3.8. So assessed, Claim C is to be paid ahead of statutory interest referable to Claim D. Upon the payment of Claim C, statutory interest will fall to be paid on Claims C and D *together*. This is in accordance with the treatment of statutory interest as an Excluded Liability viewed from the perspective of the subordination language applied to both claims and in accordance with Rule 14.23. Rule 14.23(7)(a) requires statutory interest to be paid after the proved debts and, in addition, Rule 14.23(7)(b) requires it to be paid '*equally whether or not the debts on which it is payable rank equally*'. It is therefore irrelevant that Claim D as to its proved debt ranks above Claim C as to its proved debt, as held in Sub-Debt1.

4. As noted above (at paragraph 3.3), DB is understood[3] to be contending that raising Issue 1 in the Application is precluded by the doctrine of *res judicata* on the asserted basis that the Court of Appeal in Sub-Debt1 and/or the Supreme Court in Waterfall1 has already decided Issue 1. LBHI's position is that neither the raising of Issue 1 in the Application, nor advancing arguments to the effect that Claim C ranks above statutory interest referable to Claim D is precluded by *res judicata*. In summary:

4.1. In Sub-Debt1, the Court of Appeal declared that GP1's claims '*under'* the PLC Sub-Notes rank for distribution in priority to LBHI's claims under the PLC Sub-Debt.[4] That declaration directly answered the question posed by the PLC JAs' application notice, which was phrased in corresponding terms.[5] For the same reasons as given above, statutory interest is not a claim '*under*' the PLC Sub-Notes.

4.2. The courts in Sub-Debt1 were not considering and were not addressed as to the position of Claim C vis-à-vis any statutory interest referable to Claim D. They did not, accordingly, determine that issue:

---

[3] In this connection, LBHI fully reserves its rights to respond in its reply position paper to points raised by DB in support of its application dated 27 April 2023 to strike out the inclusion of Issues 1, 4 and 5 in the Application (the **Strike Out Application**), insofar as the Strike Out Application continues to be pursued in circumstances where it has now been listed to be heard at the same time as the Application, pending further and better particularisation of the grounds on which the inclusion in the Application of each of the relevant issues is said to be precluded.

[4] The Court of Appeal's Order, at [4].

[5] See the Previous PLC Application, at [2].

4.2.1. The genesis and circumstances surrounding the Sub-Debt1 proceedings is set out in the third witness statement of Ron Geraghty dated 30 June 2023 (**Geraghty3**).

4.2.2. As summarised further below at paragraph 12, it was uncertain at that stage whether *any* of the subordinated claims against PLC might be paid, so as to give rise to an entitlement to statutory interest. That depended on the outcome of the priority contest between three subordinated facilities, where PLC was the lender (**Claim A**), and floating rate subordinated notes, where Lehman Brothers Holdings Scottish LP3 (**SLP3**), an affiliate of LBHI, was the Noteholder (**Claim B**).

4.2.3. In any event, it is doubtful that the courts in Sub-Debt1 *could* have determined the relative priority of statutory interest referable to Claim D against Claim C as to its proved debt in light of the parties' positions in those proceedings. DB's primary position was that '*PLC's liability under the PLC Sub-Notes [Claim D] is necessarily classified as a non-provable debt or liability*'.[6] It was accordingly an open question in the Sub-Debt1 proceedings whether Claim D was provable *at all* and thus may have given rise to an obligation to pay statutory interest. The fact that the order in the Sub-Debt1 proceedings states that '*the claims of GP1 under the PLC Sub-Notes are provable future debts*' also confirms that the judgments in Sub-Debt1 at first instance and on appeal were not concerned with claims for statutory interest referable to the PLC Sub-Notes. This is because statutory interest is not provable.

4.2.4. DB's reference to a single passage in the Sub-Debt1 judgment, at [83], out of its context, is misplaced.[7] Lewison LJ made clear at the start of that paragraph that he was considering '*whether Claim C is expressed to be junior to Subordinated Liabilities (i.e.* ***junior to all liabilities which are expressed to rank or which do rank pari passu with Claim D)***' (emphasis added). That could only have been a reference to the principal and any accrued interest on Claim D at the date of administration (i.e. the proved debt on Claim D), which

---

6 DB's position paper dated 22 February 2019, at [61]. That the PLC Sub-Notes are provable debts was resolved by Marcus Smith J in Sub-Debt1 ([2020] EWHC 1681 (Ch)) at [122].

7 See, e.g., DB's letter dated 23 January 2023, at [2.3(b)].

are the claims '*under'* the PLC Sub-Notes. Statutory interest on Claim D is not expressed to nor does it rank *pari passu* with Claim D.

4.3. As to Waterfall1, as Lewison LJ observed in Sub-Debt1 at [18], the Supreme Court in Waterfall1 at [64], '*says nothing about the priority, as between themselves, of those creditors at the end of the queue*'. That case concerned a distinguishable scenario involving the relative ranking between statutory interest on *unsubordinated* debts and certain subordinated debts, as opposed to the relative ranking between the proved debts on subordinated claims and statutory interest referable to those debts.

4.4. Further, insofar as it is suggested that Issue 1 properly ought to have been raised or argued in the Sub-Debt1 proceedings, in addition to the above matters, LBHI will rely on the specific procedural context in which this Application and the Sub-Debt1 proceedings took place, namely, an application by joint administrators under Schedule B1, paragraph 63 (see further below paragraphs 12.3.4-12.3.5), which is almost unlimited in its flexibility and thus inimical to any such contention. Sub-Debt1 did not in any way determine Issues 1 to 5 in this Application.

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 of the PLC Sub-Notes, or by reference to the discounted sum payable on that claim in accordance with Rule 14.44 of the Insolvency (England and Wales) Rules 2016.

5. **LBHI's position is that statutory interest payable on Claim D falls to be calculated by reference to the discounted sum payable on that claim in accordance with Rule 14.44.**

6. LBHI's position follows from the wording and purpose of Rule 14.23, Rule 14.44 and commercial common sense. In summary:

6.1. The function of statutory interest, as described judicially, is to serve as compensation for the delay in paying dividends in respect of the proved debts ascertained in accordance with the insolvency legislation: see Waterfall2A at [57] *per* Gloster LJ; and David Richards J, at first instance, at [207]. The function of statutory interest is *not* to compensate for the delay in paying the underlying debts and claims. Calculation of statutory interest on the undiscounted amount of the debt would be a reversion to the underlying claim inconsistent with this principle.

6.2. Rule 14.23(7)(a) 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.' (emphasis added)

6.3. Any surplus to be distributed in paying statutory interest on the proved debts is accordingly a '*surplus*' as against '*those debts*' that were paid. This is apparent from the statutory words emphasised above, and it has been so held by David Richards J in Waterfall2A, at [208]:

> 'The surplus arises not after the underlying debts and claims have been paid but after the admitted or proved debts have been paid. That necessarily includes future debts and estimates of contingent or other unascertained debts. They are among 'the debts proved' and they are therefore 'those debts' on which interest is to be paid in accordance with rule 2.88(7).'

6.4. In respect of future debts, the proved debt will be paid at a discounted value if it has not matured as at the dividend date. The discounted value is calculated pursuant to Rule 14.44 at a prescribed discount rate (of 5% pa[8]) that is presumed to reduce the proved debt to a present value. That is the explicit purpose of Rule 14.44, as apparent from its wording. The reason for this purpose was explained judicially in Waterfall2A, namely, equality between proving creditors. David Richards J explained, at [215]:

> 'Unless a future debt has fallen due for payment before the declaration of a dividend, all such debts are discounted back to the date of commencement of the administration. As Mr Dicker said, this is readily understandable as, in terms of the time value of money, it produces a value which ranks *pari passu* with all other creditors.'

6.5. It follows from the wording and purpose of Rules 14.23 and 14.44 that statutory interest must be calculated on the basis of the discounted amount paid on the proved debt, if the underlying debt had not matured at the time the dividend was paid:

---

8 5% pa is implicit in the compound formulae in Rule 14.44(2) $X/1.05^n$ where 'n' is '*the period beginning with the relevant date and ending with the date on which the payment of the creditor's debt would otherwise be due, expressed in years.*'

6.5.1. This is required by the wording of Rule 14.23(7)(a). The funds remaining after the discounted proved debt and other proved debts have been paid constitute the '*surplus*' to be distributed to pay statutory interest on '*those debts*'.

6.5.2. To revert to the undiscounted proved debt for the purpose of statutory interest would conflict with the equality achieved by the discounting rule by distributing a proportionately greater amount of statutory interest. This is because the dividend would be by reference to the undiscounted proved debt which was *not* the proved debt that was paid and *not* the proved debt accounted for in calculating the '*surplus*' to be distributed to pay statutory interest on '*those debts*'. The payment of statutory interest is logically to be aligned with the manner in which the surplus is calculated.

6.6. The contrary construction argued for by DB and GP1 is therefore out-of-kilter with the wording and purpose of Rules 14.23 and 14.44. GP1's proved debt is to be paid on the discounted amount in order to achieve equality with other proving creditors. Rule 14.23(7)(b) states that statutory interest ranks equally. Reverting to the undiscounted value of GP1's proved debt for the purpose of calculating statutory interest would skew the distribution of statutory interest in favour of GP1 and undo the equality achieved by discounting and would be contrary to the equality mandated by Rule 14.23(7)(b).

6.7. Moreover, calculating statutory interest on the discounted amount avoids exactly the kind of overpayment of future creditors that Lord Millett objected to in Re Park Air Services Plc [1999] 2 WLR 396.

6.8. DB's and GP1's reliance on the opening words of Rule 14.44(2) ('*For the purposes of dividend (and no other purpose)*') is misplaced. LBHI's position does not involve a re-discounting of the proved debt for the purposes of Rule 14.23 contrary to the words '*For the purpose of dividend (and no other purpose)*'. Rule 14.23(7)(a) takes the proved debts paid 'as it finds them', as it were, i.e. as paid by the declared dividends, whether estimated (in the case of contingent debts) or discounted or not (in the case of future debts, according to maturity at each dividend date or not). Thus, Rule 14.23(7)(a), in directing the application of a surplus against the proved debts paid, acts upon the calculation of the proved debts to be paid, fixed by Rule 14.44 in

the case of future debts. There is no re-discounting for the purposes of paying statutory interest. DB and GP1 are wrong to suggest that there is and that LBHI's construction conflicts with the opening words of Rule 14.44(2).

6.9. Further or in the alternative to the above, LBHI will contend that the opening words of Rule 14.44 are broad enough to encompass the payment of statutory interest pursuant to Rule 14.23 as a 'dividend' for which GP1's proof is discounted. This is apparent from, inter alia, the following:

6.9.1. As a matter of ordinary language, the payment of statutory interest to a creditor in circumstances where proved debts have been paid in full is apt to be described as a 'dividend'.

6.9.2. Unless the word 'dividend' in the Rules includes distributions of statutory interest, there is no provision made in the Rules for distributing it at all. For example, there would be no equivalent to Rule 14.34 for the declaration of dividends, nor of Rule 14.39 which requires the administrator to make provision for disputed proofs when paying dividends, nor of Rule 14.40(4) which requires creditors to repay any amount overpaid by way of dividend. This would leave inexplicable and unnecessary gaps in the insolvency scheme.

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 with the date on which PLC entered administration, or on the date on which, in accordance with the subordination provisions of the PLC Sub-Notes, the holder of the PLC Sub-Notes became entitled to submit proofs of debt in PLC's administration in respect of that claim (and, if so, what that date is).

7. **LBHI's position is that statutory interest on Claim D is calculated from the date Claim D was entitled to prove, namely after the payment of any Senior Liabilities that rank in priority to Claim D.**

8. LBHI's position follows from the wording and purpose of Rule 14.23 and the subordination of Claim D. In summary:

8.1. Pursuant to the contractual terms of its payment obligation, Claim D was not payable until Senior Liabilities were first paid.

8.2. The subordination terms applicable to Claim D meant that Claim D could not be proved '*until all prior obligations have been satisfied*', as held in Sub-Debt1, at [122(2)] and [122(4)] on a point that was not appealed and not the subject of any criticism in the Court of Appeal.

8.3. GP1 was therefore precluded by agreement from lodging a proof in respect of Claim D at the commencement of the administration, and for a long time thereafter. Rather, Claim D could only be proved when the Senior Liabilities were satisfied in full.

8.4. Turning to the wording of Rule 14.23(7), Claim D is amongst '*those debts*' paid to produce the surplus to be distributed *only* if the Senior Liabilities are first paid. Claim D is not '*outstanding*' in the administration until the Senior Liabilities are paid because, until that time, it may not be proved and become an admitted debt in the administration.

8.5. The function of statutory interest is to compensate the creditor for the delay in the payment of dividends in respect of proved debts in respect of the periods during which they have been outstanding in the administration: see Waterfall2A at [57] *per* Gloster LJ; and David Richards J, at first instance, at [207]. Although Claim D is a provable debt, there is no entitlement to prove Claim D until the Senior Liabilities are first paid. At that time, but not before, Claim D is entitled to rank in the administration and is outstanding in the administration. There is therefore no delay for which to compensate the subordinated creditor until that entitlement arises and Claim D may be admitted to proof, whether or not it is actually proved at that time or at a later time.

8.6. Accordingly, statutory interest on Claim D is calculated from the date Claim D was entitled to prove in the administration, namely after the payment of any Senior Liabilities that rank in priority to Claim D.

9. This analysis is consistent with the reasoning in Waterfall2A both at first instance and in the Court of Appeal in relation to the payment of statutory interest on unsubordinated future and contingent debts:

9.1. In Waterfall2A, David Richards J held that statutory interest on unsubordinated contingent and future debts was calculated from the date of administration to the

dates on which the dividends on those proved debts were paid. He held that '*periods*' (plural) in Rule 14.23(7)(a) recognised that the proved debts might be paid by interim and final dividends, and that the calculation of statutory interest would account for such payments (i.e. that statutory interest was calculated on the *reduced* balance of the proved debt from time to time). He also held that '*outstanding*' referred to the period from the date of administration, being the notional date of proof and distribution. See Waterfall2A, at [135] and [202]-[215]. He was upheld on appeal in respect of his conclusion on contingent debts, there being no appeal as regards his conclusion in respect of future debts (both of which were unsubordinated and therefore provable from the administration date). See Waterfall2, CA, at [53]-[57].

9.2. As explained and affirmed by the Court of Appeal (at [57]), '*the principled basis*' for the above conclusion was that the debt on which statutory interest was paid was the admitted proved debt, not the underlying debt. At [204] and [206]-[207], David Richards J had held:

> '**The issue in short is whether** in providing that interest is to be paid 'on those debts' in respect of the periods during which they have been 'outstanding' since the company entered administration, **the sub-rule is referring to the underlying debts giving rise to the admitted proofs or whether it is referring to the debts as admitted to proof**.
>
> …
>
> I do not consider that this is the right approach to rule 2.88(7). **The distribution in the administration is being made to creditors *pari passu* in discharge of their proved debts, not their underlying claims.** They are not the same thing, as clearly illustrated by the examples of an estimate of the value of a contingent debt for the purposes of proof and the admission to proof of a sterling sum in place of a debt otherwise due in a foreign currency.
>
> The purpose of rule 2.88(7), as earlier discussed in this judgment, is to provide for interest to be paid to all creditors, irrespective of whether they had any entitlement to interest apart from the administration. **What they are being compensated for by the payment of interest under rule 2.88(7) is the delay since the commencement of the administration in the payment of their admitted 'debts', as ascertained or estimated in accordance with the legislation.** It is not, in my judgment, compensation for the non payment of the underlying debt although I accept, as I stated in Waterfall I, that the rationale for

the choice of judgment rate as the minimum rate of interest payable is that the commencement of an administration or liquidation will or may prevent creditors from taking proceedings and obtaining judgment against the company.' (emphasis added)

9.3. Of this conclusion, the Court of Appeal said, at [57]:

> 'More fundamentally, we agree with the principled basis for the judge's analysis, which treats the debt as the provable debt rather than the underlying claim, and the application of the *pari passu* principle to all debts as from a single cut-off date. Statutory interest is compensation for dividends on account of provable debts having to be paid after (sometimes long after) that cut-off date, and does not depend upon there being any right to interest under the underlying claim, even though the rate of interest may do.'

9.4. Accordingly, Waterfall2A held that statutory interest is calculated from the date of administration because:

9.4.1. statutory interest is paid from the surplus on the paid proved debts (not the underlying debts); and

9.4.2. there is a single cut-off as at the administration date that corresponds to the moratorium on individual execution and the notional date of proof and distribution should apply to all such proved debts to preserve the *pari passu* payment of claims.

9.5. Neither of these reasons applies to Claim D to justify the calculation of statutory interest on that subordinated claim from the date of the administration.

9.6. There was no entitlement to lodge a proof in respect of Claim D until the Senior Liabilities were satisfied in full, and, as such, Claim D could not until that time become a proved debt upon which statutory interest could be paid. Accordingly, statutory interest payable on Claim D is not to be calculated from the date of the administration:

9.6.1. Unsubordinated present, contingent and future debts are all provable debts which may be proved at any time following commencement of the administration. Conversely, the subordinated creditor has no equivalent entitlement to prove its debt or receive dividends in respect of its admitted debt

until the Senior Liabilities have first been satisfied. There is no delay for which to compensate the subordinated creditor until that entitlement arises.

9.6.2. Nor can it be said that the subordinated creditor will or may have been prevented from taking proceedings and obtaining judgment against the company to which the Judgments Act rate would apply due to the commencement of administration (see Waterfall2A at [207]). The terms of the subordinated debt[9] limited the subordinated creditor's rights of action to instituting insolvency proceedings in certain prescribed circumstances, and proving for its debt when the Senior Liabilities were satisfied in full.

9.6.3. Accordingly, Waterfall2A must be applied to Claim D so as to require statutory interest payable on Claim D to be calculated from the date Claim D was entitled to prove, which was only after the payment of Senior Liabilities.

9.7. As to the reasoning around the single cut-off date – this is consistent with the above conclusion. This is because the single cut-off date and related notional date of proof and distribution is to ensure equality between creditors of equal rank (see Waterfall2A at [201], *per* Gloster LJ). That cut-off date is not undermined by subordination because the subordinated creditor has agreed to step back from the place in the queue that it would otherwise occupy. As stated by Lewison LJ in Sub-Debt1 at [16], '*The very purpose of a subordination clause is to exclude the pari passu principle as regards the particular creditor in order to postpone or downgrade that creditor's entitlement to be paid*'. A creditor who has chosen to step back has also chosen to receive compensation for the time-value of its proved debt *from* a later point in time. Similarly, a creditor's claim for loss or damages following disclaimer by a liquidator is only '*outstanding*' for the purposes of statutory interest from the date of the disclaimer: see Re Park Air Services Plc [1999] 2 W.L.R. 396, 407F.

ISSUE 4

Whether clause 2.11 of the ECAPS Guarantees imposes upon the Holder (as defined therein) a trust in respect of any proceeds which have been distributed by PLC, which takes effect on receipt of those proceeds and requires such proceeds to be turned over to PLC. If so what are the circumstances in which such trust arises and in respect of what proceeds.

---

[9] See the PLC Sub-Notes, Condition 4(a)(iii)-(iv) and Condition 9.

10. **LBHI's position is that Clause 2.11 imposes a trust upon the Holder where it receives a distribution or payment made on the PLC Sub-Notes, whether directly from PLC or indirectly, at a time when PLC's Senior Creditors (as defined in the ECAPS Guarantees) have not been satisfied in full.**

11. LBHI's position follows from a proper construction of Clause 2.11 against the admissible factual matrix. In summary:

11.1. By Clause 2.9 of the ECAPS Guarantees, Holders' rights against PLC as Guarantor are subordinated in right of payment to the Senior Creditors. The definition of Senior Creditors makes clear that the ECAPS Guarantees are intended to rank *pari passu* with non-cumulative preference shares.

11.2. Clause 2.11 provides that:

> '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.'

11.3. It follows from the plain wording of Clause 2.11 that a trust arises in the hands of the Holder in circumstances where:

11.3.1. PLC is in a 'winding-up'.

11.3.2. Any '*payment or distribution*' (neither of which is a defined term in the ECAPS Guarantees) of PLC's assets '*of any kind or character*' is made. Importantly, the payment or distribution need not be made *on the ECAPS Guarantee itself* in order to be caught by Clause 2.11. The language is not limited in this way, but refers to *'any*' payment or distribution.

11.3.3. The payment or distribution is '*received by any Holders*' before the satisfaction of the Senior Creditors' claims. Clause 2.11 prescribes no

particular route as to the way or circumstances in which the payment or distribution needs to have been '*received'* by the Holder. The wording is broad and includes within its scope an *indirect* receipt by the Holder of a payment or distribution of PLC's assets. Such an indirect receipt is expressly contemplated by the words, '*…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'*, which would capture a turnover payment or distribution received by the Holder, which is payable or deliverable by reason of the payment of a more junior subordinated creditor.[10] Such a payment would also be subject to the Clause 2.11 turnover obligation.

11.4. That a trust arises in the hands of the Holder in these circumstances is consistent with the commercial purpose of the structure, as described in the ECAPS prospectus materials. The ECAPS structure together with the ECAPS Guarantees are described therein as being '*intended to provide Holders with rights on liquidation equivalent to non-cumulative preference shares of the Guarantor* [i.e., PLC], *whether or not issued*'. Clause 2.11, on LBHI's construction, serves to ensure that the Holder's rights are limited in the way envisaged by the ECAPS prospectus.

11.5. LBHI's position is that Clause 2.11 would be engaged as follows:

11.5.1. PLC's distributing administration qualifies as a '*winding-up of the Guarantor*': see by analogy, Marcus Smith J's decision in Sub-Debt1 at [225] and Re Kaupthing Singer & Friedlander Ltd [2010] EWHC 316 (Ch) at [2].

11.5.2. A payment on the debt proved in respect of Claim D is a payment or distribution of PLC's assets for the purposes of Clause 2.11. A relevant payment or distribution is not limited to one made on the ECAPS Guarantees themselves and the language imposes no such limitation.

11.5.3. The assets paid or distributed in this way will be '*received'* by the Holder, being The Bank of New York Mellon (as the person in whose name the ECAPS are registered) via GP1. For the reasons above, Clause 2.11 is not

[10] The existence of which is expressly envisaged by the 'Senior Creditors' definition in Condition 2.9.

limited to a direct receipt by the Holder from PLC. As emphasised by the use of the passive voice ('*shall be received by'*), the focus of Clause 2.11 is on the receipt by the Holders of a distribution from PLC's assets in circumstances where Senior Creditors' claims remain outstanding. Any receipt by the Holder via GP1 will necessarily be of those assets, as they represent the assets GP1 has available for distribution.

11.5.4. LBHI is a Senior Creditor of PLC in respect of Claim C, which claim will not have been paid in full by the time the payments or distributions are received by the Holder. Accordingly, the payments or distributions received by the Holder will be subject to a trust, and the Holder will fall under an immediate obligation to return the same to the PLC JAs.

12. DB is understood to be contending that raising Issue 4 in the Application, along with Issue 5, to which it is connected, is precluded by *res judicata* on the basis that it is an abuse of the Court's process to raise those issues because they '*could and should'* have been raised in the Sub-Debt1 proceedings.[11] LBHI's position is that neither the PLC JAs' raising of Issue 4 or Issue 5 in the Application, nor the advancing of the argument in respect of Clause 2.11 described above, are precluded by *res judicata*. In summary:

12.1. Neither Issue 4 nor Issue 5 concerns the relative priority between Claims C and D. That was the issue determined in Sub-Debt1. There is accordingly no question of the Court of Appeal's declaration being subverted or of the PLC JAs being prevented from making a distribution to GP1 in respect of the debt proved on Claim D. By determining the Clause 2.11 related issues, the Court would not be re-determining the relative priority between Claim C and Claim D in any way: see further Issue 5 below.

12.2. The matters raised by Issues 4 and 5 did not arise on the PLC JAs' application for directions dated 16 March 2018 (the **Previous PLC Application**). Rather, they relate to what should happen to payments or distributions received by the Holder (which

[11] DB's directions hearing skeleton argument at [10(b)]. In addition, it was tentatively said by DB that those issues '*may also be precluded by a cause of action estoppel and/or an issue estoppel'* (Ibid., at fn 9). It is not understood how these doctrines could conceivably apply in relation to Issues 4 and 5, and LBHI's right to respond to these arguments as and when they are better particularised is fully reserved.

was not before the Court in the Sub-Debt1 proceedings) via GP1 at a lower level in the Lehman group's capital structure.

12.3. Having regard to the circumstances of the Sub-Debt1 proceedings, it cannot sensibly be said that the matters raised by Issues 4 and 5 ought properly to have been raised as part of the Previous PLC Application:

12.3.1. The genesis and circumstances surrounding the Sub-Debt1 proceedings is set out in Geraghty3.

12.3.2. The estimated surplus in LB Holdings Intermediate 2 Ltd (in administration) (**LBHI2**) at the time the Previous PLC Application went to trial alongside the application issued by LBHI2's joint administrators on 16 March 2018 (the **LBHI2 Application**) was estimated to range from £300 to £900 million. If, as SLP3 contended on the LBHI2 Application, this sum fell to be shared *pari passu* between Claim B (approximately US$6.1 billion in principal) and Claim A, PLC would have been unable to pay any part of Claim C or Claim D as it would not have been able to satisfy statutory interest on its unsubordinated liabilities. Moreover, DB also contended that Claim C had been released in its entirety by virtue of a New York law governed settlement agreement entered into in 2011. Accordingly, it would have been disproportionate to the cost for the PLC JAs to apply resources investigating a potential asset of the estate (i.e. the Clause 2.11 trust), if that asset had been worthless.

12.3.3. Notably, DB and GP1's position in the earlier proceedings was that the Previous PLC Application should not even be *heard* in tandem with the LBHI2 Application. The suggestion now made that the Previous PLC Application should have been yet broader in its scope is out-of-kilter with the positions being adopted previously.

12.3.4. The argument also disregards the specific procedural context in which the Sub-Debt1 proceeding took place, namely, an application by joint administrators under Schedule B1, paragraph 63. That is a provision of wide application capable of being deployed whenever an estate is under the control of an administrator, so as to enable the Court to give directions to facilitate the distribution of the fund (In re Nortel Networks UK Ltd (No 2) [2018] Bus. L.R.

206 at [72]; [81] per Snowden J). The PLC JAs have, as officers of the Court, determined that as part of administering PLC's administration estate, they require the Court's directions in relation to Issue 4 and Issue 5. It is wrong in law for DB to postulate that the PLC JAs can be estopped or precluded by *res judicata* from including these issues in the Application in these circumstances. By the same token, if DB's reasoning were correct, Issue 2 would also be precluded from inclusion in the Application. If DB had wanted to argue that statutory interest be calculated on the *undiscounted* amount of Claim D, it could have raised that argument in the context of the discounting issue in the Previous PLC Application.

12.3.5. Directions applications in the Lehman group in particular have been referred to by high authority as illustrating the '*almost unlimited flexibility*' of Schedule B1, paragraph 63 directions applications, with Lord Briggs citing the '*numerous examples of the separate resolution, in successive proceedings, of different issues between the same parties within the Lehman group, concerning their mutual dealings*': Michael J Lonsdale (Electrical) Ltd v Bresco Electrical Services Ltd (in liquidation) at [33]. Different issues have been determined iteratively as part of the directions applications making up the Waterfall proceedings in order to facilitate the distribution of funds in officeholders' hands as and when issues have come to the fore. There is no sensible line that can be drawn as to why it is supposedly abusive in the requisite sense for the Clause 2.11 related issues to be raised on the Application, when no such abuse has previously been detected in determining other related issues between the same parties in previous Waterfall proceedings. In particular, and by way of example, in Waterfall2, 40 issues were identified at the outset and divided into three parts, A-C. Many or all of these issues could, in theory, have been included in Waterfall1. And notwithstanding the approach in Waterfall2, which was intended to be comprehensive as far as possible, further issues were subsequently identified after the determination of Parts A and B that could have been part of the initial applications. The fact that further, supplementary issues were identified later was not an abuse or process in that instance, and it is not an abuse of process now.

ISSUE 5

If PLC makes distributions on the PLC Sub-Notes but proceeds are thereafter turned over to PLC by the Holder pursuant to clause 2.11 of the ECAPS Guarantees, what is the resultant order of priority, as between the PLC Sub-Debt (Claim C) and the PLC Sub-Notes (Claim D), in respect of such sums received by PLC?

13. **LBHI's position is that if the Holder is obliged to turn over receipts to the PLC JAs pursuant to Clause 2.11 of the ECAPS Guarantees, when GP1 is paid 100p in the £ on the debt proved in respect of Claim D, the funds turned over to the PLC JAs will then be available for distribution in the PLC estate, and fall to be distributed on the debt proved in respect of Claim C in accordance with the Court of Appeal's decision in Sub-Debt1.**

14. LBHI's position is supported by the wording of the ECAPS Guarantees, the ECAPS prospectus, the Rules and the judicial interpretation of the same. In summary:

    14.1. By the time the Holder has received the relevant payments or distributions which, for the reasons above, would be subject to the turnover trust in its hands, GP1's proved debt in respect of Claim D will have been paid either in part or in full.

    14.2. The distributions made will discharge GP1's proof *pro tanto*. Multiple payments cannot be made in respect of the same part of GP1's proof: see Rule 14.32(3), which provides that in the declaration of a dividend '*a payment must not be made more than once in respect of the same debt*'.

    14.3. The statutory process for proof and dividend will have replaced and extinguished GP1's contractual rights under Claim D: see Waterfall2A at [77], and Lord Neuberger PSC's judgment in Waterfall1 at [104]-[106], concluding that the provisions of the Rules then in force '*support the notion that a proving creditor should be treated as having had his contractual rights fully satisfied once he is paid out in full on his proof*' and that, '*[t]here is a powerful case for saying that the fundamental rule 2.72(1) appears to me to be expressed in terms which support the notion that, where a creditor proves for a debt, his contractual rights as a creditor are satisfied if his proof is paid in full*.'

    14.4. Accordingly, at the point at which the proved debt in respect of Claim D is paid in full, any assets available for distribution in PLC's estate, including assets turned over

by the Holder to the PLC JAs pursuant to Clause 2.11, fall to be applied to pay Claim C, which is the next claim in the order of priority established in the Sub-Debt1 proceedings.

15. LBHI's position as to the contention that raising Issue 5 in the Application is precluded by the doctrine of *res judicata* is rejected for the same reasons as set out above at paragraph 12. In addition, insofar as it is suggested by the Application's wording of Issue 5 that there would be any alteration to the order of priority as between Claim C and Claim D decided in Sub-Debt1 were the Clause 2.11 trust and turnover obligation to be engaged, that is incorrect. The proved debt in respect of Claim D ranks above Claim C for distribution. It is only when the debt proved in respect of Claim D is paid 100p in the £ in the administration that any distributions would fall to be made on Claim C. There is accordingly no different '*resultant*' order of priority.

DAVID ALLISON KC
ADAM AL-ATTAR
EDOARDO LUPI

30 June 2023