In the Supreme Court

of the United Kingdom

Permission to Appeal

On appeal from

Court

Court of Appeal (Civil Division)

Date of decision being appealed

20 October 2021 (Order sealed 21 October 2021)

In the proceedings between

[Claimant/Appellant in the Lower Court] (1) Lehman Brothers Holdings Scottish LP 3 (A3/2020/1787) (2) The Joint Liquidators of LB GP No.1 Limited (in liquidation) (A3/2020/1810) (3) Deutsche Bank A.G. (London Branch) (A3/2020/1811)

and

[Defendant/Respondent in the Lower Court] Please see Continuation Sheet Part A.

For Court use only

UKSC reference	**Date of filing**

Details of the party appealing ('The Appellant')

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MJL/LM/MB/58399.0011

Is the Appellant in receipt of public funding/legal aid? **Yes ☐** **No ☒**

If yes, please provide the certificate number

N/A

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D3JAT/F1JBB/10199184 (matter ref 161762/000001)

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Details of additional parties (if any) are attached **Yes ☒** **No ☐**

Please see Continuation Sheet Part B

The decision being appealed

Name of Court

Court of Appeal (Civil Division)

Names of Judges

Lord Justice Lewison, Lord Justice Henderson, Lady Justice Asplin

Date of Order/Interlocutor/Decision being appealed

20 October 2021 (Order sealed on 21 October 2021)

Date of Order refusing permission to appeal, if separate

As above.

Neutral citation number of the judgment being appealed

[2021] EWCA Civ 1523 (also reported [2021] 10 WLUK 239)

References to Law Report in which any relevant judgment is reported

Judgment of Mr Justice Marcus Smith dated 3 July 2020 (Chancery Division) [2020] EWHC 1681 (Ch) and [2020] 7 WLUK 720

What order are you asking the Supreme Court to make?

Order being appealed

☒ **set aside** ☐ **vary**

Original Order

☐ **set aside** ☒ **restore** ☒ **vary**

You should attach the following on a separate sheet(s)

- **Narrative of the facts**
- **Statutory framework**
- **Chronology of proceedings**
- **Relevant orders made in the Courts below**
- **Issues before the Court appealed from**
- **Treatment of issues by the Court appealed from**
- **Proposed grounds of appeal (To include Counsel's name or signature. Grounds of appeal exceeding 10 A4 pages must be accompanied by an explanation from Counsel. (PD 3.1.2(3))**
- **Reasons why permission to appeal should be granted**

Other Information about the appeal

Are you applying for an extension of time? **Yes ☐** **No ☒**

If yes, please provide reasons

Extension of time reasons are attached/continued on a separate sheet(s)
Yes ☐ **No ☒**

Have you previously been granted an extension of time pending public funding/legal aid by the Registrar? **Yes ☐** **No ☒**

If yes, please provide a copy of the decision on public funding/legal aid and the letter confirming the extension of time

Does the appeal raise issues under the Human Rights Act 1998?
Yes ☐ **No ☒**

Are you seeking a declaration of incompatibility? **Yes ☐** **No ☒**

Are you challenging an act of a public authority? **Yes ☐** **No ☒**

If you have answered yes to any of the questions above, please give details

Details are attached/continued on a separate sheet(s) **Yes ☐** **No ☒**

Does this appeal involve the Court's Devolution jurisdiction?

Yes ☐ No ☒

If yes, please give details

Further details are attached/continued on a separate sheet(s)

Yes ☐ No ☐

Are you asking the Supreme Court to
Depart from one of its own decisions or from one made by the House of Lords? **Yes ☐ No ☒**

Make a reference to the Court of Justice of the European Union?

Yes ☐ No ☒

If you have answered yes to either of these questions, please give details

Details are attached/continued on a separate sheet(s) Yes ☐ No ☒

Is this a case where there was or should be a departure from any retained EU caselaw? **Yes ☐ No ☒**

If yes, please give details

Details are attached/continued on a separate sheet(s) Yes ☐ No ☒

Will any of the parties request an expedited hearing? **Yes ☐** **No ☒**

If yes, please give details

Expedition reasons are attached/continued on a separate sheet(s)

Yes ☐ **No ☒**

Certificate of Service

The date on which this form was served on the Respondent(s)

17 November 2021

I certify that this document was served on

Name

Please see Continuation Sheet Part C.

By

Weil, Gotshal & Manges (London) LLP

Method of Service

Email

A certificate of service is attached/continued on a separate sheet(s)

Yes ☒ **No ☐**

Subject matter catchwords for indexing

Please see Continuation Sheet Part D.

Please return your completed form to:

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Website: The Supreme Court

UK SUPREME COURT FORM 1 (PERMISSION TO APPEAL)

Continuation Sheet Part A
Defendant/Respondent in the Lower Court

In the matter of LB Holdings Intermediate 2 Limited (in administration)
(Court of Appeal No. A3/2020/1787)

(1) Lehman Brothers Holdings plc (in administration)
(2) Deutsche Bank A.G. (London Branch)
(3) The Joint Administrators of LB Holdings Intermediate 2 Limited (in administration)

In the matter of Lehman Brothers Holdings plc (in administration)
(Court of Appeal No. A3/2020/1810 and A3/2020/1811)

(1) The Joint Administrators of Lehman Brothers Holdings plc (in administration)
(2) Lehman Brothers Holdings Inc.

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In the matter of Lehman Brothers Holdings plc (in administration) (A3/2020/1810 and A3/2020/1811)

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Continuation Sheet Part C
Certificate of service

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By Weil, Gotshal & Manges (London) LLP by email to the above email addresses on 17 November 2021.

Signed:

_____

Mark Lawford, Partner
Weil, Gotshal & Manges (London) LLP

Continuation Sheet Part D
Subject matter catchwords for indexing

Administration – distributing administration – winding up – liquidation – insolvency – Insolvency Rules – regulatory capital – preferred securities – ranking – priority – proof – claim – dividend – waterfall – provable debts – contractual construction – pari passu – debtor – classes of creditors – senior creditor – junior creditor – loans – debt – senior debt – senior liabilities – junior debt – unsubordinated creditors – subordination – subordinated creditors – subordinated debt – subordinated notes – solvency condition – contingent debt – rectification – contractual amendments – intention – guarantee – part payment – surety – settlement agreement – release – subrogation – rule against double proof – Lehman Brothers

Court of Appeal Refs: A3/2020/1787, A3/2020/1810 and A3/2020/1811

IN THE SUPREME COURT OF THE UNITED KINGDOM
ON APPEAL FROM THE COURT OF APPEAL, CIVIL DIVISION (LORD JUSTICE LEWISON, LORD JUSTICE HENDERSON, LADY JUSTICE ASPLIN)

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

FORM 1 (PERMISSION TO APPEAL) PAGE 7

INFORMATION ABOUT LEHMAN BROTHERS HOLDINGS INC. AND LEHMAN BROTHERS HOLDINGS SCOTTISH LP 3 APPLICATIONS FOR PERMISSION TO APPEAL, INCLUDING GROUNDS OF APPEAL

(A) INTRODUCTION

1. The Appellants, Lehman Brothers Holdings Inc. ("**LBHI**") and Lehman Brothers Holdings Scottish LP 3 ("**SLP3**"), recognise that this is an unusually long document for an application seeking permission to appeal. In particular, the Grounds of Appeal (Section (H) below) are more than 10 pages. LBHI and SLP3 apologise for the amount of detail that follows, but they respectfully submit that it is appropriate in circumstances where (a) the judgment of the Court of Appeal dated 20 October 2021 (the "**CA Judgment**") dealt with three appeals by three separate appellants, (b) LBHI and SLP3 are seeking permission to appeal the decisions reached in the court below in respect of each of those three appeals, (c) the distinct issues raised by the proposed appeal fall into three separate (though related) categories, and (d) the points of law in issue are both novel and highly complex. In order to assist the Court, the Appellants are providing this short Introduction and an Executive Summary (Section (B) below).

2. LBHI is the United States parent company of the global Lehman Brothers group ("**Lehman Group**") and is the indirect owner of SLP3.

3. LB Holdings Intermediate 2 Ltd (in administration) ("**LBHI2**") and Lehman Brothers Holdings plc (in administration) ("**PLC**") are entities within the Lehman Group, which are in distributing administration in England:

   (1) LBHI2 is the debtor in respect of: (a) three subordinated facilities[1] where PLC is the lender ("**Claim A**" or the "**LBHI2 Sub-Debt**"); and (b) floating rate subordinated loan notes where SLP3 is the noteholder ("**Claim B**" or the "**LBHI2 Sub-Notes**").[2]

   (2) PLC is the debtor in respect of: (a) three subordinated facilities[3] where LBHI (by a series of assignments) is now the creditor ("**Claim C**" or the "**PLC Sub-Debt**"); and (b) three series[4] of subordinated loan notes ("**Claim D**" or the "**PLC Sub-Notes**"), which are held by three partnerships (the "**Partnerships**") of which LB GP No 1 Ltd (**GP1**) is the general partner. Deutsche Bank A.G. (London Branch) ("**Deutsche Bank**") acquired junior preferred securities issued by the Partnerships from which it derives its indirect financial interest in these proceedings.

4. Following payments of principal and statutory interest to LBHI2's unsecured unsubordinated creditors, a large surplus estimated by LBHI2's joint administrators to be between £800 million and £1 billion has arisen in the administration of LBHI2. The surplus is insufficient to pay both Claim A and Claim B in full or, following PLC's receipt of any funds from LBHI2, both Claim C and Claim D in full. Accordingly, novel legal questions concerning the relative ranking of subordinated debts issued for regulatory capital purposes have arisen for decision.

5. The issues in the proposed appeal fall into three categories:

   (1) The first category concerns the relative ranking of certain subordinated debts. The first ranking issue relates to the relative ranking between Claim A and Claim B (the "**LBHI2 Ranking Issue**"). SLP3 contends that Claim A and Claim

[1] There is a $4.5 billion long-term facility, a €3 billion long-term facility and a $8 billion short-term facility.

[2] The LBHI2 Sub-Notes have a face value of $6.139 billion.

[3] Claim C has three facilities in the same sizes as Claim A. There is a $4.5 billion long-term facility, a €3 billion long-term facility and a $8 billion short-term facility.

[4] There is a series of (a) €225,000,000 fixed rate subordinated notes due 30 March 2035, (b) a series of €200,000,000 fixed rate subordinated notes and a series of €50,000,000 fixed rate subordinated notes due 21 September 2035 and (c) a series of €500,000,000 fixed/floating rate subordinated notes due 22 February 2036.

B rank *pari passu* for distribution. The second ranking issue relates to the relative ranking between Claim C and Claim D (the "**PLC Ranking Issue**"). LBHI contends that Claim C and Claim D rank *pari passu* for distribution (together with the LBHI2 Ranking Issue, the "**Ranking Issues**"). In contrast, the Respondents contend that (a) Claim A ranks above Claim B and (b) Claim D ranks above Claim C. The material subordination provisions in Claims A, B, C and D are set out for convenience in the Annex below.

(2) The next category relates to the rectification of the terms and conditions in the offering circular giving rise to Claim B (the "**Rectification Issue**"). SLP3 contends that, to the extent that certain amendments which were made to the offering circular in 2008 caused the ranking of Claim B to change, that was not the common intention of the parties and the amendments ought to be rectified.

(3) The final category concerns the Court of Appeal's treatment of the partial discharge of Claim C (the "**Partial Discharge Issue**"). LBHI contends that Claim C has not been reduced, discharged or diminished by virtue of any payments in respect of guarantee claims, whereas Deutsche Bank contends that it has.

(B) EXECUTIVE SUMMARY

6. Each of the three sets of issues raised by the proposed appeal is of general public importance, albeit for rather different reasons. Whilst the factual background is complex, the three key legal issues, in very brief terms, are as follows:

(1) How should the court interpret and reconcile similarly worded regulatory subordinated instruments operating in parallel, which do not expressly cross-refer to each other but whose ranking depends on referential subordination provisions?

(2) Can rectification be granted in relation to an amendment to a document where the amendment has had a significant and unintended effect?

(3) Is it appropriate to devise an exception to the well-established principle that a creditor can prove for the whole of a debt without giving credit for part payment by a surety following the debtor's entry into insolvency?

7. As to the two Ranking Issues (para 6(1) above):

(1) The Court of Appeal wrongly interpreted each subordinated debt instrument by reference to the other and in an inconsistent manner.

(2) The Court of Appeal's approach was uncommercial, ignoring the centrality of the *pari passu* principle (contrary to the approach adopted by this Court in *Re Sigma Finance Corp* [2010] BCC 40) and the default position that Lower Tier 2/Tier 3 regulatory debt (all of which Claims A, B, C and D constituted) rank *pari passu*.

(3) The contractual language under consideration is used in many instruments in the multi-billion pound London subordinated debt market. The standard form in issue was prescribed by the Financial Services Authority ("**FSA**") at the time, and forms in similar terms continue to be prescribed or suggested at present by the Financial Conduct Authority ("**FCA**") in relation to up to 14,000 regulated firms.[5] Accordingly, the Court of Appeal's decision will affect the primary and secondary debt market.

(4) Depending on the outcome of the LBHI2 Ranking Issue, the PLC Ranking Issue may impact the allocation of more than £500 million between Claim C and Claim D, and affects thousands of stakeholders.

(5) The decision of the Court of Appeal on the PLC Ranking Issue was inconsistent with the publicly available FSA Waiver Directions (as defined at para 10(4), below), which raises the issue of the weight of such a direction by an issuer's relevant regulator.

(6) The reasoning of the Court of Appeal leaves the approach to the ranking and subordination of debts decided by this Court in *Waterfall I* [2017] UKSC 38 (overruling the Court of Appeal) in an uncertain state.

8. As to the Rectification Issue (para 6(2) above):

(1) The Court of Appeal wrongly held that rectification must be refused where the amendment has an unintended effect because there was no actual statement that it should not have that effect.

[5] See below at para 60(1).

(2) The Court of Appeal wrongly ruled that if the words of the amendment were as intended, rectification must be refused even though the legal effect of the words was unintended.

(3) The appeal also raises the question of how far an "in-house" amendment should be treated as a unilateral, rather than a bilateral, document.

(4) The decision of the Court of Appeal on points (1) and (2) above is inconsistent with prior authority, which strongly suggests that the Court of Appeal's decision, if it is not overturned, will leave the law in a state of uncertainty.

9. As to the Partial Discharge Issue (para 6(3) above):

(1) The principle that a creditor can prove for the whole of a debt without giving credit for part payment by a surety – the "rule in *Re Sass*"[6] – is, as the Court of Appeal accepted, a well-established judge-made principle, recognised in cases and textbooks. As the Supreme Court has very recently said in *CPS v Aquila Advisory Ltd* [2021] UKSC 49, courts should be very slow to introduce *ad hoc* amendments to such principles, but in this case the Court of Appeal wrongly conceived a novel exception.

(2) The Court of Appeal wrongly conflated the rule in *Re Sass* and the rule against double proof.

(3) The Court of Appeal wrongly held that partial payment of a principal debt gave rise to a right of subrogation.

(4) The Court of Appeal misunderstood the *ratio* of its own decision in *MS Fashions* [1993] Ch 425.

(5) The decision of the Court of Appeal, if left uncorrected, leaves the law in a state of confusion, not only in relation to the rule against double proof and the rule in *Re Sass*, but also more widely in relation to the law of suretyship.

[6] See *Re Sass* [1896] 2 QB 12.

(C) NARRATIVE OF THE FACTS

10. Taking the subordinated debts in the chronological order in which they were entered into or issued, Claim C and Claim D against PLC arose in the following circumstances:

(1) PLC and Lehman Brothers UK Holdings Ltd ("**LB Holdings**") entered into the first two facilities making up Claim C on 30 July 2004, and the third facility was entered into on 31 October 2005 ("**Claims C(i), C(ii), and C(iii)**"). LB Holdings borrowed on a subordinated basis from a chain of companies. The ultimate lender was LBHI.

(2) Each of Claims C(i), C(ii) and C(iii) arises from separate standard form loan agreements in Annex 10 of the Interim Prudential Sourcebook for Investment Businesses ("**IPRU(INV)**") introduced by the FSA in 2001 ("**FSA Standard Form 10**") or its predecessor standard forms. The purpose of Claim C was to provide regulatory capital to the Lehman Group. FSA Standard Form 10 agreements were in place between Lehman Group entities at every step in the UK corporate chain leading to LBHI.

(3) PLC issued four series of subordinated notes (subsequently consolidated to three series) making up Claim D on 29 March 2005, 19 September 2005, 26 October 2005 and 20 February 2006 to the Partnerships.

(4) The purpose of Claim D was also to provide regulatory capital to the Lehman Group. PLC applied for a waiver from the requirement to use FSA Standard Form 10 in order to issue subordinated notes qualifying as regulatory capital (the "**FSA Waiver Application**"). The FSA granted publicly available waiver directions in respect of each series of the PLC Sub-Notes (the "**FSA Waiver Directions**"). Amongst other matters, these sanctioned specific, limited differences in the subordination provisions creating Claim D and those contained in FSA Standard Form 10. A modification to the definition of "Subordinated Liabilities" provided that Liabilities which "*rank or are expressed to rank pari passu with the Notes*" are not "Senior Liabilities" in Claim D. The FSA Waiver Application stated of the modification that "*we have used this definition which better reflects borrowing in a bond, rather than a loan format*". The FSA Waiver Directions stated that "*the degree of*

subordination of the loan capital is no less than that provided for by [FSA Standard Form 10]" (emphasis added).

(5) Each of the Partnerships issued junior preferred securities known as "ECAPS", constituting limited interests in the Partnerships. The ECAPS had equity-like features. In an insolvency scenario, the terms of the ECAPS envisaged that the ECAPS would be substituted for preferred stock in LBHI, so as to be structurally subordinated to all debt issued within the Lehman Group.[7] The ECAPS holders' ("**ECAPS Holders**") only direct claim against PLC is pursuant to various guarantees that PLC gave to ECAPS Holders as part of the ECAPS issue ("**Claim E**"). All the parties agreed in the High Court proceedings that Claim E ranks lower than Claim C and Claim D.

11. Claim A and Claim B against LBHI2 arose in the following circumstances:

(1) LBHI2 and PLC entered into three facilities making up Claim A on 1 November 2006 ("**Claims A(i)**, **A(ii), and A(iii)**"). Like Claim C, Claim A arises on FSA Standard Form 10. The purpose of Claim A was to provide regulatory capital to the Lehman Group.

(2) LBHI2 issued the LBHI2 Sub-Notes making up Claim B pursuant to an offering circular dated 26 April 2007, which partially refinanced Claim A on materially the same commercial terms. The LBHI2 Sub-Notes were briefly held by PLC before being transferred ultimately to SLP3. By 2007, the FSA had replaced IPRU(INV) with the General Prudential Sourcebook ("**GENPRU**"). Unlike IPRU(INV), GENPRU did not require the use of standard forms to implement the particular requirements it prescribed for Tier 2 capital instruments (Rule 2.2.164). This afforded firms greater flexibility, but required the documentation to be supported by a legal opinion.

(3) The LBHI2 Sub-Notes were amended pursuant to a resolution dated 3 September 2008. LBHI2's board minutes stated that the purpose behind the amendments was "*to allow the Company to defer payments of interest on the*

[7] While the substitution of the preferred stock for the ECAPS did not in fact occur, this was not caused by any failure of the ECAPS documents to permit such a substitution.

Notes at its discretion". The amendments also amended Condition 3, which deals with the subordination of Claim B. In relation to this:

(a) The amendments were co-ordinated and supervised by the European head of tax, Ms Jackie Dolby. She confirmed at trial that all she intended to achieve from the amendments was the deferral of interest for tax purposes (and that she would have shared that intention with the authorised signatories at LBHI2 and SLP3).

(b) The amendments were drafted by an associate at the Lehman Group's external lawyers, Allen & Overy ("**A&O**"), Mr Tom Grant. Mr Grant confirmed at trial that he had not been instructed by Ms Dolby to alter the ranking of Claim B, and that the drafting of the amendments was intended to preserve the *status quo* for ranking purposes and to maintain Claim B's Lower Tier 2 status.

12. PLC entered administration on 15 September 2008 and LBHI2 entered administration on 14 January 2009.

13. Under Section 2.04 of a settlement agreement dated 24 October 2011 (the "**Settlement Agreement**"), LBHI allowed a claim by LB Holdings (as original lender) under a guarantee it had issued or allegedly issued in relation to all liabilities of PLC in respect of Claim C (the "**LBHI Guarantee**"). Under Section 8.02(iii) of the Settlement Agreement, LBHI's right to an indemnity from PLC as a consequence of the payments made under the LBHI Guarantee was released. LBHI subsequently made distributions of approximately $222 million in respect of the LBHI Guarantee claim. Claim C was ultimately assigned to LBHI in April 2017. Section 2.04 of the Settlement Agreement also contains a claw-back provision, which ensured that no creditor could ever recover more than 100 pence in the pound.

14. The ECAPS have been actively traded on the post-insolvency secondary market. Many of the ECAPS Holders are financial institutions, such as Deutsche Bank or US-based hedge funds.

(D) STATUTORY FRAMEWORK

15. IPRU(INV) and GENPRU were the means by which the FSA implemented EU Directives on capital adequacy in the UK, which in turn gave effect to the First Basel Accord and then the Second Basel Accord ("**Basel II**"). IPRU(INV) and GENPRU formed the basis for the FSA's capital adequacy regime at the relevant time. GENPRU came into effect on 31 December 2006.

16. At first instance, Marcus Smith J (the "**Judge**") said this of the shift from IPRU(INV) to GENPRU: "[o]*f course, the purpose behind regulatory capital remained the same, and (to an extent) earlier precedents remained in use or were "grandfathered" in*."[8]

17. Three tiers of capital were specified by Basel II: Tier 1, Tier 2 and Tier 3. Tier 2 was divided into Upper Tier 2 capital and Lower Tier 2 capital. Claims A, B, C and D in this case were dated subordinated debts which qualified either as Lower Tier 2 or Tier 3 capital, as opposed to undated subordinated debts which would qualify as Upper Tier 2 debts. The default expectation in the market was for Tier 3 to rank *pari passu* with Lower Tier 2; with Upper Tier 2 ranking junior to Tier 3/Lower Tier 2; and, finally, with Tier 1 ranking junior to Upper Tier 2. It was common ground between SLP3 and PLC[9] that the default position (subject to contractual language evincing a contrary intention) was that Lower Tier 2 and Tier 3 capital would rank *pari passu* with each other.

18. The contractual subordination provisions in these claims take effect within the statutory insolvency scheme under the Insolvency Act 1986 ("**IA1986**") and the Insolvency (England and Wales) Rules 2016 ("**IR16**"). A creditor wishing to claim in an insolvency must prove its debt (Rule 14.3 IR16). Where creditors with provable claims lodge their proofs of debt at the same time in an insolvency their claims rank *pari passu* pursuant to Rule 14.12(2) IR16:

> "*Debts other than preferential debts rank equally between themselves and, after the preferential debts, must be paid in full unless the assets are insufficient for*

[8] See First Instance Judgment, at [68].

[9] See PLC Respondent Skeleton dated 1 March 2021 in the LBHI2 Appeal, at [9]. This was confirmed by materials that were before both the Judge and the Court of Appeal (including one of the Basel II working papers, and the evidence of a partner in the A&O capital markets team, Mr Stephen Miller).

meeting them, in which case they abate in equal proportions between themselves."

(E) CHRONOLOGY OF PROCEEDINGS AND ORDERS MADE IN THE COURTS BELOW

19. The Joint Administrators of LBHI2 and PLC respectively issued applications for directions under paras 63 and 68(2) of Schedule B1 to the IA1986 on 16 March 2018 (the "**LBHI2 Application**" and the "**PLC Application**") (together the "**Applications**"). The Applications sought the determination of a number of issues relating to Claims A, B, C, D and E. LBHI2, PLC and SLP3 were the original parties to the LBHI2 Application. PLC, GP1, LBHI and Deutsche Bank were the original parties to the PLC Application.

20. By order of Mann J dated 24 July 2018, it was ordered that the two Applications be case managed and tried together. Deutsche Bank was joined as a party to the LBHI2 Application.

21. The two Applications were heard by the Judge from 11 to 22 November 2019. Seven factual witnesses were cross-examined, as well as experts on New York law in relation to the Settlement Agreement. Judgment was handed down on 3 July 2020 (the "**First Instance Judgment**"). The orders giving effect to the First Instance Judgment were dated 24 July 2020 (the "**HC Orders**"). They contained declarations that:

    (1) In relation to the LBHI2 Ranking Issue, Claim A ranks for distribution before Claim B (para 1 of the HC Orders). The Judge held that whereas the unamended Claim B ranked above Claim A, the amended Claim B ranks below Claim A. SLP3's rectification claim was dismissed.

    (2) Claim C has not been released pursuant to the Settlement Agreement (para 5 of the HC Orders).

    (3) In relation to the Partial Discharge Issue, Claim C has not been reduced, discharged or diminished by virtue of any payments in respect of guarantee claims (para 6 of the HC Orders).

    (4) In relation to the PLC Ranking Issue, Claim C ranks for distribution *pari passu* with Claim D (para 7 of the HC Orders).

(5) Claim D is a provable future debt, the quantum of which falls to be discounted under Rule 14.44 IR16 (para 8 of the HC Orders).

(6) GP1 may not prove for any interest accruing on Claim D after 15 September 2008 (para 9 of the HC Orders).

22. It was also declared by consent that the ECAPS Holders' Claim E ranks for distribution after Claim C and Claim D (para 10 of the HC Orders).

23. The declarations relating to the LBHI2 Ranking Issue and the PLC Ranking Issue were appealed to the Court of Appeal with the permission of the Judge. Para 17 of the HC Orders specifically denied Deutsche Bank permission to advance its "Dividend Stopper" argument, as defined in the First Instance Judgment.

24. Deutsche Bank additionally sought permission to appeal paras 5, 6, 8 and 9 of the HC Orders, but not in respect of its Dividend Stopper argument. SLP3 sought permission to appeal on the rectification of Claim B.

25. By orders of Newey LJ dated 14 December 2020, the Court of Appeal granted permission to appeal to SLP3 in relation to its rectification claim and to Deutsche Bank in respect of the Partial Discharge Issue. Newey LJ did not give Deutsche Bank leave to appeal in respect of paras 5, 8 and 9 of the HC Orders.

26. The Court of Appeal (Lewison, Asplin, and Henderson LJJ) heard the three appeals (with appeal numbers A3/2020/1787, A3/2020/1810, A3/2020/1811) over five days from 4 to 8 October 2021. The CA Judgment was handed down on 20 October 2021.

27. The order giving effect to the CA Judgment was sealed on 21 October 2021 (the "**CA Order**"). The CA Order:

(1) Dismissed SLP3's appeal in relation to the LBHI2 Ranking Issue.

(2) Allowed GP1's and Deutsche Bank's appeals in relation to the PLC Ranking Issue and declared that Claim D ranks for distribution in priority to Claim C, reversing the Judge's decision.

(3) Allowed Deutsche Bank's appeal in relation to the Partial Discharge Issue, reversing the Judge's decision. It declared that: "*The liability of PLC under the PLC Sub-Debt has been reduced, including for the purposes of proof, by the*

*amount of any payments made by LBHI as surety for PLC's liability in respect of such claim*s."

(F) ISSUES BEFORE THE COURT APPEALED FROM

28. The first set of issues before the Court of Appeal concerned the LBHI2 Ranking Issue. There were four principal sub-issues between the parties:

(1) First, the manner in which the subordination provisions in question take effect in an insolvency. SLP3 submitted by reference to the Supreme Court's judgment in *Waterfall I* that (a) the subordination provisions in question prevent the lodging of a proof of debt until all "Senior Liabilities" or "Senior Creditors" have been satisfied, and (b) that the subordinated debts cannot be proved at any time as contingent debts. PLC submitted that the Supreme Court had not disagreed with Lewison LJ's judgment in the Court of Appeal in *Waterfall I* ([2015] EWCA Civ 485, [2016] Ch 50) that, pursuant to clause 5(1) of FSA Standard Form 10, the subordinated debts in question were contingent debts.

(2) Second, the relative ranking between Claim A and the unamended Claim B. SLP3 submitted that Claim A and the unamended Claim B ranked *pari passu*. In particular, it submitted that the solvency conditionality in the unamended Claim B (which also applies outside a winding-up in the amended Claim B) was not an expression of juniority from Claim A's perspective for the reasons summarised at CA Judgment [60]. PLC contended that the solvency conditionality in Claim B was an expression of juniority from Claim A's perspective because it subordinated Claim B to all debts that have fallen due.

(3) Third, the relative ranking between Claim A and the amended Claim B. SLP3 submitted that Claim A and the amended Claim B rank *pari passu*. PLC submitted that Claim B ranks below Claim A for the same reasons as the Judge. The principal issues for the Court of Appeal concerned: (a) the effect of the notional holder mechanism inserted by the amendments in light of the express subordination to defined "Senior Creditors" in the same provision; (b) whether the Judge's construction of Condition 3(a) was consistent with the italicised confirmatory note at the end of that clause (the "**Confirmatory Note**"), which stated that Claim B (a Lower Tier 2 debt) was intended to rank above any Upper

Tier 2 securities; and (c) the effect of the assumption that the LBHI2 Sub-Notes should be paid 100% of principal and interest in a winding-up.

(4) Fourth, in the event that the amendments to Claim B had caused a ranking alteration, whether Claim B should be rectified for common mistake.

29. The second set of issues concerned the PLC Ranking Issue:

(1) GP1 contended that Claim D ranks senior to Claim C based on "*narrow construction arguments*".[10]

(a) GP1 submitted that Claim C is not "*expressed to be junior*" to Claim D.[11] However, the "*rank… pari passu*" wording in Claim D denoted liabilities "*which, actually, rank pari passu with the Notes irrespective of what they express*".[12] GP1 argued that, from Claim D's perspective, there was an option that Claim C could rank *pari passu*. It submitted that "*on a tentative pari passu ranking*" with Claim C, Claim D would not be expressed to be junior to Claim C, such that Claim C must "*fall to be more junior still*".[13]

(b) LBHI submitted that, properly construed, the *pari passu* wording in Claim D does not result in its seniority over Claim C. As the Judge correctly held, Claim D is a "Senior Liability" from Claim C's perspective, and Claim C is a "Senior Liability" from Claim D's perspective, resulting in a *pari passu* outcome. The "*rank…pari passu*" wording in Claim D does not cause Claim C to be an "Excluded Liability" from Claim's D's perspective. Rather, if, as GP1 submitted, the *pari passu* wording in Claim D is engaged then that is the end of the analysis and the instruments must actually rank *pari passu*. If Claim C ranks or is expressed to rank *pari passu* with Claim D, that cannot cause Claim C to be an "Excluded Liability" from Claim D's perspective.

(c) Alternatively, pursuant to its Respondent's Notice, LBHI submitted that Claim C does not fall to the bottom of the pile and that it too is plainly

[10] GP1 Appeal Skeleton dated 18 January 2021, at [5].
[11] GP1 Appeal Skeleton, at [21.2].
[12] GP1 Appeal Skeleton, at [19.5].
[13] GP1 Appeal Skeleton, at [21.2(iv)].

capable of ranking *pari passu* with other subordinated debts given that, as the Judge correctly held, Claims C(i), C(ii) and C(iii) rank *pari passu* between themselves. That being so, there is no logical reason why Claim C should not also be capable of ranking *pari passu* with Claim D, which is a debt based on FSA Standard Form 10.

(2) Deutsche Bank's principal argument on the PLC Ranking Issue was the "Dividend Stopper" argument. Its core premises were that (a) there is a circularity as between Claim C and Claim D (which LBHI agrees with, and as was found by the Judge at first instance), and (b) "*there were strong commercial reasons for Claim D to be paid in priority to Claim C*",[14] namely, the operation of the Dividend Stopper in the ECAPS. The Dividend Stopper argument was relied upon to break the circularity which Deutsche Bank acknowledged arose between Claim C and Claim D. LBHI contended that Deutsche Bank had no permission to run the argument but that, in any event, the argument was unsustainable on the facts (including the Judge's unchallenged findings at [373] and [376] that the Dividend Stopper argument was inconsistent with the documentary evidence).

30. As to the Partial Discharge Issue:

(1) Deutsche Bank argued that as a matter of general principle, a payment by a surety will discharge *pro tanto* the debt due by the principal debtor to the creditor (*MS Fashions v BCCI* [1993] Ch 425, 448D, per Dillon LJ; *Milverton Group Ltd v Warner World Ltd* [1995] 2 EGLR 28). Where the surety makes payment after the commencement of insolvency, a different rule applies, and the creditor's claim may be maintained for the full guaranteed amount ("the rule in *Re Sass*"). However, given that LBHI, as the surety, had released its indemnity claim, the rule against double proof was not engaged. Instead, it submitted that the general principle applied, as any other result would lead to an overpayment to the creditor at the expense of other creditors.

(2) LBHI submitted that there is no general rule outside insolvency that part payment by the surety discharges the debt *pro tanto*. *MS Fashions v BCCI* and

[14] Deutsche Bank Appeal Skeleton dated 18 January 2021, at [14].

Milverton Group Ltd v Warner World Ltd are cases concerning principal debtor clauses in the context of insolvency set-off and the law of landlord & tenant. The rule against double proof is not engaged because of the release of the surety's indemnity, but the (separate) rule in *Re Sass* applies in any event. Further, LBHI submitted that there is no unjust enrichment because (a) LBHI cannot recover more than 100 pence in the pound and (b) in any event, it is Deutsche Bank which is enriched by PLC's aggregate liability being reduced below 100 pence in the pound.

(G) TREATMENT OF ISSUES BY THE COURT OF APPEAL

31. The LBHI2 Ranking Issue was dealt with in the CA Judgment as follows:

(1) First, as to the way subordination is given effect, having considered that in *Waterfall I* the "*real issue was when the subordinated creditor could lodge a proof*", the Court of Appeal declined to "*enter any further into this debate*" (at [25] and [26]). Instead, it concluded that it was up to each Insolvency Officer as to how to give effect to the court's interpretation (at [35]).

(2) Second, the Court of Appeal held that the effect of the unamended Claim B is only relevant to the claim for rectification (at [37]). Overturning the Judge's conclusion that Claim A ranked below the unamended Claim B, it concluded that Claim A ranked above the unamended Claim B. The Court of Appeal reasoned that the term "*debts*" in the solvency conditionality would have to be interpreted as excluding debts which are expressly junior to Claim B in order to avoid absurdity (at [61]), but nevertheless held that the solvency condition in Claim B is an expression of juniority from Claim A's perspective (at [63]).

(3) Third, as to the amended Claim B:

(a) The Court of Appeal held that "*the immediately relevant part of condition 3(a), then, is the second paragraph*" (at [42]), which de-coupled the notional holder mechanism from the express definition of "Senior Creditors" in the first paragraph. It held that the notional holder mechanism postpones the liability under Claim B to all other liabilities, whether subordinated or not (at [43]).

(b) The Court of Appeal dealt with the Confirmatory Note at [46], holding that the obvious inference was that the drafter intended Claim B to be the equivalent of Upper Tier 2 capital (at [46]), despite the note stating that Claim B was intended to rank in priority to "*any securities of the Issuer which qualify … as Upper Tier 2 Capital*" (emphasis added).

(c) The Court of Appeal held that the effect of the assumption that the LBHI2 Sub-Notes would be paid an amount equal to principal with interest was to do no more than make it clear that the holders of the LBHI2 Sub-Notes are to be paid in priority to the real holders of preference shares (at [43]).

(4) Fourth, having rejected the premise on which SLP3's rectification case arises by finding that Claim B ranked below Claim A in both unamended and amended form, the Court of Appeal dismissed the rectification appeal shortly (at [64]-[68]). It held that, in order for the claim in rectification to succeed, what must be established is a positive intention not to change the relative ranking of Claim B (at [66]).

32. As to the PLC Ranking Issue:

(1) The Court of Appeal framed the issue as being whether the "*rank…pari passu*" wording "*made all the difference*" at [79]. Overturning the Judge's conclusions that Claim C and Claim D rank *pari passu* for distribution and that the "*rank…pari passu*" wording does not make a difference to the ranking outcome (First Instance Judgment [356]), the Court of Appeal held that Claim C is an "Excluded Liability" from Claim D's perspective (at [83]), and that Claim D is a "Senior Liability" from Claim C's perspective (at [89]-[90]). This was on the footing that (a) there is an expression of juniority in Claim C because "*If a claim would otherwise rank pari passu with Claim C, Claim C has subordinated itself to that claim*" (at [83]) and (b) as a result of the "*rank…pari passu*" wording, Claim D "*takes its place in the queue alongside other creditors whose claims rank pari passu with it*" (at [90]).

(2) In reaching the above conclusions, the Court of Appeal did not address (a) LBHI's Respondent's Notice or (b) the issue of whether Claims C(i), C(ii) and

C(iii) rank *pari passu* as between themselves (nor, for that matter, the ranking as between Claims A(i), A(ii) and A(iii)).

(3) Having ruled during the course of the appeal hearing that Deutsche Bank did not have permission to advance the Dividend Stopper argument (such that LBHI did not have an opportunity to respond to it), the Court of Appeal nevertheless went beyond GP1's textual argument and endorsed (at [91]) the premise to the Dividend Stopper argument (which had been rejected by the Judge) that: "*the Notes which give rise to Claim D, unlike the Sub-Debt agreement which give rise to Claim C, were intended to raise money from external investors outside the Lehman group. It would be commercial reason enough to repay external investors before internal ones*."

33. As to the Partial Discharge Issue:

(1) The Court of Appeal held (at [114]) that, in relation to the position outside insolvency, it was bound by the decision in *MS Fashions* because the declaration originally made by Hoffmann LJ and upheld subsequently was that payment of part of a debt by sureties discharged the principal debt *pro tanto* which "*must have been part of the ratio of the decision*". It held that it was not bound by the decisions (to the contrary) in *Re Sass* and *Ulster v Lambe* [1966] NI 161 and that, despite academic criticism of the dictum of Dillon LJ in *MS Fashions* at 448D, it was not possible to say the case was decided *per incuriam*.

(2) Lewison LJ held (at [168]), as to the position within insolvency, that the creditor's entitlement to prove for the whole amount despite part payment by the surety is a "*judge-made fiction*", but that it would be unfair to apply the rule on the facts because it would mean that the proving creditor could receive more than 100 pence in the pound (and there was no legal basis for the creditor to account for any surplus over 100 pence to the surety). This was described by Lewison LJ as a "*modest development*" of the rule against double proof which did not intrude upon "*legislative competence*" (at [172]). In a separate judgment, Asplin LJ held (at [183]) that the rule against double proof was not engaged, and there was "*nothing as a matter of policy or otherwise to interfere with the principles in MS Fashions and the Milverton case*".

(H) GROUNDS OF APPEAL

34. SLP3 & LBHI rely on the following grounds of appeal in relation to (a) the LBHI2 Ranking Issue (b) the Rectification Issue (c) the PLC Ranking Issue and (d) the Partial Discharge Issue. This is the order in which the issues were addressed in the CA Judgment: it is not based on the relative importance[15] of each point.

The LBHI2 Ranking Issue (Claim A and Claim B)

35. As regards both Ranking Issues, the Court of Appeal should have had regard to and applied the following principles of construction (the "**Relevant Principles**"), in addition to those it set out at [27]-[28]:

    (1) Standard forms and/or contracts that incorporate standard terms should be construed in a manner which promotes consistency and legal certainty (*GSO v Barclays Bank* [2016] EWHC 146 (Comm), at [27]; *Pioneer Shipping Ltd v BTP Tioxide Ltd ("The Nema")* [1982] AC 724).

    (2) The more an interpretation which accords well with the actual words used produces a commercially improbable result, the more ready the court will be to give the words another, perhaps linguistically more strained, interpretation (*Re Sigma Finance Corp* [2009] BCC 393, at [99], per Lord Neuberger).

    (3) The reasonable reader of Lower Tier 2/Tier 3[16] subordinated debts would expect those debts to rank *pari passu* in the absence of clear wording to the contrary (*cf. Re Sigma Finance Corp* [2010] BCC 40, at [12], per Lord Mance; *Re Golden Key Ltd* [2009] EWCA Civ 636).

36. In determining the LBHI2 Ranking Issue, the Court of Appeal did not have regard to Relevant Principles (1) and (2) above, and it misapplied Relevant Principle (3). It erred in law in concluding that Claim A ranks for distribution above Claim B. It ought to

[15] In view of the LBHI2 administrators' estimate of the likely size of the surplus available to pay subordinated creditors, the Partial Discharge Issue only has commercial relevance if the Court of Appeal's decision on the PLC Ranking Issue is overturned.

[16] It was common ground between SLP3 and PLC that market expectation would be that Lower Tier 2 and Tier 3 would rank *pari passu* as "*a default*" (PLC Appeal Skeleton, at [9]). This position was consistent with other materials before the Court of Appeal, including a Basel I working paper. Despite having been given the references to SLP3's very detailed trial submissions on the regulatory background, the Court of Appeal stated, incorrectly, at [11] that Tier 3 ranks above Tier 2. This was an unfortunate, but significant, error when it came to consider the relative ranking of Claim A and Claim B, which (it is common ground) are Tier 3/Lower Tier 2 instruments.

have found that amended Claim B was intended to rank above Upper Tier 2 debt, and that it was Lower Tier 2 debt which, in the absence of an expression to the contrary, would in the usual course rank *pari passu* with other Lower Tier 2/Tier 3 debt, and that Claim A and Claim B rank *pari passu* for distribution.

37. First, the Court of Appeal erred in law in construing the payment conditions[17] in Condition 3(a) and 3(b) of Claim B (in both its unamended and amended forms), each of which followed the word "*accordingly*", in a way that is inconsistent with the express reference to subordination to "Senior Creditors" which precedes it:

(1) Having correctly held (at [39]) that the payment conditions in Condition 3(a) and 3(b) are "*spelling out the consequences of the statement that the debt is subordinated to Senior Creditors*", the Court of Appeal proceeded to construe the payment conditions as having consequences which are <u>inconsistent</u> with the subordination to the "Senior Creditors".

(2) In this regard, in construing the payment condition operative in its amended form inside a winding up, the Court of Appeal held that Claim B is "*postponed to all other liabilities, whether subordinated or not; unless they, too, have been relegated to the place in the queue occupied by shareholders*" (at [43]). Similarly, in construing the payment condition operative in its unamended form and outside a winding-up in its amended form, the Court of Appeal accepted the argument that Claim B is subordinated "*to the lowest possible level of debts due*" (at [59]). However:

(a) The definition of "Senior Creditors" provides that Claim B is <u>not</u> subordinated to subordinated creditors whose claims "*rank, or are expressed to rank, pari passu with, or junior to, the claims of the Noteholders*" both inside and outside a winding-up. The Court of Appeal overlooked this wording when holding, in essence, that Claim B is subordinated to <u>all</u> other debts. Moreover, the Court of Appeal thereby failed to give any effect to the word "*accordingly*" in the first paragraph of Condition 3(a).[18]

[17] These Conditions are set out in the Annex.

[18] This is despite the Court of Appeal stating at [39] that the word "*accordingly*" should be interpreted to mean "*in consequence*" or "*therefore*", and despite this being common ground between SLP3 and PLC.

(b) In the context of Claim D, the Court of Appeal considered that the "*rank…pari passu*" wording in the definition of "Subordinated Liabilities" allows Claim D to take its place in the queue "*alongside other creditors whose claims rank pari passu with it*" (at [90]). In the context of Claim B, however, the Court of Appeal adopted a different approach and did not recognise the same possibility, concluding instead that Claim B falls to the bottom.

38. Second, the Court of Appeal erred in law in concluding that, from the perspective of Claim A, Claim B contained an expression of juniority in the form of the "cashflow" solvency[19] condition (at [63]) both in its unamended form and outside winding-up in its amended form:

(1) The Court of Appeal was wrong to conclude that the words "*the Issuer shall be 'solvent' if (i) it is able to pay its debts as they fall due*" were an expression of juniority. As Lewison LJ accepted at [61], to avoid absurdity, the term "*debts*" would have to be interpreted as excluding debts which are expressly junior to Claim B. In those circumstances, the Court of Appeal ought to have concluded that the words in parentheses "*(other than its Liabilities to persons who are not Senior Creditors)*" qualified both the "cash flow test" in limb (i) as well as the "balance sheet test" in limb (ii), alternatively, that by implication the debts referred to in limb (i) are limited to "Senior Creditors".

(2) Further, the Court of Appeal should have held that Claim A has a solvency condition at Clause 5(2) which cannot be distinguished from the "cash flow" solvency condition in Claim B, and which therefore has an equivalent effect to it. In this regard:

(a) The solvency condition in Claim A requires LBHI2 to be able to pay all its "Liabilities" save for its "Excluded Liabilities" (and the broad definition of "Liabilities" includes all debts, not just debts falling due).

(b) The "cash flow" solvency condition in Claim B requires LBHI2 to be able to "*pay its debts as they fall due*". As Lewison LJ acknowledged at

[19] Further, the Court of Appeal was wrong to consider that the unamended Claim B was only relevant to the premise of the rectification claim (at [37]) in circumstances where Claim B's solvency condition applies both post-amendment (outside a winding-up), and pre-amendment (both inside and outside a winding-up).

[61], this would necessarily exclude debts which are expressly junior to Claim B.

(c) The solvency conditions in both Claim A and Claim B require the payment of all debts as they fall due, save for debts expressed to be junior. They are equivalent, such that there is no expression of juniority in Claim B for the purposes of Claim A, or vice versa.

(d) Accordingly, the Court of Appeal was wrong to conclude that the "cash flow" solvency condition in Claim B was a "*much broader definition than that contained in Claim A*" and that Claim A "*does not contain the same condition precluding payment*" (at [59]).

(e) Having not found there to be any other expression of juniority in Claim B (in its unamended form or outside a winding-up in its amended form) from the perspective of Claim A, the Court of Appeal ought to have found that Claim A and Claim B rank *pari passu*.

39. Third, the Court of Appeal erred in law in concluding that the notional holder mechanism operative in a winding-up in amended Claim B constitutes an expression of juniority to "*all*" forms of debt (at [45]):

(1) The Court of Appeal failed to construe the amended Condition 3(a) in a unified way. In particular, the Court of Appeal did not have proper regard to the words in the first paragraph: "*The rights of the Noteholders against the Issuer in respect of the Notes are subordinated in right of payment to the Senior Creditors (as defined below) and accordingly...*" (emphasis added), pursuant to which SLP3 agreed to subordinate its rights to the "Senior Creditors" as defined, not to the claims of "*all*" creditors, as the Court of Appeal held it has done.

(2) Further or alternatively, if the notional holder mechanism does imply (as the Court of Appeal held at [43]) a ceiling as well as a floor, on a unified reading of the provision, the ceiling is the "Senior Creditors". Claim B ranks above all securities qualifying as Upper Tier 2 capital (including any Upper Tier 2 debt, including the Notional Holders) such that the LBHI2 Sub-Notes are in the Lower Tier 2 layer, envisaging a *pari passu* ranking with other Lower Tier 2/Tier 3 debts (such as Claim A), as contemplated by the definition of "Senior Creditors".

(3) Further or alternatively, the Court of Appeal erred in law in its construction of the Confirmatory Note in italics at the end of Condition 3(a). This Confirmatory Note is an unusual statement of the parties' intent. The Court of Appeal should have construed the Confirmatory Note as stating that the LBHI2 Sub-Notes rank above all securities qualifying as Upper Tier 2 capital (including any Upper Tier 2 debt) such that the LBHI2 Sub-Notes are in the Lower Tier 2 layer, *pari passu* with other Lower Tier 2/Tier 3 debts (such as Claim A). The Confirmatory Note is inconsistent with the Court of Appeal's contrary conclusion (at [45]) that Claim B expresses itself to rank junior to "*all*" forms of debt,[20] including all Upper Tier 2 debt: it is plain from the Confirmatory Note that the parties' intention was that Claim B would rank above Upper Tier 2 debt, and *pari passu* with other Lower Tier 2 debt. In this connection, it was never SLP3's case that the Confirmatory Note provides that Claim B has priority over all Lower Tier 2 capital, as stated (incorrectly) at [47], just that Claim B ranks *pari passu* with Lower Tier 2 capital.

(4) Further or alternatively, Condition 3(a) introduces a qualifying assumption to the notional holder mechanism: "*on the assumption that such preference share was entitled to receive, on a return of assets in such winding-up, an amount equal to the principal amount of such Note together with Arrears of Interest*". The Court of Appeal held that the effect of the assumption of being entitled to 100% of principal and interest in a winding-up was to do no more than make it clear that the holders of the LBHI2 Sub-Notes are to be paid in priority to "*real holders of preference shares*" (at [43]). However, that function is already performed by the language in Conditions 3(a)(i) and (ii) which expressly describe the position of the LBHI2 Sub-Notes over preference shareholders and "Notional Holders". Accordingly, the Court of Appeal erred by giving no meaning to that assumption. On a proper construction, the assumption is consistent with the LBHI2 Sub-Notes being entitled to prove for their full principal amount alongside other debts in the Lower Tier 2/Tier 3 level.

[20] Separately, the Court of Appeal found in the following paragraph (at [46]) that "*the drafter intended Claim B to be the equivalent of Upper Tier 2 capital*". This was plainly at odds with its previous finding at [45].

40. For all of the above reasons, the Court of Appeal erred in law in concluding that Claim B falls below "*all forms of debt*" (at [45]) and "*all other creditors (including subordinated creditors) but before real preference shareholders*" (at [43]). If it had construed each claim independently, the Court of Appeal would have held that Claim A was a "Senior Creditor" from Claim B's perspective, and that Claim B was a "Senior Liability" from Claim A's perspective, such that they rank *pari passu*. Alternatively, pursuant to its Respondent's Notice (see para 46(2) below), if the "*rank…pari passu"* wording in Claim B has a substantive effect on ranking, then there is no material point of distinction between Claim A and Claim B as a result of a purposive construction of Claim A and/or the implication of a term having equivalent effect such that they rank *pari passu*.

The Rectification Issue

41. Further, the Court of Appeal erred in law (at [64]-[68]) in dismissing the rectification claim concerning the 2008 amendments to the Claim B offering circular.

42. First, in finding (at [65]) that the material mistake was "*no more than an uncontemplated knock-on effect of the words deliberately inserted*", the Court of Appeal implicitly concluded that rectification is not available where the parties intended to use the words in respect of which rectification is subsequently sought. This approach to rectification is too narrow, as well as being inconsistent with both authority and common sense. The correct analysis is that rectification is available "*where the words of the document were purposely used but it was mistakenly considered that they bore a different meaning from their correct meaning as a matter of true construction*" (*Re Butlin's Settlement Trusts* [1976] Ch 251, 260, per Brightman J, cited by the Court of Appeal in *FSHC v GLAS* [2019] EWCA Civ 1361, at [70]; see also per Lawrence Collins J in *AMP (UK) Plc v Barker* [2001] Pens LR 77, at [70]). If the Court of Appeal's interpretation is upheld, this was a classic case where the parties did not appreciate or understand the legal effect of the amendments to Condition 3.

43. Second, the Court of Appeal erred in holding (at [66]) that "*what must be established by convincing evidence is a positive intention (manifested by outward accord) not to change the relative ranking of Claim B*". It is not a necessary condition for rectification that there be a positive intention not to effect a particular change. This much was

common ground[21] with PLC in the court below. Neither Henry Carr J nor the Court of Appeal in *FSHC v GLAS* held that it was necessary to have such a positive intention. It is sufficient to rectify a document that there be a positive intention only to make specific and limited legal change X to an existing contractual arrangement, such that it necessarily follows that the decision makers did not actually intend to make further legal change Y.

44. Third, further or alternatively, where A&O (a) were acting in connection with an internal transaction between affiliates in the Lehman Group and (b) positively intended not to alter the ranking of Claim B (satisfying Lewison LJ's formulation of the test for rectification at [66]), the Court of Appeal should have held that A&O's intentions were attributable to LBHI2 and SLP3 such that, if there was a mistake by A&O, that mistake is to be attributed to LBHI2 and SLP3. Further, the Confirmatory Note drafted by A&O, and as explained by Mr Grant in his evidence, records the express intention not to alter Claim B's ranking position.

The PLC Ranking Issue (Claim C and Claim D)

45. In determining the PLC Ranking Issue, the Court of Appeal did not have regard to Relevant Principles (1) and (2) above, and it misapplied Relevant Principle (3). It erred in law in concluding that Claim D ranks for distribution above Claim C. It should have held that (a) Claim C falls within the category of "Senior Liabilities" in Claim D, and (b) Claim D falls within the category of "Senior Liabilities" in Claim C, which results in the subordination provisions in Claim C and Claim D being ineffective (as the Judge held, First Instance Judgment [356]-[358]) or unenforceable in that particular instance, such that the claims rank *pari passu*.

46. First, the Court of Appeal erred in law by concluding (at [83]) that Claim C contains an expression of juniority such that it falls within the category of "Excluded Liabilities" in Claim D, and that "*If a claim would otherwise rank pari passu with Claim C, Claim C has subordinated itself to that claim*". In summary:

    (1) The Court of Appeal's reasoning at [83] that Claim C "*is therefore within Claim D's definition of Excluded Liabilities*" was based on the false premise that Claim

[21] See PLC Appeal Skeleton, at [77].

C is precluded from ranking *pari passu* with other subordinated debts. It is not, and far clearer wording would have been required in Claim C to evince the intention that it ranked below debts which otherwise ranked *pari passu* with it. In this regard:

(a) The Court of Appeal did not address the ranking *inter se* of Claims C(i), C(ii) and C(iii) (or Claims A(i), A(ii) and A(iii)) and did not consider the Judge's conclusion at First Instance Judgment [151]-[154], [248]-[250] that separate claims on FSA Standard Form 10 rank *pari passu* with each other because the subordination provisions are ineffective or unenforceable as between each other.[22]

(b) This was a critical analytical step in the First Instance Judgment which has not been overturned by the Court of Appeal.

(c) Accordingly, at a minimum, Claim C has not subordinated itself to other claims drawn up on FSA Standard Form 10.

(d) The Court of Appeal did not go onto consider why, logically, Claim C cannot also rank *pari passu* with Claim D, which only differs from FSA Standard Form 10 in that it contains "*rank…pari passu*" wording.

(e) If the FSA's concern was only to ensure the subordination of regulatory subordinated debts to unsubordinated[23] creditors (at [76]), then that regulatory purpose would not be furthered by preventing claims on FSA Standard Form 10 from ranking *pari passu* with other dated subordinated debts forming part of the same tier of regulatory capital

(f) Such a reading of Claim C would be entirely consistent with Lewison LJ's conclusion at [61] that "*in order to avoid absurdity*" the expression "*its debts*" in Claim B "*would have to be interpreted as excluding debts which are expressly junior to the Notes*".

[22] All the parties agreed with the Judge's conclusion but not his methodology in this regard: GP1 Appeal Skeleton, at [17]; DB Trial Skeleton, at [180]. Likewise, GP and Deutsche Bank both accepted that Claims D(i), D(ii), D(iii) and D(iv) ranked *pari passu* (GP1 Trial Skeleton, at [57]; DB Trial Skeleton, at [180]).

[23] FSA Standard Form 10 was imposed by IPRU(INV), Chapter 10, which in turn implemented EU Directive 89/299/EC. Article 4(3) stipulated that regulated subordinated debt had to rank behind "*all other creditors*".

(g) In this regard, it would plainly be possible for Claim C to rank *pari passu* with another subordinated instrument ("**Claim K**"), which expressed itself in terms to rank *pari passu* to Claim C (and far clearer wording would be required in Claim C if this were not to be the result).

(2) Further or alternatively, as per LBHI's Respondent's Notice, the Court of Appeal ought to have applied a purposive construction of Claim C and/or implied a term so as to conclude that Claim C is not precluded from ranking *pari passu* with other subordinated debt, such that it does not contain an expression of juniority from the perspective of Claim D.

(3) Further or alternatively, if the Court of Appeal was correct to conclude at [44] that Claim A, which is drawn up on FSA Standard Form 10, does not contain an expression of juniority to Claim B, then the same conclusion ought to have applied by extension to Claim C in the context of the PLC Ranking Issue. However, the Court of Appeal wrongly construed the two identical provisions in an obviously inconsistent manner (*cf.* GSO v Barclays Bank, above).

47. Second, the Court of Appeal erred in law by according the "*rank…pari passu*" wording in Claim D's definition of "Subordinated Liabilities" too much weight, wrongly concluding that those words make all the difference to the PLC Ranking Issue and render Claim C junior to Claim D. It is illogical and uncommercial for the inclusion of the "*rank….pari passu*" wording in Claim D, which merely acknowledges the commonplace concept of a *pari passu* ranking, to constitute an expression of seniority over other debt. In this regard:

(1) The Judge correctly held at First Instance Judgment [356] that the "*rank…pari passu"* wording in Claim D "*makes no difference to the [ranking] outcome*". This was based on his conclusions that: (a) Claim C is not "expressed to rank *pari passu*" with Claim D (at [356]); and (b) the meaning of the phrase "*rank…pari passu*" is "*elusive*"[24] when applied to subordinated creditors (at [166(2)(e)(i)]). Since the "*rank…pari passu*" wording has no substantive effect for the purposes of relative ranking beyond encompassing claims that are "*expressed to rank*" *pari passu,* the Court of Appeal ought to have concluded

[24] This is because 'subordinated', by definition, will exclude creditors relying solely on their priority as determined by law.

that Claim C and Claim D are substantively identical, such that they rank *pari passu*.

(2) Further or alternatively, the Court of Appeal ought to have concluded that (a) the "*rank…pari passu*" wording is not engaged, (b) Claim C and Claim D are both "Senior Liabilities" from each other's perspective, and (c) Claim C and Claim D rank *pari passu* for the reasons identified at First Instance Judgment [356]-[358]. In summary:

(a) If, after considering Claim C from the perspective of Claim D, the conclusion is that Claim C "*rank[s] or [is] expressed to rank pari passu*" with Claim D, then Claim D agrees and the two claims do in fact rank *pari passu*. Once that *pari passu* outcome is established, there is not then a further stage in the construction which renders Claim C junior to Claim D from Claim D's perspective.

(b) If, after considering Claim C, the conclusion is that it does not[25] "*rank or [is] expressed to rank pari passu*" with Claim D, then Claim C is not a "Subordinated Liability" for the purposes of Claim D. Since the remaining language in the two subordination clauses is identical, Claim C and Claim D must (as the Judge held at First Instance Judgment [356]-[358]) rank *pari passu* for the same reasons that Claims C(i), C(ii) and C(iii) rank *pari passu* among themselves.

(3) Accordingly, the Court of Appeal ought to have concluded (consistent with the Judge) that, according to its plain and natural meaning in a subordination context, the additional "*rank…pari passu*" wording in Claim D does not result in a substantive difference between the "Senior Liabilities" in Claim D, and the "Senior Liabilities" in Claim C for the purposes of their relative ranking *inter se*. The Court of Appeal ought to have upheld the Judge's reasoning that Claim C and Claim D rank *pari passu*.

48. Third, in reaching the conclusion that the "*rank…pari passu*" wording in Claim D's definition of "Subordinated Liabilities" makes all the difference to the ranking with Claim C, the Court of Appeal erred in law by having insufficient regard to the relevant

[25] GP1's position on appeal was that Claim C might have a "*tentative*" *pari passu* ranking in Claim D (GP1 Appeal Skeleton, at [21.2(iv)]).

regulatory context. This was part of the admissible factual matrix and would have been known to market participants at the time. Had the Court of Appeal had proper regard to the regulatory context, it would have noted that its construction of the "*rank…pari passu*" wording contradicted the FSA Waiver Directions in two significant respects. In summary:

(1) At the time each series of PLC Sub-Notes was issued, the relevant FSA Waiver Direction permitted Claim D to derogate from FSA Standard Form 10 in specific, very limited respects. The FSA Waiver Directions stated that:

(a) "*the degree of subordination of the loan capital is no less than that provided for by* [FSA Standard Form 10]" (emphasis added); and[26]

(b) As regards the modified definition of "Subordinated Liabilities", this was permitted by the FSA to "*better reflec*[t] *borrowing in a bond, rather than a loan format*". Further, the FSA Waiver Direction of 21 March 2006 stated in terms that *"[t]he definition of 'Subordinated Liabilities' may be changed only to the extent required to reflect borrowing in a bond rather than a loan*" (emphasis added). This reflected, verbatim, the explanation PLC had provided the FSA as to why FSA Standard Form 10's definition of "Subordinated Liabilities" had been modified in Claim D.

(2) Having stated correctly that the regulatory background is a potential aid to construction (at [31] and [76]), Lewison LJ erred in holding that the FSA Waiver Directions were not "*of any real moment*" (at [76]):

(a) As to sub-para 1(a) above, the Court of Appeal erred in interpreting the FSA Waiver Directions as being concerned only with Claim D's subordination *vis-à-vis* unsubordinated creditors. The FSA Waiver Directions state in terms that Claim D's degree of subordination was to be no less than FSA Standard Form 10 (i.e. Claim C). The effect of the Court of Appeal's construction is that Claim D is, in fact, less

[26] The FSA Waiver Directions were based on the FSA Waiver Application. The application submitted by PLC also appended an A&O opinion specifically stating that the PLC Sub-Notes have equivalent subordination to the FSA Standard Form: "*we [i.e. A&O] hereby confirm that the terms and conditions of the Notes provide equivalent subordination to that in the FSA Standard Form and that each Note is similarly and identically bound by the subordination requirements*."

subordinated than Claim C by virtue of the "*rank…pari passu"* wording.

(b) As to sub-para 1(b) above, this wording was not addressed at all by the Court of Appeal. The FSA Waiver Directions made clear that the "*rank…pari passu"* wording was not permitted to have substantive effect, but rather its effect was limited to reflecting the formal change from loan to bond format. The effect of the Court of Appeal's construction is that the "*rank…pari passu"* wording did, in fact, effect a substantive change to the ranking of FSA Standard Form 10.

(3) Where, as in this case, there are two possible alternative constructions available, the reasonable addressee would read Claim D in such a way as not to contravene the regulatory scheme. LBHI's construction is consistent with the FSA Waiver Directions, whereas the construction of the Court of Appeal contravenes them.

49. Fourth, when construing Claim C and Claim D, the Court of Appeal did not address each instrument independently from its own perspective. A flaw in the Court of Appeal's methodology is that the overall result of the construction exercise is dependent on which claim one starts with. In summary:

(1) As Lewison LJ correctly said at [56], it is not possible to decide whether a liability is "*expressed to be*" junior to a particular claim without looking at the terms of the instrument creating that liability. That necessitates considering afresh from each claim's perspective whether the instrument creating the other liability contains an expression of juniority.

(2) The Court of Appeal did not consider each instrument afresh, and erred in not doing so. In this regard:

(a) From Claim D's perspective, the Court of Appeal held (at [83]) that Claim C falls within the definition of an "Excluded Liability".

(b) However, when it came to the exercise from Claim C's perspective, Lewison LJ's approach (at [87]) was circular: "*if Claim D is not subordinated to Claim C, then it does not express itself as being junior to Claim C*".

(3) Accordingly, the Court of Appeal proceeded to rely (at [89]) on its earlier conclusion from Claim D's perspective to determine the outcome of the exercise from Claim C's perspective: "*Since they* [Claim C] *fall within that definition* [*i.e.* Claim D's definition of "Excluded Liabilities"], *Claim D does not subordinate itself to Claim C*" (emphasis added).

(4) That approach failed to construe ranking from Claim C's perspective afresh, and was unprincipled and wrong.

50. Fifth, the Court of Appeal erred in law by taking into account an alleged commercial rationale to repay external investors before internal ones as part of the admissible factual matrix against which to construe Claim C and Claim D:

(1) This was a premise of Deutsche Bank's "Dividend Stopper" argument, in respect of which, although Deutsche Bank made written and oral submissions, permission to appeal was refused both by the Judge and by the Court of Appeal. Accordingly, LBHI did not have an opportunity to respond to it.[27]

(2) The premise to Deutsche Bank's "Dividend Stopper" argument was inconsistent with the Judge's unchallenged findings. For example, the Judge found that:

(a) "*This question [of the relative priority of the PLC Sub-Notes] was either not discussed at all, or else the view was taken in drafting that the PLC Sub-Notes should rank lower in the waterfall of subordinated debt. There is no evidence to support the suggestion that the PLC Sub-Notes should rank <u>below</u> unsubordinated debt, but above other forms of subordinated debt*" (at [373(3)]) (original emphasis).

(b) "*I am in some doubt that the evidence sought to be adduced by Deutsche Bank could even be regarded as material relevant to issues of construction*" (at [376(3)]).

[27] If it had had the opportunity to respond, LBHI would have submitted, for example, that the ECAPS were preferred securities akin to equity, with a deeply subordinated guarantee from PLC as security, and which could be converted into preferential shares in LBHI which would be structurally junior to all debt within the Lehman Group.

(3) In any event, the distinction between external and internal investors is a mere assertion that is irrelevant as a matter of law. It did not constitute proper grounds for favouring one interpretation of the subordinated instruments over another.

51. For all the reasons above, the Court of Appeal erred in law in concluding that Claim D ranked senior to Claim C, and it ought to have concluded that they rank *pari passu*.

Partial Discharge Argument

52. The Court of Appeal erred in concluding that the liability of PLC under Claim C has been reduced, including for purposes of proof, by the amount of any payments made by LBHI as surety for PLC's liability in respect of such claims. The Court of Appeal reached this conclusion, incorrectly, on the basis that LBHI, as surety, has released any right to indemnity from PLC.

53. First, insofar as its reasoning (at [172]) was based on a "*modest development*" of the rule against double proof, the Court of Appeal erred in its description (and therefore its application) of that judge-made rule. In this regard:

(1) At [139] Lewison LJ described the rule against double proof as having "*two main facets*": first, that "*it permits the creditor to prove for the whole of the original debt without giving credit for any part payment received from the surety*"; second, that "*it precludes the surety from proving unless and until the creditor has recovered 100 p in the pound (either inside or outside the insolvency)"*.

(2) However, these "*two facets*" are in fact two separate principles. The second facet embodies the rule against double proof, which the Court of Appeal correctly described (at [136]) as "*a rule against the receipt of two dividends*"; however, the first facet is the so-called "rule in *Re Sass*", which provides that a creditor is entitled to prove for the full amount in the principal's insolvency without giving credit for an amount received from the surety. These two principles are free-standing and distinct: see *Goode on Principles of Corporate Insolvency Law* (Van Zwieten, 5th edition), where they are treated separately at 8-048 ("No deduction need be made for third-party receipts") and 8-049 ("No double proof").

(3) Further, even if the rule against double proof was not engaged in the present case, there is no reason why the rule in *Re Sass*[28] should not continue to apply. In this regard, the consequences of (a) the surety's inability, because of the rule against double proof, to prove until the creditor has been paid in full and (b) the surety's waiver of its right of indemnity against the principal debtor, should be and are the same. In either case, the creditor should be entitled to maximise its recoveries (subject to never recovering more than 100 pence in the pound), and the other unsecured creditors of the debtor should not otherwise be able to "*receive a windfall*" (*Rowlatt on Principal and Surety*, 6th edition, 11-02).

54. Second, to the extent the Court of Appeal held that it was extending and developing the rule against double proof to mitigate against "*potential unfairness*" (at [169]) in the circumstances of this case, its reasoning was erroneous. In summary:

(1) Lewison LJ posited a hypothetical scenario where (a) the principal debtor owes the creditor £1 million (b) the surety pays the creditor £500,000 (c) the creditor proves for the entire £1 million (d) the creditor receives a dividend of £600,000 such that (e) the creditor receives £1.1 million (more than the original debt). On these facts, he concluded that (f) the creditor would receive a windfall and (g) the creditor was under no obligation to pay the surplus of £100,000 to the surety "*since the surety no longer has a right to be indemnified*".

(2) There are several flaws with this hypothesis:

(a) First, the scenario described by Lewison LJ is based on a false premise. This is because it overlooks the well-established principle, set out in both the case-law and the textbooks, that the creditor is entitled not to give credit for the amount received from the surety so long as the creditor does not receive more than 100 pence in the pound (*The Law of Guarantees*, Andrews/Millett, 7th edition,13-007; *Rowlatt on Principal and Surety*, 11-02). As Asplin LJ recognised (at [182]), in these circumstances a creditor will be liable to repay the surety any surplus he has received over and above the original debt: see, in this regard, *Legal*

[28] Further, the rule in *Re Sass* is not a "*judge-made fiction*" which is "*procedural only*" (at [168], per Lewison LJ, at [182], per Asplin LJ). It represents the principled application of the respective rights between surety, creditor and principal debtor, and the right of the creditor to claim is a substantial and continuing right which reflects the fact that the underlying debt has not been discharged.

Problems of Credit & Security (Goode & Gullifer, 6th edition), at 8.18, citing *Re Sass*, and *Westpac Banking v Gollin & Co Ltd* [1988] VR 397, at 403.

(b) Second, the facts described by Lewison LJ would lead to the same legal outcome irrespective of the waiver by the surety of its indemnity against the principal debtor. The legal obligation on the creditor to hold the surplus on trust[29] for and/or return the excess to the surety (which prevents the unjust enrichment of the creditor) is unaffected by the surety's agreement with the principal debtor to waive their right to an indemnity. Similarly, the legal obligation of the creditor to repay any surplus to the surety is unconnected to the surety's right to an indemnity from the principal debtor. Further, if (which is not accepted) the creditor was not under a legal obligation to return any surplus to the surety after being paid in full (as a result of the waiver of the surety's indemnity), the creditor, being unjustly enriched, would be obliged to return it to the liquidator in any event, failing which the estate would have a right to seek restitution from the creditor in relation to the mistaken payments.

(c) Third, on the hypothetical facts suggested by the Court of Appeal, the proving creditor would not receive a windfall at the expense of creditors. Subject to not recovering more than 100 pence in the pound, the creditor merely receives the dividend to which they would have been entitled absent the guarantee (and any enhanced recovery reflects the fact they have entered a contract of suretyship). There is no disturbance of *pari passu* distribution. Rather, in the converse situation (where the creditor is required to reduce their proof), it is the estate (i.e. the principal debtor)

[29]See *Rowlatt on Principal and Surety*, at 11-007, and 11-008; *Ulster v Lambe* [1966] NI 161, 169, per Lowry J. In this case, there was a separate obligation, under Clause 2.04 of the Settlement Agreement, which had (at [170]) the effect of substituting the surety's equitable right to receive payment from the creditor of any surplus with a contractual right to the same effect under New York law. The Court of Appeal held that this point was not raised at trial, and it was "*not covered by that evidence*": such that it would not be fair to Deutsche Bank to refer to it. This overlooks the fact that (a) Deutsche Bank's argument based on the release of the indemnity is a new one that was not advanced substantively until after the trial had finished (in a post-trial submission dated 26 November 2019) in circumstances where its trial case had focused on a (different) argument that LBHI claimed as an assignee (which the Judge rejected at First Instance Judgment [290]-[291], [303]-[304]); and (b) the principles of contractual construction under New York law are clearly identified in the First Instance Judgment (such that the Court of Appeal was not prevented from applying them in relation to the Settlement Agreement).

that takes the double-benefit of (a) the creditor being unable to claim in full and (b) the surety's waiver of their indemnity. This means that it is the principal debtor who is unjustly enriched, and there is more money available for other creditors (in this case, Deutsche Bank). It is entirely unclear why the creditor *should not stand* to benefit from its guarantee and, conversely, the other creditors (who are not a party to the guarantee) *should stand* to benefit from it. Finally, it would be inequitable that the creditor should have to give credit for something which (absent the waiver of the indemnity) the surety would have been unable to prove for in any event because of the rule against double proof.

55. Third, to the extent the Court of Appeal held (per Lewison LJ, at [114]) that the *ratio* of *MS Fashions* [1993] Ch 425 was that part payment of a debt by a surety discharges the principal debtor *pro tanto*, and that this is a principle of general application outside insolvency, it was wrong to do so. In relation to this:

(1) The decision in *MS Fashions* hinged (*cf*. Lewison LJ at [107]-[109]) on the "*principal debtor*" clause in the underlying documentation.

(a) As Patten LJ explained in *McGuinness v Norwich Peterborough BS* [2011] EWCA Civ 1286 (at [62]) the critical issue in *MS Fashions* was "*whether the liability under the guarantee was a primary one, or merely a [secondary] liability contingent on the making of a demand*".

(b) The *ratio* of the case was that the primary debtor clause created a mutual debt which could be subject to automatic insolvency set-off under rule 4.90,[30] not (per Dillon LJ, at 448D) that a payment by a surety discharges the principal debt *pro tanto*.

(c) Further, and in any event, there is no such principle of general application outside insolvency.[31] The question of whether part-payment by a surety discharges the principal debt is a fact-sensitive exercise,

[30] In this regard, the declaration by Hoffmann LJ (at 439B-C) was that "*the indebtedness of each of the companies as at the date of the winding up has been extinguished or reduced by the amount which on that date was standing to the credit of the directors on their respective deposit accounts*". Similarly, the judgments of Scott LJ (at 575) and Woolf LJ (and 577) in the earlier decision reported at [1992] BCC 571 are both obviously concerned with the discharge of principal indebtedness via automatic set-off.

[31] See *Ulster v Lambe*, at 169; *Re Sass*, at 14; and *Legal Problems of Credit and Security*, at 8-018.

which depends on the terms of the guarantee and the distinction between primary/secondary obligations.

(2) Furthermore, the Court of Appeal was wrong to find support for its erroneous application of *MS Fashions* in further case law and textbooks. By way of example:

(a) At [97]-[98]: the extract cited from *Chitty on Contracts* (33rd edition[32], 45-084) is not a general statement, and refers to the specific situation where the guarantee is entered "*at the request*[33] *of the principal debtor*". Further, it is inconsistent with the further passage at *Chitty,* 45-078 (cited to the Court of Appeal by LBHI) which states that a payment by a surety does not discharge the principal debt *pro tanto*. Finally, the passage in *Chitty* at 45-084 (see Lewison LJ, at [98]) refers to discharge of the surety (not the principal debtor) and is obviously irrelevant.

(b) At [107]: the decision of Field J in *Lehman Brothers Commodity Services Inc v Credit Agricole Corporate Investment Bank* [2011] EWHC 1390 (Comm) at [29] is plainly concerned with set-off between two parties (not the tri-partite relationship of surety, principal debtor, and creditor).

(c) At [116]-[123]: the Court of Appeal cited several cases on subrogation which had not been addressed by the parties in their written or oral submissions. Relying on these, and without having had the benefit of argument, the Court of Appeal wrongly held (at [117]) that the right of subrogation arises where the principal debt has been part-paid. However, the right only arises where the principal debt has been satisfied and the creditor has been paid in full (see *The Modern Contract of Guarantee*, 4th edition, O'Donovan/Phillips, 12-270 - 12-272; and *The Law of Guarantees*, 11-018). Accordingly, in *Banque Financière de la Cité* [1999] 1 A.C. 221 and *Commercial Bank* [1893] AC 181, there was payment in full; in *Brook's Wharf* [1937] 1 KB 534 there was concurrent liability where the warehouseman had paid in full; and *Carter v Carter*

[32] The current version of *Chitty* is in fact the 34th (not the 33rd edition) (in which this passage is at 47-088).
[33] This is to be contrasted with the 'volunteer' surety (in which regard, see *The Law of Restitution*, Burrows, 3rd edition, pages 460-468).

(1829) 5 Bing 406 was a case in which a tenant was compelled to make a payment in full (and where there was no relevant surety relationship). These cases do not in fact support the Court of Appeal's reasoning.

(3) Finally, if the Court of Appeal's decision were correct, it would create obvious scope for abuse. For example, in a situation where the surety and principal debtor are group companies (which must be common), and the surety itself has other claims against the debtor, the surety could deliberately release its indemnity claim against the debtor, thus reducing the creditor's proof, and causing the surety to be paid out more on its own proof.

(I) REASONS WHY PERMISSION SHOULD BE GRANTED

56. LBHI and SLP3 submit that the reasons why permission to appeal to this Court should be granted fall under four headings:

(1) The Ranking Issues.

(2) The Rectification Issue in respect of Claim B.

(3) The Partial Discharge Issue in respect of Claim C.

(4) Due process.

The Ranking Issues

57. In broad terms, the Ranking Issues deserve consideration by the Supreme Court because of:

(1) the broader commercial significance of the Ranking Issues given the prevalence of similarly worded instruments in the London market and the volume (many billions of pounds) of regulatory subordinated debt issued annually;

(2) the need for commercial certainty about the proper construction of standard form agreements given their inconsistent interpretation by the Court of Appeal across the two Ranking Issues;

(3) the need for legal certainty as regards the operation of subordination in light of the Court of Appeal's treatment of *Waterfall I*;

(4) the novelty of the legal issues involved;

(5) the weight to be attributed to the FSA Waiver Directions where an interpretation (such as that adopted by the Court of Appeal) contradicts them; and

(6) the amount of money at stake and the number of stakeholders affected.

58. Each of these points is addressed in more detail below.

59. First, the ranking issues are significant in view of the size of the subordinated debt market. In 2020 alone, over £20 billion[34] of subordinated instruments were issued by UK financial institutions to investors.

60. Second, the subordination provisions in each of Claims A, B, C and D are based on wording which is in widespread use in the market today. In this regard:

(1) Claim A and Claim C are taken directly from FSA Standard Form 10, which does not contain wording providing that other liabilities which "*rank….pari passu*" are excluded from the definition of "Senior Liabilities". This form of wording, which was originally produced by the FSA *inter alia* to give effect to European rules on capital adequacy,[35] continues to be commonplace in the market. In this regard, at least five regulatory standard form subordinated debt agreements[36] presently prescribed or suggested by the FCA continue[37] to use identical definitions of "Senior Liabilities", "Subordinated Liabilities" and "Excluded Liabilities" to FSA Standard Form 10. Approximately 14,000 firms fall within prudential categorisations in relation to which the FCA requires or suggests the use of these standard forms. In summary:[38]

[34] This is based on information in relation to subordinated debts compiled from Bloomberg.

[35] As Lewison LJ said "*All the other instruments discussed on this appeal were either standard forms imposed by the FSA; or were derived from such forms or at the very least had an underlying regulatory function*" (CA Judgment [28]).

[36] MIPRU 4.4.7R/4.4.9G, which provide "*an example of a subordinated loan agreement which would meet the required conditions*"; IPRU-INV 3-63(2)R, IPRU-INV 9.5.4R(a), IPRU-INV 13.1A.20R(5) and IPRU-INV 13.15.8(4), which prescribe standard form subordinated loan agreements. These regulatory regimes will be replaced in January 2022 by a new regime called IFPR/MIFIDPRU, which will no longer require prescribed forms. However, there are transitional provisions which provide that the Tier 2 instruments issued before the new regime comes into force will continue to be recognised (such that the issues of ranking/subordination will remain material).

[37] The parts of the IPRU regulatory regime that prescribed standard form debt agreements for firms like Lehman Brothers were replaced by GENPRU but the standard forms were similarly grandfathered for continued use.

[38] Figures are based on figures obtained from a third party data extract service, which extracts data from the FCA Register (https://www.fca.org.uk/firms/financial-services-register) using a pragmatic methodology which allows

(a) Approximately 9,900 firms are subject to MIPRU 4, which applies to (non-bank) mortgage lenders, mortgage intermediaries, and insurance intermediaries.

(b) Approximately 3,200 firms are subject to IPRU-INV 3, which applies to certain securities and futures firms, including certain commodities firms, energy market participants and oil market participants.

(c) Approximately 900 firms are subject to IPRU-INV 9 or IPRU-INV 13, which apply to certain investment management firms, securities and futures firms and to certain personal investment firms.

(d) Furthermore, materially similar standard forms to FSA Standard Form 10 are used in the Channel Islands, the Isle of Man and other offshore jurisdictions.

(2) Claims B and D include wording to the effect that "Liabilities" which "*rank...pari passu*" are not "Senior Liabilities". The use of this wording continues to be commonplace in the market, and numerous recent examples[39] are available from open sources.[40]

(3) At first instance, the Judge held that debts on FSA Standard Form 10 rank *pari passu* between each other (*i.e.* Claims C(i), C(ii) and C(iii)), as well as with subordinated debts which include "*rank…pari passu*" wording (*i.e.* Claim C and Claim D). He reasoned that between subordinated debts containing "*rank…pari passu*" wording and subordinated debts which do not contain such wording, an endless loop arises. In resolving this issue, he said that "*as far as I am aware, there is no authority*" on the point and that none of the parties had pointed to any (First Instance Judgment [248]). The Court of Appeal's reasoning did not deal with the "*endless loop*" which plainly arises on the face of FSA Standard Form 10 or the Judge's approach to resolving this highly novel issue. Accordingly, the CA Judgment leaves considerable doubt as to whether (a) FSA Standard Form 10 debts (or debts with equivalent language) rank *pari passu* among themselves, and (b) whether such debts rank *pari passu* with other

for an approximate estimation of the number of firms subject to each of the relevant chapters of MIPRU and IPRU-INV.

[39] Several of these examples were disclosed by SLP3/LBHI and deployed at trial.

[40] For instance, the prescribed loan agreement under IPRU-INV 5 uses similar "*rank…pari passu*" wording.

instruments which do contain "*rank…pari passu*" wording, or whether they are automatically junior to debts including that wording.

(4) It follows that the CA Judgment leaves doubt for numerous parties where relative ranking questions arise as to (a) whether instruments without *pari passu* wording admit the possibility of ranking *pari passu* with any other debts; (b) how far down the queue liabilities with and without the "*rank…pari passu*" language are subordinated; and (c) how instruments with and without the "*rank…pari passu*" language will interact when issued by the same firm.

61. Third, since many financial institutions have multiple issuances of subordinated instruments, the issue referred to above will be hugely significant. Further, and contrary to the Court of Appeal's statement at [41] that it was only what happened in insolvency that was of any concern to the regulators, the issue will plainly not be restricted to the position inside insolvency. For example:

(1) The relative ranking of subordinated debt instruments is important in the primary market (where it will affect setting the coupon) and in the secondary market (where it will affect trading prices).

(2) The relative ranking of subordinated debt instruments will also be material to a firm's planning for bank resolution under the Bank Recovery and Resolution Directive (the "**BRRD**"). Under the BRRD, banks are obliged to provide details of their subordinated debt instruments as part of their resolution planning (as required by the Prudential Regulation Authority), and they are required to estimate the likely recovery that each class of creditor would have received in insolvency for the purposes of assessing the potential compensation to be paid under the "no creditor worse off" safeguard.

(3) Finally, under the new IFPR/MIFIDPRU regime which comes into force in January 2022, investment firms will be required to undertake an Internal Capital and Risk Assessment ("**ICARA**") which will require them to set out, while they are a going concern, their recovery and resolution planning assumptions. In order to prepare and present an ICARA, an investment firm will need legal certainty regarding the relative ranking of its subordinated liabilities.

62. Fourth, the CA Judgment treated the significance of "*rank…pari passu*" wording in the different subordinated instruments in issue inconsistently as between the LBHI2 Ranking Issue and the PLC Ranking Issue (see para 37(2)(b) above). There is a real risk of sending mixed signals to the market in circumstances where commercial certainty is highly desirable (see *GSO v Barclays Bank*, above), given that the questions are significant in both a solvent and an insolvent context.

63. Fifth, the Ranking Issues are legally novel.[41] The proposed appeal raises a point of law as to how to construe the interaction and inter-relationship between two separate agreements for ranking purposes, in circumstances where the purchaser of subordinated debt is unlikely to have access to the terms of all of the other subordinated instruments issued by the relevant borrower (see, by analogy, the difficulties involved in construing a referential bid in *Harvela Investments Ltd v Royal Trust Company of Canada (CI) Ltd* [1986] 1 AC 207). The CA Judgment is the leading decision on this issue. Absent any appeal, the CA Judgment will be the sole guidance in future cases concerning:

(1) The correct approach to determining the relative ranking of subordinated instruments operating in parallel, which do not expressly cross-refer to each other but whose ranking depends on referential subordination provisions: para 49 above.

(2) The degree to which the terms of FSA Standard Form 10 can be read commercially, in a way that enables a *pari passu* distribution between claims on that standard form and other subordinated debts in light of *Re Sigma Finance Corp* [2010] BCC 40, Arden LJ's analysis of the *pari passu* principle's significance in *Re Golden Key Ltd* [2009] EWCA Civ 636 (referred to at CA Judgment [13]-[14])) and *GSO v Barclays Bank* [2016] EWHC 146 (Comm): para 46 above.

(3) The significance of the regulatory scheme in which subordinated debts are issued as an aid to construction: para 48 above.

[41] In *Waterfall I*, the Supreme Court held that claims on FSA Standard Form 10 (issued by LBIE to LBHI2) ranked behind both statutory interest and non-provable liabilities. However, the Supreme Court did not have to address the proper approach towards the construction of two or more subordinated debt instruments which do not expressly cross-refer to each other, which is a fundamental question arising in this appeal.

(4) Whether the reasonable addressee of these subordinated instruments would look principally to the express definitions of "Senior Liabilities" or "Senior Creditors" to determine relative ranking or look principally to the payment conditions[42] or mechanisms which spell out the commercial effect of the definitions: para 37 above.

64. Sixth, despite the clear authority of the Supreme Court decision in *Waterfall I*, which addressed subordinated regulatory debt within the Lehman Group drawn up on the same FSA Standard Form 10 used in relation to Claims A and C, the CA Judgment has now created uncertainty and confusion about the manner in which subordination is given effect within an insolvency. In this regard:

(1) At [25], Lewison LJ declined to express a definite view as to whether the subordination provisions in this case permitted the claims to be proved at any time as contingent debts, or not until the Senior Liabilities had been paid, stating that "*I need not enter any further into this debate*". The Judge had held they could operate as both.

(2) Instead, Lewison LJ held that "*the manner in which the Insolvency Officer gives effect to the court's interpretation will be a matter for them*" (at [35]). This has left uncertain how subordination operates in regulatory subordinated debt. Individual officeholders should not be left to interpret, in each case, how such subordination provisions operate as a matter of law.

(3) This important issue requires clarification by the Supreme Court, particularly in circumstances where (LBHI/SLP3 respectfully submit) the point was clear following the statements in *Waterfall I* at [68]-[72].

65. Seventh, the CA Judgment affects the entitlements of a large number of stakeholders to the very significant surpluses in the estates of LBHI2 and PLC, and it has been closely followed by the global financial industry. In summary:

(1) The Applications are one of the last major pieces of litigation concerning the global Lehman Group and, like other "Waterfall" litigation (in relation to which,

[42] For example, the LBHI2 Ranking Issue was resolved in the CA Judgment by reference to the "cash flow" solvency condition. The effect of this is that market participants will be required to construe differences between subordinating mechanisms and to consider, on each occasion, whether they contain a requisite "expression of juniority" instead of being able to establish ranking by looking to the express definitions.

see the decision of the Supreme Court in *Waterfall I*), they will ultimately affect the dividend prospects of many thousands of international stakeholders.

(2) The decision will contribute to determining the amounts payable to LBHI and, in turn, the dividend payable to its unsubordinated creditors. It will also determine any amounts payable to the holders of the ECAPS.[43]

(3) The sums involved are extremely large. It is anticipated by LBHI2's joint administrators that between £800 million and £1 billion will be distributed on the subordinated debts that are in issue in the Applications. Further, depending on the outcome of the LBHI2 Ranking Issue, the decision on the PLC Ranking Issue may impact the allocation of more than £500 million between Claim C and Claim D.

(4) The determination of the respective rankings for payment is accordingly being closely followed in the financial markets, and has been extensively reported by mainstream news outlets in the UK,[44] and internationally.[45]

66. Eighth, the result of the Court of Appeal's decision is highly surprising[46] from a commercial perspective in view of the Lehman Group's capital structure. The ECAPS securities issued by the Partnerships envisaged them being converted into preferred stock in LBHI in the event of insolvency. Moreover, the ECAPS Holders' only direct rights against PLC were in the form of Claim E, which was agreed by all parties to rank

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[43] "*A ruling on once-forgotten subordinated debt issued by Lehman Brothers before its collapse could yield a huge payday for Deutsche Bank AG and other distressed-debt investors…Deutsche Bank is the largest holders of ECAPS notes...Other investors include Barclays Plc, CarVal, and Farallon Capital Management*" (https://fa.news/articles/deutsche_bank_could_get_500_million_payout_from_lehman_brothers_debt-39172).

[44] See, for example, an article in Bloomberg dated 20 October 2021: "*Deutsche Bank inches closer to winning Huge Bet on Lehman Debt*", which reports that the ECAPS Holders could receive "*a windfall of £500 million*", and the ECAPS were changing hands for "*next to nothing*" before the commencement of these proceedings five years ago.

[45] For example, an article in the '*Frankfurter Allgemeine*' dated 4 October 2021 (https://www.faz.net/aktuell/finanzen/deutsche-bank-kaempft-um-lehman-nachlass-17568836.html).

[46] This may be related to the fact that LBHI did not have an opportunity to make oral submissions in relation to the commercial considerations underlying the PLC Ranking Issue. Deutsche Bank advanced its "Dividend Stopper" argument (which the Court of Appeal adopted at [91] of the CA Judgement) in oral submissions. However, once it had done so, the Court of Appeal held (Day 3, page 161) that Deutsche Bank did not have permission to appeal on the "Dividend Stopper" ("*we are all of a view the order is clear, and the argument is not open to Deutsche Bank*"). Accordingly, there were no grounds for LBHI to make (and it did not make) any responsive submissions. An unfortunate consequence of this procedural anomaly was that the CA Judgment is (and the finding at [91]) was based on a one-sided and, with respect, inaccurate view of the commercial background.

behind Claim C and Claim D. However, the effect of the Court of Appeal's decision is that the ECAPS will be paid ahead of Claim C, and ahead of LBHI's unsubordinated creditors, who have to date been paid between 16 and 47 cents in the Dollar depending on class.

The Rectification Issue

67. The Rectification Issue raises novel and important points about the application and scope of the remedy of rectification which were not addressed by the Court of Appeal in *FSHC v GLAS*, in circumstances where rectification has not been considered at the highest level since the House of Lords' decision in *Chartbrook Ltd v Persimmon Homes Ltd* [2009] UKHL 38. For the reasons given in paras 41 to 44 above, the Appellants submit that the CA Judgment is wrong, and that this is an issue which should be determined by this Court at this time.

The Partial Discharge Issue

68. The Partial Discharge Issue is also highly novel, and the Court of Appeal concluded[47] ([141], [164]) that there is no relevant authority on the point. The Court of Appeal acknowledged (CA Judgment [172]) that its findings constitute a "*development*" to the (judge-made) rule against double proof. However, as Lord Neuberger explained in *Waterfall I*, "*any judge should think long and hard before extending or adapting an existing rule*" and there was no principled reason for doing so in the present case.[48] Furthermore:

    (1) The decision of the Court of Appeal represents a serious inroad into the rule, and one which is inconsistent with precedent both in England and Australia, and

[47] In any event, LBHI say that there was existing Court of Appeal authority – the decision in *Midland Banking Co v Chambers* (1869) LR 4 Ch App 398 – which does address the position where a surety waives their right of subrogation, and which establishes that there is nothing to prevent the creditor from claiming for the full amount of the proof against the principal debtor (however, it is not entitled to receive more than 100 pence in the pound on its claim).

[48] For an example of commentary questioning the correctness of Court of Appeal's decision, see *Practical Law UK*: "*a better solution might have been to confirm that any surplus should be returned to PD's estate as this would not have inhibited (because of the possible existence of competing claims from other unsecured creditors) the ability of C to recover its debt in full by preventing it from proving for the full debt amount. And it seems unfortunate that the quantum of recovery by C should be affected by an agreement between PD and S in which C may have had no say*" ('The rule against double proof where guarantor has waived indemnity right (Court of Appeal)' by Practical Law Restructuring and Insolvency, published on 21 October 2021).

the leading textbooks on guarantees/insolvency. The creation of *ad hoc* exceptions to judge-made rules runs the risk of diminishing the clarity and simplicity of the law, and is undesirable: see *Crown Prosecution Service v Aquila Advisory Ltd* [2021] UKSC 49, [72] *per* Lord Stephens, citing *FHR European Ventures LLP v Mankarious* [2014] UKSC 45; [2015] AC 250 at [35].

(2) There are, at least arguably, serious errors in the Court of Appeal's reasoning which could lead to confusion and incorrect decisions being reached in the lower courts unless the matter is addressed by the Supreme Court. As a result of the Court of Appeal's decision, the law is left in an arbitrary state as the interests of a creditor can be harmed by a surety who elects to disclaim: the surety could auction their disclaimer between the insolvent debtor and the proving creditor.

(3) The Court of Appeal's analysis at [108] expressly prefers the treatment of principal debtor clauses in *The Law of Guarantees* (Andrews/Millett, 7th edition, 6-002), to Briggs J's approach in *McGuinness v Norwich and Peterborough BS* [2010] EWHC 2989 (Ch). The approach of Briggs J (namely that the surety makes the principal debtor's debt "*his own*") is to be preferred.

(4) The significance of the CA Judgment extends beyond the facts of the case, given that the rule against double proof underpins the statutory scheme of insolvency, and the principles referred to in the CA Judgment have been established law since the 19th century. The novelty of the point in issue, and the legislative context of the application (and in this case, development) of the rule, render this a case of general public importance.

(5) As well as addressing the effect of part-payments by sureties on the creditor's right to proof *within* an insolvency, the CA Judgment also addresses the position of creditors' rights to sue *outside* an insolvency. Given the core significance of contracts of guarantee to the banking industry (and commerce more generally), the position at common law would benefit from clarification at the highest judicial level.

Due Process

69. Finally, the CA Judgment unfortunately referred to or relied on ten[49] new authorities in relation to the Partial Discharge Issue alone[50] which were not referred to by the parties in their oral or written submissions, and on which the Court of Appeal did not invite any submissions before relying on them in the CA Judgment. In some cases, the propositions taken from these cases (and the conclusions based upon them) are, with respect, plainly wrong, a key example being in the context of the law of subrogation: see para 55(2)(c) above.

70. Whilst this error of process in and of itself raises a further issue of general public importance about the need, in an adversarial system, for courts to bring new case law and/or authorities to the attention of the parties and to give them an opportunity to make submissions if the court is proposing to rely on them to any material extent in its judgment, it also serves to explain why the Court of Appeal has gone wrong in a number of important respects in this case.

[49] *Carter v Carter* (1829) 5 Bing 406; *Davies v Humphreys* (1840) 6 M & W 153; *Re Bedell ex p Gilbey* (1878) 8 Ch D 248; *Brook's Wharf and Bull Wharf Ltd v Goodman Bros* [1937] 1 KB 534; *McColl's Wholesale Pty Ltd v State Bank of New South Wales* [1984] 3 NSWLR 365; *Wight and others v Eckhardt Marine GmbH* [2003] UKPC 37; *Lehman Brothers Commodity Services Inc v Crédit Agricole Corporate Investment Bank* [2011] EWHC 1390 (Comm), [2012] 1 All ER (Comm) 254; *McGuinness v Norwich and Peterborough BS* [2011] EWCA Civ 1286, [2012] 2 BCLC 23; *Royal Bank of Scotland NV v TT International Ltd* [2012] SGCA 9; and *Ibrahim v Barclays Bank plc* [2012] EWCA Civ 640, [2013] Ch 400.

[50] Furthermore, ten further authorities were referred to by the Court of Appeal in relation to the remaining issues, which had also not been cited by the parties in their written or oral submissions: *Grey v Pearson* (1857) HL Cas 61; *Digby v General Accident Fire and Life Assurance Corporation Ltd* [1943] AC 121; *City Alliance v Oxford Forecasting Services Ltd* [2001] 1 All ER (Comm) 233; *Portsmouth City FC Ltd v Sellar Properties (Portsmouth) Ltd* [2004] EWCA Civ 760; *Office of Telecommunications v Floe Telecom Ltd* [2009] EWCA Civ 47, [2009] Bus LR 1116; *Crema v Cenkos Securities PLC* [2010] EWCA Civ 1444, [2011] 1 WLR 2066; *Re Lehman Brothers (No 8)* [2016] EWHC 2417 (Ch), [2017] All ER Comm 275; *Barnardo's v Buckinghamshire* [2018] UKSC 55, [2019] ICR 495; *Fowler v HMRC* [2020] UKSC 22, [2021] 1 WLR 2227; and *City of London v Leaseholders of Great Arthur House* [2021] EWCA Civ 431, [2021] L & TR 13.

Overall Conclusion

71. For all these reasons, each of the issues in relation to which permission is sought raises an arguable point of law of general public importance that ought now to be heard by this Court.

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ANNEX

Subordination Provisions

Claim A

Paragraph 5 of the LBHI2 Sub-Debt provides:

> "(1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon –
>
> > (a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 100% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that –
> >
> > > i. paragraph 4(3) has been complied with; and
> > >
> > > ii. the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and
> >
> > (b) the Borrower being "solvent" at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be "solvent".
>
> (2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be "solvent" if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding–
>
> > (a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and
> >
> > (b) the Excluded Liabilities."

Paragraph 1(1) includes the following definitions:

(1) "Liabilities" are "all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever)".

(2) "Senior Liabilities" are "all Liabilities except the Subordinated Liabilities and Excluded Liabilities".

(3) "Subordinated Liabilities" are "all Liabilities to the Lender in respect of the Loan or each Advance made under this Agreement and all interest payable thereon".

(4) "Excluded Liabilities" are "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".

Amended Claim B

Condition 3 of the amended LBHI2 Sub-Notes provides:

"Status and subordination

(a) The [LBHI2 Sub-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. The rights of the Noteholders against the Issuer in respect of the Notes are subordinated in right of payment to the Senior Creditors (as defined below) and accordingly payment of principal and interest (including Arrears of Interest as defined below) in respect of the Notes is (subject as provided below) conditional upon the Issuer being solvent at the time of, and immediately after, such payment, and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Issuer could make such payment and still be solvent immediately thereafter.

The conditionality referred to above shall not apply where an order is made by a competent court, or a resolution passed, for the winding-up or dissolution of the Issuer (except for the purposes of a reconstruction, amalgamation, reorganisation, merger or consolidation on terms previously approved in writing by an Extraordinary Resolution of the Noteholders).

If any time an order is made by a competent court, or a resolution passed, for the winding-up or dissolution of the Issuer (except for the purposes of a reconstruction, amalgamation, reorganisation, merger or consolidation on terms previously approved in writing by an Extraordinary Resolution of the Noteholders), there shall be payable by the Issuer in respect of each Note (in lieu of any other payment by the Issuer) such amount, if any, as would have been payable to the Noteholder, if, on the day prior to the commencement of the winding-up and thereafter, such Noteholder were the holder of one of a class of preference shares in the capital of the Issuer having a preferential right to a return of assets in the winding-up of the Issuer over:

(i) the holders of all other classes of issued shares in each case for the time being in the capital of the Issuer; and

(ii) the Notional Holders,

on the assumption that such preference share was entitled to receive, on a return of assets in such winding-up, an amount equal to the principal amount of such Note together with Arrears of Interest (if any) and any accrued interest (other than Arrears of Interest).

For the purposes of the above provisions:

"Notional Holder" means any creditor of the Issuer whose claims against the Issuer on a winding-up are quantified as though they held a Notional Share.

"Notional Share" means any notional and unissued shares in the capital of the Issuer which have a preferential right to a return of assets in the winding- up of the Issuer over the holders of all other classes of issued shares for the time being in the capital of the Issuer but not further or otherwise.

The Notes are intended to have a right to a return of assets in the winding-up or dissolution of the Issuer in priority to the rights of the holders of any securities of the Issuer which qualify (or, save where their non-qualification is due only to any applicable limitation on the amount of such capital, would qualify) as Upper Tier 2 Capital or Tier 1 Capital (within the respective meanings given to such terms in the General Prudential Sourcebook published by the Financial Services Authority, as amended, supplemented or replaced from time to time).

(b) For the purposes of Condition 3(a) above, the Issuer shall be 'solvent' if (i) it is able to pay its debts as they fall due and (ii) its Assets exceed its Liabilities (each as defined below) (other than its Liabilities to persons who are not Senior Creditors). A report as to the solvency of the Issuer by two directors of the Issuer or, if the Issuer is dissolved or being wound up, its liquidator, shall, in the absence of proven error, be treated and accepted by the Issuer and the Noteholders as correct and sufficient evidence thereof.

For the purposes of the above provisions:

"Senior Creditors" means creditors of the Issuer (i) who are unsubordinated creditors of the Issuer or (ii) who are subordinated creditors of the Issuer other than those with whose claims the claims of the Noteholders are expressed to rank *pari passu* and those whose claims rank, or are expressed to rank, *pari passu* with, or junior to, the claims of the Noteholders;

"Assets" means the unconsolidated gross assets of the Issuer and "Liabilities" means the unconsolidated gross liabilities of the Issuer, all as shown by the latest published audited balance sheet of the Issuer, but adjusted for contingencies and for subsequent events, all in such manner as two directors of the Issuer, its auditors or its liquidator (as the case may be) may determine."

Unamended Claim B

Condition 3 of the unamended LBHI2 Sub-Notes provided:

"Status and subordination

(a) The [LBHI2 Sub-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. The rights of the Noteholders against the Issuer in respect of the Notes are subordinated in right of payment to the Senior Creditors (as defined below) and accordingly payment of principal in respect of the Notes is conditional upon the Issuer being solvent at the time of, and immediately after, such payment, and accordingly no such amount which would otherwise fall due for payment

shall be payable except to the extent that the Issuer could make such payment and still be solvent immediately thereafter.

(b) For the purposes of Condition 3(a) above, the Issuer shall be 'solvent' if (i) it is able to pay its debts as they fall due and (ii) its Assets exceed its Liabilities (each as defined below) (other than its Liabilities to persons who are not Senior Creditors). A report as to the solvency of the Issuer by two directors of the Issuer or, if the Issuer is dissolved or being would up, its liquidator, shall, in the absence of proven error, be treated and accepted by the Issuer and the Noteholders as correct and sufficient evidence thereof. For the purposes of the above provisions:

"Senior Creditors" means creditors of the Issuer (i) who are unsubordinated creditors of the Issuer or (ii) who are subordinated creditors of the Issuer other than those with whose claims the claims of the Noteholders are expressed to rank *pari passu* and those whose claims rank, or are expressed to rank, *pari passu* with, or junior to, the claims of the Noteholders;

"Assets" means the unconsolidated gross assets of the Issuer and "Liabilities" means the unconsolidated gross liabilities of the Issuer, all as shown by the latest published audited balance sheet of the Issuer, but adjusted for contingencies and for subsequent events, all in such manner as two directors of the Issuer, its auditors or its liquidator (as the case may be) may determine."

Claim C

Paragraph 5 of the PLC Sub-Debt provides:

"(1) Notwithstanding the provisions of paragraph 4, the rights of the Lender in respect of the Subordinated Liabilities are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) of the Subordinated Liabilities is conditional upon –

(a) (if an order has not been made or an effective resolution passed for the Insolvency of the Borrower and, being a partnership, the Borrower has not been dissolved) the Borrower being in compliance with not less than 120% of its Financial Resources Requirement immediately after payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that –

i. paragraph 4(3) has been complied with; and

ii. the Borrower could make such payment and still be in compliance with such Financial Resources Requirement; and

(b) the Borrower being "solvent" at the time of, and immediately after, the payment by the Borrower and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Borrower could make such payment and still be "solvent".

(2) For the purposes of sub-paragraph (1)(b) above, the Borrower shall be "solvent" if it is able to pay its Liabilities (other than the Subordinated Liabilities) in full disregarding–

(a) obligations which are not payable or capable of being established or determined in the Insolvency of the Borrower, and

(b) the Excluded Liabilities."

Paragraph 1(1) includes the following definitions:

(1) "Liabilities" is defined as "all present and future sums, liabilities and obligations payable or owing by the Borrower (whether actual or contingent, jointly or severally or otherwise howsoever)".

(2) "Senior Liabilities" are "all Liabilities except the Subordinated Liabilities and Excluded Liabilities".

(3) "Subordinated Liabilities" are "all Liabilities to the Lender in respect of each Advance made under the Agreement and all interest payable thereon".

(4) "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 Borrower Officer".

Claim D

Condition 3 of the PLC Sub-Notes provides:

"(a) The [PLC Sub-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. The rights of the Noteholders in respect of the Notes are subordinated to the Senior Liabilities and accordingly payment of any amount (whether principal, interest or otherwise) in respect of the Notes is conditional upon:

(i) (if an order has not been made or an effective resolution passed for the Insolvency of the Issuer) the Issuer being in compliance with not less than 100 per cent of its Financial Resources Requirement immediately after such payment, and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that (a) Condition 3(d) or Condition 3(g), as the case may be, has been complied with; and (b) the Issuer could make such payment and still be in compliance with such Financial Resources Requirements; and

(ii) the Issuer being solvent at the time of, and immediately after, such payment, and accordingly no such amount which would otherwise fall due for payment shall be payable except to the extent that the Issuer could make such payment and still be solvent.

(b) For the purposes of Condition 3(a) above, 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."

The conditions include the following definitions:

(1) "Senior Liabilities" is defined as "all Liabilities except the Subordinated Liabilities and Excluded Liabilities".

(2) "Liabilities" are "all present and future sums, liabilities and obligations payable or owing by the Issuer (whether actual or contingent, jointly or severally or otherwise howsoever)".

(3) "Subordinated Liabilities" are "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".

(4) "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".