

SOUTH SQUARE BRIEFING

21 February 2014

LEHMAN BROTHERS INTERNATIONAL (EUROPE) – WATERFALL APPLICATION DECISION

Mr Justice David Richards today announced his decision in the Lehman “waterfall” application, which addressed a number of issues arising from the likelihood of a surplus in the estate of Lehman Brothers International (Europe) (“LBIE”) after payment of all proved debts.

The issues for consideration arose as between the shareholders of LBIE on the one hand and creditors of LBIE’s insolvent estate on the other. In particular, the application considered whether the subordinated debt held by LB Holdings Intermediate 2 Limited was subordinated to the claims of creditors of LBIE to be paid post-administration statutory interest. It also considered whether creditors of LBIE with a contractual entitlement to be paid in a currency other than sterling had a claim against LBIE for any shortfall suffered by them as a result of being paid dividends on their proved debt in sterling, and whether the subordinated debt of LB Holdings Intermediate 2 Limited was subordinated also to such foreign currency conversion claims. The application further considered, in light of the fact that LBIE is an unlimited liability company, the extent of the obligation of LBIE’s shareholders to contribute to the assets of LBIE in its administration or in liquidation, and addressed issues of set-off as between the shareholders’ contingent liability to contribute in LBIE’s liquidation and the subordinated and unsubordinated debt claims of the shareholders in LBIE’s insolvency.

The reasoned judgment will not be available until later in March, but the Judge stated his conclusions as follows:

- “1. Conclusions on issues which are not connected with the status of Lehman Brothers International Europe (LBIE) as an unlimited company:
 - (i) The claims of LB Holdings Intermediate 2 Limited (LBHI2) under its subordinated loan agreements with LBIE are subordinated not only to provable debts but also to statutory interest and un-provable liabilities.
 - (ii) Creditors of LBIE whose contractual or other claims are denominated in a foreign currency are entitled to claim against LBIE for any currency losses suffered by them as a result of a decline in the value of sterling as against the currency of the claim between the date of the commencement of the administration of LBIE and the date or dates of payment or payments of distributions to them in respect of their claims. Such currency conversion claims rank as un-provable liabilities, payable only after the payment in full of all proved debts and statutory interest on those debts.
 - (iii) If the administration of LBIE is immediately followed by a liquidation, any interest in respect of the period of the administration which has not been paid before the commencement of the liquidation will not be provable as a debt in the liquidation nor will it be payable as statutory interest under either rule 2.88 of the Insolvency Rules 1986 or section 189 of the Insolvency Act 1986.
 - (iv) Those creditors of LBIE with debts which carry interest by reason of contract, judgment or other reasons unconnected with the administration or liquidation of LBIE will be entitled to claim in a liquidation of LBIE, which immediately follows the

administration, for interest which accrued due during the period of the administration, as an un-provable claim against LBIE, payable after the payment in full of all proved debts and statutory interest on such debts.

2. Conclusions on those issues which arise from the status of LBIE as an unlimited company:
 - (i) The obligation of members to contribute under section 74(1) of the Insolvency Act 1986 extends not only to provide for proved debts but also for statutory interest on those debts and un-provable liabilities.
 - (ii) The contributory rule (that is, the rule that a contributory of a company in liquidation cannot recover anything in respect of any claims he may have as a creditor until he has fully discharged his obligations as a contributory) applies only in a liquidation. It does not apply in an administration, including the administration of LBIE. The equitable rule in *Cherry v Boulton* also does not apply.
 - (iii) LBIE, acting by its administrators, will be entitled to lodge a proof in a distributing administration or a liquidation of either Lehman Brothers Limited (LBL) or LBH12 in respect of those companies' contingent liabilities under section 74(1) of the Insolvency Act 1986 which may arise if LBIE were to go into liquidation. The valuation of such claims would be a matter of estimation under the provisions of the Insolvency Rules.
 - (iv) In a distributing administration or liquidation of LBL or LBH12, the claims of those companies respectively as creditors of LBIE would be the subject of mandatory set-off against the claims of LBIE in respect of those companies' contingent liabilities as contributories. I have reached the conclusion that the decision in *In re Auriferous Properties Limited (No 1)* 1898 1 Ch 691 was wrong and should not be followed.
 - (v) In the administration of LBIE the contingent liabilities of LBL and LBH12 as contributories will be the subject of mandatory set-off against the admitted proofs of debt of those companies as creditors of LBIE."

Four silks and two juniors from South Square, representing three different parties, appeared on the application: William Trower QC and Daniel Bayfield (representing the joint administrators of LBIE); Antony Zacaroli QC and David Allison (representing a creditor of LBIE) and Barry Isaacs QC and Mark Arnold QC (representing Lehman Brothers Holdings Inc).

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