

<p>The Pensions Regulator</p>	<p>REASONS of the DETERMINATIONS PANEL of THE PENSIONS REGULATOR in relation to the Determination Notice issued on 13 September 2010</p> <p>The Lehman Brothers Pension Scheme (the “Scheme”)</p>	<p>The Pensions Regulator case ref: TM5916</p>
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Introduction	2
Facts Relied On:	4
Lehman Brothers Limited & the Scheme:	4
Lehmans London group business:	8
LBL’s Business:	13
The Preliminary Applications:	15
Exclusion of Trustees’ Evidence:	15
No Fair Hearing:	19
Lack of Time:	20
Disclosure:	27
FSD Requirements:	30
Substantive Determination:	34
Value of the Benefits:	35
Secondment, services, uplift and profit sharing:	36
General provision of directors and oversight:	38
Property:	38
Intercompany balances & payments:	39
Tax issues:	39
Asset Parking:	39
The Individual Targets:	40
LBHI:	40
The Operating Companies:	41
The Investment Companies:	46

INTRODUCTION

1. The Determinations Panel of the Pensions Regulator (“the Panel”) convened an oral hearing which took place over two days, on 8th and 9th September 2010. In that hearing the issues for determination were whether Financial Support Directions (“FSDs”) should be issued against a number of companies within the Lehmans group, as set out below. The occupational pension scheme concerned was the Lehmans Brothers Pension Scheme (“the Scheme”).
2. The Warning Notice originally listed 73 ‘targets’, a term which we use throughout this determination for the sake of convenience but without attaching any pejorative sense to it. However, by the date of the oral hearing the Pensions Regulator (“TPR”) had decided not to proceed against a total of 29 targets, leaving 44 active targets to the Warning Notice.
3. A number of the parties were represented before us. Specifically:
 - (i) TPR appeared by leading and junior counsel, Miss Raquel Agnello QC, Jonathan Hilliard and Thomas Robinson;
 - (ii) The trustees appeared by counsel Mr Nicholas Stallworthy, instructed by Messrs Travers Smith;
 - (iii) Of the remaining targets only Lehmans Brothers Holdings Inc (“LBHI”), Lehman Brothers Asset Management (Europe) Ltd (“LBAM”), LB Re Financing No.1 Ltd (“FIN1”) and LB Re Financing No.2 Ltd (“FIN2”) appeared by leading and junior counsel Mr Andrew Spink QC and Mr Richard Hitchcock, instructed by Messrs Weil, Gotshal & Manges.
4. A number of the other remaining targets were represented by either Denton Wilde Sapte LLP or Linklaters LLP. Whilst these parties did not appear before us they did provide us with written submissions in the form of correspondence, which we considered, and their representatives attended the hearing in an observational capacity.

5. A further group of targets had been represented by Messrs Taylor Wessing, who had filed a response to the Warning Notice and evidence, and had indicated an intention to appear at the oral hearing until TPR decided on 27th August 2010 not to proceed against them.
6. Finally, one respondent to the Warning Notice, Chancerygate Lehman LLP, did not attend and was not represented by any solicitors. However, they had confirmed to TPR that they had received the Warning Notice and notice of the hearing, and were content to not attend or make submissions.
7. The Panel had at the beginning of the hearing considered and rejected an application to exclude parts of the representations made by the Trustees for reasons explained below. After the conclusion of the hearing the Panel considered the evidence and submissions. In particular the Panel first considered a further preliminary application by various of the targets to dismiss the entirety of the proceedings on the basis of 'no fair hearing'. Only once we had decided to dismiss that application (for the reasons given below) did we then consider the substantive matter, and we then determined that FSDs should be issued against:
 - (i) Lehman Brothers Asset Management (Europe) Limited;
 - (ii) Lehman Brothers Europe Limited;
 - (iii) Lehman Brothers Holdings Incorporated;
 - (iv) Lehman Brothers Holdings Plc;
 - (v) Lehman Brothers International (Europe); and
 - (vi) Lehman Brothers UK Holdings Ltd.
8. The Panel also determined not to issue FSDs against the remaining targets.
9. We now set out our reasons for so determining.

FACTS RELIED ON:

10. The Lehman Brothers group was the well known global financial services and investment banking business. In 2008 in the midst of the recent financial crisis it suffered what can loosely be described as a financial collapse, with its parent company Lehman Brothers Holdings Inc filing for Chapter 11 bankruptcy protection in the New York court on 15th September 2008.
11. Whilst the Lehman Brothers group operated a world wide business it did so, at least on a strict legal basis, through a group structure, i.e. through a series of related companies and other corporate entities (e.g. limited liability partnerships). There has been reference in the Chapter 11 proceedings to there being over 4,000 legal entities in 28 countries [WN exhibit 59 page 1254] and the Warning Notice itself refers at paragraph 31 to over 7,000 entities. However, the group operated on global business/product lines, which cut across the legal entity structure, with the top management in New York, supported by regional headquarters in London and Tokyo. London was the regional HQ for European and Middle East business.
12. The London group of Lehman Brothers itself had a complicated corporate structure. We were provided with a flow-chart setting out the interrelationship of approximately 200 corporate bodies, and it is apparent from that chart that there were yet more which were not shown. We return to the corporate structure in more detail below.

Lehman Brothers Limited & the Scheme:

13. Within the London group was Lehman Brothers Ltd (“LBL”). LBL was a 100% held subsidiary of Lehman Brothers Holdings plc, which was itself a 100% held subsidiary of Lehman Brothers UK Holdings Ltd, which was an (indirectly held) subsidiary of the ultimate group parent company, Lehman Brothers Holdings Inc (“LBHI”).

14. On 15th September 2008 LBL entered into administration, and it remains in administration to the current date. At 15th September 2008 LBL was the sole sponsoring employer of the Scheme, and employed approximately 4,400 employees, of which approximately 2,000 were seconded to other Lehman group companies. LBL's financial position was and is less certain. On 15th September 2008 it was estimated that it had:

- (i) Fixed assets of \$1.151 bn
- (ii) Current assets of \$2.874 bn
- (iii) Creditors of \$3.687 bn
- (iv) Net assets of \$0.338 bn.

However, its fixed assets included capitalised leases (\$1.14bn) and its current assets included \$2bn of receivables from other Lehman Brothers entities, and are extremely likely therefore to be impaired.

Equally, it owed other Lehman Brothers entities \$965m. The problem is that as a result of the complexity and continuing uncertainty as to the outcome of the Lehman Brothers insolvencies it was and is impossible to determine to what extent its inter-company receivables are impaired and therefore if LBL is solvent or insolvent and if it is insolvent then to what degree it is. On 15th September 2008 its directors stated it was likely to be balance sheet insolvent.

15. LBL was at all material times the principal employer of the Lehman Brothers Pension Scheme ("the Scheme"), an occupational pension scheme other than a money purchase scheme within the meaning of the Pensions Act 2004. The Scheme had been a final salary scheme, but it ceased to accrue final salary benefits in May 1999 and thereafter accrued money purchase benefits. However:

- (i) There was a continuing salary link for accrued defined benefits, and a large number of those members remained employed by LBL up to 15th September 2008 thereby increasing their defined benefits; and

- (ii) There was a small number of 'old scheme guarantee members' who continued to be employed by LBL and accrue final salary benefits right up to 15th September 2008.

16. The Scheme was funded on an ongoing basis at all material times. Between 2002 and 2008 both ordinary and special contributions to the DB element of the scheme were as follows:

	Ordinary	Special
(i) 2002:		£60m
(ii) 2003:	- unknown -	
(iii) 2004:	£1.7m	£5m
(iv) 2005:	£621k	£-
(v) 2006:	£1.55m	£10.2m
(vi) 2007:	£3.3m	£20m
(vii) 2008:	£5.9m	£-

17. Its funding position varied from 92% funded with a deficit of £11.3m on 1st January 2001, to 103% funded with a £7.4m surplus on 1st January 2004, and back to 91.3% funded with a £23.0m deficit on 1st January 2007. However, there is no allegation that the Lehman group acted in any way improperly or even poorly towards the Scheme, and the Panel accepts that as a fact. At all times the Scheme was funded appropriately and the Lehmans group, in one form or another, faced its responsibilities appropriately. This begs the question, of course, of what those responsibilities were and who they fell on.
18. In strict legal terms LBL was responsible to the Scheme for payment of contributions. However, we are satisfied that the contributions, which would have been made in cash, would in practice have come from LBHI acting as group treasurer, given that all spare cash in all Lehman's subsidiaries was swept back to New York at the end of each working day (see paragraph 23 below). Furthermore, a proportion of LBL's responsibilities would have been covered directly under the secondment agreements referred to below, and the remainder would

have been met under the general recharging arrangements also referred to below.

19. In terms of how the Scheme operated, we accept the evidence of Mr Gamester in his 1st witness statement. Mr Gamester was not only a trustee from 1998 to date but was an employee of LBL from 1988 to 2005. He explained that in general when a company decision needed to be made it would start with consideration by the European and Middle East HR department. They would make recommendations to the Chief Administrative Officer, and sometimes the Chief Financial Officer for European & Middle East Region, and if it was sufficiently significant the issue would be raised with their superiors in New York and London. This description does not appear to have been challenged by any of the targets.
20. As at 15th September 2008 the Scheme was in deficit on the buy-out basis. It was estimated that the s.75 debt (Pensions Act 1995) would be £148m as at 1st January 2007.
21. Although LBL was the principal employer there were some other participating employers. Specifically, there were 3 others with 19 active members employed as at 15th September 2008. It is apparent that the vast majority of the s.75 debt will fall on LBL, although we note that the precise percentage is not accepted by the targets. However, on 27th June 2008 LBHI entered into a guarantee with the trustees of the Scheme for LBL's liabilities to the Scheme. We have seen evidence from Mr Lipkin, a New York attorney-at-law, as to the impact of LBHI's chapter 11 proceedings on the guarantee. Mr Spink made it clear in his forceful submissions that this evidence was not accepted, and pointed out that by its very nature the outcome of the chapter 11 process is uncertain until it is finalised, and may well change throughout its development. We accept those points, and simply note that because of the chapter 11 process the impact of the guarantee is necessarily uncertain in the insolvency.

Lehmans London group business:

22. As noted above, Lehman's used a variety of local corporate entities to implement a global business organised on business/product lines.
23. At the head was LBHI which, as the holding company, provided general supervision over and took key strategic decisions for the group as whole, but with a good deal of delegation to the regional headquarters in London and Tokyo. LBHI also acted as treasurer for the group with the LBHI London branch playing a substantial role. Most group companies did not operate their own bank accounts, and LBHI controlled cash balances, operating a regular 'cash sweep' out of group accounts and into LBHI's New York account. Group companies received money as and when they needed it, with intercompany balances remaining on their books for periods of time during which they were not being utilised by the receiving party. Weil, Gotshal & Manges Response at paragraph 43.1 demonstrates that in the case of LBL between 1999 and the end of 2007 this intercompany receivables balance remained relatively static, averaging ten months' worth of service provision.
24. In the London group the principal operating companies through which the Lehman group carried out its business were:
- (i) Lehman Brothers International (Europe) ("LBIE"): This was an unlimited company, which was a wholly owned subsidiary of Lehman Brothers Holdings plc through two intermediate holding companies¹, and through LBL holding 1 share. Its business included trading, market making and broking in the capital markets. It entered administration on 15th September 2010.
 - (ii) Lehman Brothers Europe Limited ("LBEL"): This was also a wholly owned subsidiary of Lehman Brothers Holdings plc, this

¹ LB Holdings Intermediate 1 Ltd, and LB Holdings Intermediate 2 Ltd.

time being directly held by it. Its business included investment banking services. It entered administration on 23rd September 2010.

(iii) Lehman Brothers Asset Management (Europe) Ltd (“LBAM”): This was also a wholly owned subsidiary of Lehman Brothers Holdings plc, again directly held by it. However, on 7 May 2009 a majority share in it was sold to Neuberger Berman with LBHI retaining a 49% interest. Its business included providing investment management services. It has not entered administration.

25. These companies have been described collectively as “the operating companies”. The way they operated is a core factor in this matter.
26. Despite being the principal operating companies none of them had substantial staffs of their own. Rather, they operated through the use of:
- (i) Directors; and
 - (ii) Staff seconded from LBL to them.
27. When we say they did not have substantial staffs of their own the precise figures may be difficult to identify. However, it is clear and we find as a fact that the vast majority of their staffs were seconded to them. For example, in LBEL’s case it is apparent that for the years 2003-2005 it claimed to have no employees of its own. More generally, a comparison of the numbers of seconded staff to each of them in September 2008, and the number of staff they had as at 30 November 2007 (at least, according to their reported accounts) shows that they must in fact have had the vast majority of their staff provided by way of these secondments:

	November 2007	September 2008
(i) LBIE	1,442	1,179
(ii) LBEL	871	843
(iii) LBAM	91	88

28. Again, the precise figures have not been accepted by the targets, but regardless of any issues about the exact numbers we find as a fact that the vast majority of the operating companies' staff were seconded to them from LBL.
29. LBHI's London group operated in part through the use of seconded LBL employees. However, it only had 52 seconded employees, which we suspect was a small percentage of its overall staff numbers although we can find no evidence directly on the issue.
30. The secondees were seconded under written agreements between the LBIE and LBEL and LBL under which the staff were to "*report to and act upon the instructions of [the operating company]*" (see, e.g. clause 2.2 of the LBEL agreement at [WN/Tab 7/790]). Under the agreements LBL remained liable to pay and provide for all of the secondees "*all contractual pay and benefits*", but the operating company then reimbursed LBL for all those costs at cost, i.e. with no uplift or profit element for LBL. In practice the reimbursement took place by means of intercompany recharges, which we return to below. In LBHI and LBAM's case there seems to have been no written agreement, but it appears at least in the case of LBAM that it operated on the same basis as LBIE and LBEL in relation to its LBL secondees.
31. The directors of the operating companies (but not LBHI) were also in large part LBL employees. Again, whether every single director was an LBL employee is beside the point - it is quite clear that the vast majority of them were, at least in September 2008.
32. The operating companies also did not own or hold most of the physical assets necessary for their functioning, such as the property their staff occupied and their computer/IT equipment. Nor did they provide their own 'back room' services, such as HR or (apparently) brokerage and clearance services. Rather, these were owned and provided by LBL,

and the operating companies were recharged by LBL for their provisions under written 'service agreements'. In this case all three operating companies and LBHI entered into such express agreements. The service agreements appear to have been in similar forms for all the operating companies, and required LBL to provide a variety of 'back room' support services including compensation and benefits, technology and communications, occupancy and brokerage and clearance. These services were charged to the operating companies at cost plus 10%, and again took place in practice through intercompany recharges. The operating companies were also recharged with all the residual costs of LBL's own staff, which could not be attributed to individual companies.

33. As to the distinction between which staff were seconded, and which remained within LBL, it appears that "*as a general rule, revenue-generating staff and closely related support staff were seconded from LBL to [the operating companies]*" (Mr Gamester's 1st w/s, paragraph 13) whilst 'back room' support staff remained with LBL.

34. Although they were separate legal entities, it is clear that the operating companies operated as part of a globalised group. In particular:
 - (i) Miss Agnello took us to various Lehman's pre-insolvency generated documents where they described their business as having a "*high degree of integration*" [WN/Tab 33/page 547], with such matters as capital adequacy "*co-ordinated by Treasury at global and regional level, integrating the Firm's risk management, strategy and regulatory capital considerations*" [WN/Tab 45/page 880].
 - (ii) Further, the administrators of LBIE, LBEL and LBL gave evidence to the Courts that the business of LBHI (i.e. of the Lehman Brothers group) was "*organised in functional and market areas, rather than by legal entity*", and on a day to day basis it was "*managed and run **mainly** along global product lines, rather than as separate entities*"; [see Warning Notice para

32]. We would stress the “mainly” in this statement, for reasons we set out below.

- (iii) The ‘targeted’ management of the group business was provided at a high level through various global or regional committees, including for example the European and Middle East Executive Committee, or the European Financial Resources Committee. These committees were made up of various Lehman group employees. We have seen evidence of the European and Middle East Executive Committee being made up on average of 92% LBL employees. The precise details of membership of the other committees is less clear, although TPR says in the Warning Notice at para 42 that “*given the role of London as Lehman’s European headquarters and given the role of LBL as principal employer of Lehman employees in the UK it is certain that these committees included LBL employees in significant numbers*”. Whilst the precise details of membership is unclear, in our view it is likely that a significant number of members of these committees were LBL employees or secondees.

35. The operating companies divided the profits they made under a profit share arrangement, which was submitted to the regulatory authorities in both the UK and the US, and which provided no element of profit for LBL. Mr Spink made the point, and we accept, that this was because LBL did not participate in the production of that profit, just as it was not liable for the downside risk.
36. The London group also included a third group of companies, 40 of which are included in TPR’s list of “targets”. For convenience we group these together as the “Investment Companies” a sobriquet we borrow from Ms. Agnello, though in fact they fall into three sub-groups. The nature of these companies’ activities and their relationships with LBL and the rest of the London Group are dealt with at length in the substantive part of our determination.

LBL's Business:

37. As set out above, LBL provided services and seconded employees to the operating companies. In doing so it recharged its costs to the operating companies either at cost (seconded staff) or at cost plus 10% (services). Some services costs were directly invoiced where incurred exclusively for one or other of the operating companies. The remaining non-directly attributable costs were split between the operating companies on the basis of an allocation methodology "e.g. occupancy costs or based on usage information provided by the vendor", and the unattributed remainder was divided between them on the basis of headcount. This included all LBL's own costs. We find the following evidence relevant:

- (i) First - a reply to a request by TPR under the Pensions Act 2004 s.72 at [WN/Tab 77/page 1795]. This states that "The remaining costs [after certain items were directly invoiced] remained in LBL and together with its own staff costs and other overheads were charged out with a 10% mark up to the three main group companies using LBL's services (LBIE, LBEL, LBAM) based on headcount. The percentages for 2007 were:
 - (a) LBIE 59%;
 - (b) LBEL 41%;
- (ii) For 2008:
 - (a) LBIE 55%;
 - (b) LBEL 41%;
 - (c) LBAM 4%.
- (iii) Secondly - a chain of emails provided by way of LBAM's Response where the 4% recharge is discussed.

38. Mr Spink made two points in respect of this:

- (i) First - he submitted that what came of the email chain is uncertain; and

- (ii) Secondly - that the s.72 response appears [at page 1804] to indicate that LBAM actually had only 1.8% of headcount, rather than 4%.
39. However, on the headcount point it appears to us that Mr Stallworthy's submission that it is LBAM's share of seconded staff that amounts to 4% (rounded up) is correct - i.e. LBAM's share of headcount of secondees is 4% (rounded up), whereas its share of headcount of all LBL employees is only 1.8%. Furthermore, the email chain appears to us to effectively be corroborative evidence for the evidence in the s.72 response. The e-mails in the chain are a contemporary record of discussions on the charging percentages to be attributed to the operating companies for 2008 and 2007 between LBL staff responsible for taking the decision, at least one of whom (Anthony Rush) was also a respondent to the s.72 questions. On the outcome of the e-mail exchanges we agree with TPR's view that the only issue in dispute in the e-mails is whether LBAM should be retrospectively charged with 4% of LBL's residual costs for 2007 as well as 2008. While taken in isolation the s.72 answers and the e-mails might be thought of as somewhat uncertain, we judge that on the balance of probabilities LBAM was at the very least responsible for 4% of LBL's residual costs not recharged to or reimbursed to another company for 2008.
40. Finally, we would note that LBL also entered into service agreements with two other Lehman companies, Lehman Brothers Lease & Finance (No.1) Ltd and (it is claimed in the Warning Notice) Furno & del Castano Capital Partners LLP for services, but on a fixed monthly charging structure. Neither of these appear to us to be significant to LBL, and the fixed fee clearly differentiates them from the standard service agreement with the operating companies. With no more information on them we find it impossible to draw any conclusions from them.

41. In conclusion, it is quite clear that LBL's turnover is solely or principally derived from amounts charged for the provision of the services of employees of LBL to other members of the Lehmans group.

THE PRELIMINARY APPLICATIONS:

42. There were a number of preliminary applications made by various targets. In particular:
- (i) Weil, Gotshal & Manges clients applied to exclude certain evidence adduced by the Trustees in their response; and
 - (ii) Effectively all the targets applied to, in essence, strike out the entire Warning Notice on the basis of what can broadly be described as an inability to have a fair hearing.
43. Given that a determination notice, if one was to be issued at all, had to be issued by 13th September 2010, it was not practical to hear the preliminary issues prior to the oral hearing. Furthermore, it appeared to us that the 'no fair hearing' application was such that to a large extent submissions on it would overlap with or deal with the evidence. As a consequence we directed that:
- (i) The Weil, Gotshal & Manges application would be heard at the beginning of the oral hearing, and would be determined there and then, with detailed reasons to follow;
 - (ii) The 'no fair hearing' application should be addressed by the parties as part of their general submissions, but that we would consider it first. Only if we considered that the application failed would we then turn to the substantive matter.
44. We therefore turn to the preliminary applications.

Exclusion of Trustees' Evidence:

45. This application was originally set out in a letter of 13th August 2010. It was then supplemented by way of their Skeleton Argument and in oral submissions by Mr Spink.

46. Originally the application was put forward in part on the basis of the Trustees not being entitled to give evidence at all because they were not 'Directly Affected Parties' or covered by various directions. However, Mr Spink did not pursue this line of argument - rightly, it appears to us. The Warning Notice was served on the Trustees by TPR, thereby identifying them as a "directly affected" person under Pensions Act 2004 s.96(2)(a). If this was not enough, the Panel named them as 'directly affected parties', under its directions of 2nd and 16th July 2010, thereby identifying them as such for the purposes of s.96(2).
47. Mr Spink, however, pursued a more general submission addressed towards four specific pieces of evidence:
- (i) Mr Gamester's 2nd witness statement paragraphs 5-8 and 13, together with the tables referred to in the witness statement at tabs 5-7, 10 and 13 of the Trustees' Response evidence;
 - (ii) The evidence of Mr Lipkin's 1st witness statement in relation to the impact of the chapter 11 proceedings; and
 - (iii) The evidence provided by Hewitts, actuaries to the Scheme, at tab 2 of the Trustees Response evidence, on various figures related to the Scheme.
48. In particular he submitted that:
- (i) It was unjust and unfair for his clients to face effectively 2 prosecutors, with the Trustees acting in conjunction with and as back up for TPR.
 - (ii) It was impossible to check the evidence or respond to it in time. In this regard he made extended submissions as to the difficulties his clients faced in investigating these matters which we return to in regard to the 'no fair trial' application.
 - (iii) The evidence of Mr Lipkin was irrelevant, as it was bound to be out of date.

49. We determined to admit all of this evidence. Our reasons are as follows:
50. First, in regard to the '2 prosecutors' argument, this is simply a mischaracterisation of what this process is. There is no 'prosecutor'. Whilst TPR may issue the Warning Notice and present the case and needs to prove on the balance of probabilities what it alleges, the Panel is not a judge or court. Rather, it is an executive committee of a regulatory body which has a separate function to the regulator as a whole. Our task is to look at the case on the facts available to us, and it would be positively wrong for us to ignore evidence which was before us simply on the basis of who it came from. When Mr Spink submitted that his clients should only have to answer the case which is put in the Warning Notice, and any evidence in support should be served with that, he was ignoring the rights of the Trustees, as is reflected in our procedure, for them to present evidence in support of their and their beneficiaries' position. To hold otherwise would deny a right of audience to the very people TPR is seeking to protect.
51. That said, we of course acknowledge his more general point that a target to a Warning Notice should know the case it is answering in good time to respond to it. Often this will be by way of the case being entirely contained within the Warning Notice and supporting evidence. However, so long as a target has a reasonable time to deal with the case reasonably then we do not see in principle that no further evidence should be admitted.
52. This brings us to the second argument. In this regard, Mr Spink addressed the Hewitts and Mr Gamester evidence in particular.
53. In relation to Hewitts, he said that without being provided with the data it would be impossible to check their evidence, and even with the data there was no real chance of checking it in the time allowed. We see the force of this point in theory, but in practice we are extremely

reluctant to exclude the evidence of the Scheme's own actuary. Furthermore, to the extent that the figures were inaccurate, we would require some substantial reason before assuming that they might be **materially** inaccurate. For example, the calculation that at least 96% of the s.75 debt relates to LBL is consistent with the other evidence before the Panel, and even if it is marginally wrong the point the evidence goes to is a broad one rather than an issue of detail and precise figures.

54. In relation to the tables objected to by Mr Spink, this distinction between the evidence going to an issue of precise figures also applies. Mr Spink said that his clients could not reasonably or practically check or respond to the evidence contained in them. He said they had no direct access to the relevant data, and even if they did they had practical difficulties in accessing it arising out of the insolvency of the group. We have no doubt that this is correct. However:
- (i) In so far as the information relates to his own clients' employees, we would expect it to be possible to check that data in a reasonable period of time. All of the data in the tables challenged by Mr. Spink were drawn from information collected either by LBL, the Scheme Trustees or (in the case of the FSA list of authorised persons) by the operating companies for their own business needs. It was necessary for their own purposes that this data should be accurate. It is therefore reasonable to assume that it would have been within LBAM's capacity to check this information in the time available; and
 - (ii) Even to the extent that the data was not possible to be checked, the points made with the evidence are broad ones, rather than issues which require absolute accuracy. Without more to suggest that they are broadly wrong, and given that overall they simply put flesh on pre-existing submissions, we see no reason to exclude them.

55. The evidence given by Mr Gamester's 2nd witness statement at paragraph 13, however, is significantly different. In that paragraph he expands on what he said in his 1st witness statement as to how the service charge uplift of 10% was fixed. Mr Stallworthy sought to characterise this as simply explaining what he meant in his 1st witness statement, and whilst strictly true it plainly underplays the potential significance of what he says. The point is that the paragraph could be said to be making or suggesting some sort of value judgment, or evidence towards a value judgment, of the level or nature of the 10% uplift.
56. Mr Spink points out that no detail is given as to how, when, by who, where or why it is said to have been so fixed, and emphasises that it would be effectively impossible for his clients to have investigated this point at such short notice. We agree with this point, and as a result this issue gave us considerable pause for concern. However, we concluded that it was better to allow the evidence, whilst expressly stating that we did not consider it to be proved and that in the event that anything turned on it we would address such weight to it as appears appropriate in the circumstances. In fact, as is set out below, we consider that nothing did turn on the issue of why or how the service charge uplift of 10% was fixed.
57. In respect of the third argument, that Mr Lipkin's evidence was out of date and irrelevant, whilst we acknowledge that it was necessarily going to be out of date this does not appear to us to be a reason to exclude it. Rather, we acknowledge the point that it is out of date, and draw from it the more general conclusion that the impact of the chapter 11 procedure on the guarantee renders its effect uncertain.

No Fair Hearing:

58. As noted above, we considered this application prior to considering the substantive matter.

59. In this application, we not only heard submissions from Mr Spink, but we also had the written submissions of Denton Wilde Sapte LLP and Linklaters LLP which we considered in full.
60. This application was made on three grounds:
- (i) First - by all the targets, on the basis of an inability to have a fair hearing due to lack of time.
 - (ii) Secondly - by Weil, Gotshal & Manges in particular, on the basis that TPR had failed to disclose or had made late disclosure of relevant documents.
 - (iii) Thirdly - by Weil, Gotshal & Manges alone, on the basis that TPR had failed to address the details of what an FSD would require, and as such the Panel could not make a reasoned determination to issue one.
61. The first two arguments inevitably segued into one another to an extent, and we considered them as such. For the sake of clarity and ease of understanding, however, we have dealt with our reasoning in relation to the arguments in turn.
62. The targets have also argued that the lack of particularity in the Warning Notice, at least as against a number of the targets, renders it fundamentally unfair to issue an FSD against them. We deal with those arguments, however, within the context of the substantial decision.

Lack of Time:

63. It is undeniable that the timetable in this case was a tight one. The Warning Notice was issued on 24th May 2010. It was then served on LBIE's solicitors electronically on 24th May, on the majority of the remaining targets on 1st June 2010, although it served on LBAM on 8th June, on FIN1 and FIN2 on 18th June and in the case of Lehman Brothers Holdings plc it was only served on 12th July 2010.

64. Originally TPR gave the targets until 21st June to respond. The targets' solicitors immediately started complaining and asking for more time. On 15th June TPR extended the time to respond to 5th July. Then on 29th June TPR extended it further to 30th July 2010.
65. During this entire period TPR was in control of the process, as it had not handed over the case to the Panel. In the end Weil, Gotshal & Manges applied for judicial review of TPR's decision not to extend the timeline. TPR at this stage agreed to hand the case over to the Panel, which it formally did on 30th June 2010.
66. Thereafter, we issued draft directions on 30th June, and then directions on 2nd July 2010 providing for responses to the Warning Notice and evidence by 9th August, notices of intention to cross examine by 24th August and skeleton arguments by 24th August. The times for skeleton arguments and notices of cross-examination were later extended to 31st August and the hearing date fixed for 8th and 9th September.
67. Mr Spink expressly stated that he had no complaint of how the Panel dealt with this matter once it had taken it over, and we are not aware of any complaints to that effect from the other targets. Rather, he submitted that:
- (i) The time was simply too short in a case such as this fully to assimilate and, in particular, respond to what amounts to highly detailed allegations, and substantial evidence.
 - (ii) The problems were compounded by the fact that due to the insolvency of the Lehmans group it is more difficult for his clients, and indeed all the targets, to research and obtain information. They no longer employ many of the relevant staff, and where they do the documentation is often with another of the corporate entities which are in turn no longer controlled by them or fully staffed.

- (iii) In his clients' case, in particular in LBAM's case, its role was dwarfed by LBIE and LBEL's roles, and therefore it is facing an even greater uphill struggle. This is particularly the case given LBAM's sale in 2009.
 - (iv) What little time there was was then wasted by TPR's intransigence over handing the case over the Panel, necessitating the judicial review.
 - (v) It was further compounded by the multiple, short movements of TPR's timetable.
 - (vi) Finally, it was further compounded by the refusal to provide full disclosure and the late disclosure which was provided.
68. Finally, both Denton Wilde Sapte LLP and Linklaters LLP also submitted that they had each taken TPR's original timetable at face value, and given how short a period of time was allowed had concluded that it was utterly impossible to respond properly and had accordingly not bothered to respond substantively, but rather had focused on critiquing the Warning Notice on a 'no case to answer' basis. By the time the timetable was extended, it was too late to start in any event.
69. TPR and the Trustees responded by making a number of points:
- (i) First, they suggested that any problems with the process could be corrected by means of a reference to the Tribunal. As such a reference is a re-hearing, no prejudice would apply.
 - (ii) Secondly, they pointed out that many of the documents relied upon were the targets' own documents, and that the targets were 'immersed' in the issues.
 - (iii) Thirdly, they emphasised that actually the vast majority of evidence was unchallenged. It was really the emphasis and in particular the interpretation and conclusions to be drawn from them which was being challenged.
 - (iv) Fourthly, they pointed to the evidence put forward by the Targets which did respond, as proving that there was sufficient time to make a proper response.

70. We have reminded ourselves that it is a requirement of Pensions Act 2004 s.96 that the standard procedure should allow for directly affected persons “*an opportunity to make representations*”. As a matter of statutory construction and common sense this must be a reasonable opportunity. It is also apparent to us that our process must comply with natural justice or, to use the more modern phraseology, we must act fairly and accordingly our processes must be fair. In order for our process to be fair it must be that the targets have a reasonable opportunity to respond properly to the case being brought against them - in other words, they must have the ability to make “*meaningful and focused representations*”; R v Secretary of State for the Home Department, ex parte Harry [1998] 1 WLR 1737 at 1748. That said, the Panel is not a court, and the sophisticated machinery and technical rules of civil litigation do not apply to us. Rather we must simply ensure that the targets have a fair opportunity to know and answer the case against them.
71. With these points in mind, we have been considerably troubled by the question of whether the targets had a fair opportunity to respond and make meaningful and focused representations in this case. We have concluded, after careful consideration of the matter, that they did - but only just. Two points assisted us in particular in reaching this conclusion.
- (i) First - as a matter of fact both Weil, Gotshal & Manges and Messrs Taylor Wessing managed to put in substantial responses. Those responses dealt at the very least with the principal issues, and to the extent that issues were not covered fully or in depth they appear to us to have been of relatively minor importance. The quality of the responses was extremely high, and the evidence gathered was of sufficient breadth and depth to convince us that whilst a counsel of perfection might have called for more time in this case there was sufficient time available.

(ii) Secondly - the point made by TPR and the Trustees that the majority of facts were not disputed is a good one. Obviously some issues were in dispute. In particular, we note LBAM's submissions on the questions of recharging of pension costs and service and secondment charges (and in particular uplifts thereon). However, in relation to the majority of issues the question was the reasonableness of the arrangements - not whether or not they were in fact as alleged. Whilst that question is one which takes time to respond to, it does not require as much evidential input as a pure dispute of fact would.

72. We also considered that the argument that by the time the full timetable was in place targets had missed the boat is misplaced. It is incumbent on any party to a process such as this to make the most it can of the time and resources available, whilst attempting to correct any impediments. As such, if a party chooses to not respond they must bear the results. Furthermore, we note that they do not say they would not appeal to the Tribunal in the event of an FSD being issued against them. On this basis we would expect that work done preparing the case for presentation to the Panel would to a large degree not be wasted in any event. Obviously there may be some costs implications - but given their size and the level of the s.75 debt in this case such costs are not a determinative issue.

73. However, we do not accept a number of the other points made by TPR and the Trustees.

74. First - the argument that the ability to appeal somehow provides a fair hearing is wrong. Although we are technically a committee of the regulator, in carrying out our essential functions of making determinations it is our duty to make our own independent judgment. It is the Panel's role, as embodied in the statute, to ensure that the targets have a fair and reasonable opportunity both to know the case against them and then respond to it. If the targets have not had this

opportunity then it is our obligation not to make an FSD, and we would have no hesitation in refusing to do so. To hold otherwise would be a derogation of duty by the Panel. Accordingly, the existence of a right of appeal to the Tribunal is irrelevant, in that it does not and cannot change the essential nature of our task and how we go about it.

75. Secondly - the argument that the targets were 'immersed' in the issues, and the documents were their own, was not in this case a necessarily good one. Usually we would accept the force of this submission. Here, however, the insolvency of the Lehmans group, and the unparalleled complexity of that insolvency, rendered any assumptions of the kind unsafe. Accordingly one must start from the assumption that the targets were going to have to approach this matter from a position of relatively little relevant information and understanding. This is a matter of degree, but in the absence of cogent evidence that the targets were being unrealistic in their characterisation of their position we would accept that they started out at a disadvantage when compared to most entities.
76. Thirdly - it must be obvious that in a case as complicated as this, and with as short a timescale available as here, that TPR is under a heightened obligation to ensure that the targets are given every reasonable opportunity to respond to the case being put against them. With this maxim in mind we were concerned by a number of aspects of the way this matter was undertaken.
77. At the outset, the failure to serve the Warning Notice immediately on all the targets was unfortunate. In a case such as this, with a foreshortened timescale, it is obviously to be preferred if TPR serves all the parties simultaneously and at the first available date. Since this has not occurred here, the Panel decided it was necessary to look carefully at whether any individual targets had been particularly prejudiced.

78. We therefore considered in particular the service on Lehman Brothers Holdings plc on 12th July 2010. We have seen no explanation of this delay, and doubt there could be one other than it was an administrative error. We considered very carefully whether it was proper to make an FSD against Lehman Brothers Holdings plc given their particularly truncated timescale. Ultimately we only concluded that it was appropriate to do so because there appeared to us to be nothing setting them apart from, for example, Lehman Brothers UK Holdings Ltd. As we explain below, our decision in relation to those two targets was primarily based on their relationship with LBL, and that point was entirely capable of being addressed within the time allowed even to Lehman Brothers Holdings plc. We would stress, however, that had there been any dispute or inconsistency in the evidence in their case it might well have been a different matter.
79. We also considered the service on the other targets, and concluded that there was nothing in relation to any of their service which, in all the circumstances, rendered it impossible for them to have a fair hearing.
80. There is then the dispute between the parties, prior to the Panel taking over the matter, on the issue of timetables. We are aware of Weil, Gotshal & Manges bringing a judicial review of TPR's actions, but we have not been informed of the details of this or how TPR ultimately came to pass the matter to the Panel. As such we are not in a position to assess who, if anybody, was in the right or wrong here. However, Mr Spink made the more general point that the existence of that dispute diverted resources from dealing with the substantive matter, and thereby exacerbated the problems his clients faced. We do acknowledge that in a case where timescales are as tight as this one satellite litigation over procedural matters could impact on targets' ability to respond. However, in this case it appears to us that Mr Spink's clients were not in fact adversely affected to such a degree as to defeat their ability to deal reasonably and fairly with the case against them.

81. However, none of the above fundamentally altered our conclusion that in this case the targets did have sufficient opportunity to respond fairly to the case being made against them.

Disclosure:

82. As noted above, this argument segued into and was put as part of the general 'no fair hearing' issue, and we considered it as such.
83. The first point we would note is that there was no suggestion of a deliberate attempt to suppress documentation that might go against TPR's case. Rather, the point made by Mr Spink and his instructing solicitors was essentially this:
- (i) TPR had obtained over 6,000 pages of documents in their investigations, but the Warning Notice only exhibited approximately 2,000 pages.
 - (ii) There was some late disclosure of various documents in July 2010, including 'evidence packs' prepared for various of the targets in their insolvencies. (We permitted this evidence to be adduced late in an earlier preliminary determination, but expressly without prejudice to parties' submissions on procedural unfairness.)
 - (iii) Weil, Gotshal & Manges asked for disclosure of the remaining documents on the basis that they could be relevant to the matter or assist them in responding to the Warning Notice. By their letter of 27th July 2010 they asked for disclosure of, amongst other things:
 - (a) All s.72 request responses, and supporting documentation received by TPR; and
 - (b) *"all the documents reviewed or obtained by the Regulator during its investigations in this matter and not previously disclosed"*.

- (iv) Weil, Gotshal & Manges also specified four instances of cross-references between the response to a s.72 request at Tab 77 to the Warning Notice, and apparently earlier s.72 responses.
- (v) TPR refused to disclose this documentation.
- (vi) This failure to disclose relevant documentation hampered the targets' ability both to understand the case being brought against them, and to respond to it fully.

84. In response in correspondence, TPR said in its letter of 30th July 2010 that *"There is no requirement on the Regulator to disclose all responses to Section 72 Requests"*. In respect of the four identified cross-references TPR said in its letter of 5th August 2010 that:

"We accept that documents in evidence cross refer to other documents that are not in evidence. That is unsurprising given that several exhibits, including this response, relate to different subject areas and given that many corporate documents are exhibited, dealing with a range of matters relating to the Lehman Group. However, you do not explain why the existence of the four cross references that you list make it impossible, without disclosure of all Section 72 responses, for you to understand the case your clients have to meet, and/or to respond to it. The four answers in Tab 77 that you list and that cross refer to earlier responses to section 72 requests either repeat an answer given in an earlier document (paragraphs A1(a) and B16, where the answer given in tab 77 is clear and easy to understand) or provide an answer that is not relied on by the Regulator as it does not in fact answer the question posed (paragraphs A1(d) and B14)."

85. TPR also said, in its letter of 5th August 2010 that *"Our letter [of 30th July 2010] did not state that we have decided that none of the Section 72 or Undisclosed Documents is relevant to this matter. We have not decided that all of those documents are either relevant or irrelevant. We have simply decided not to rely upon them in support of the Warning Notice."*

86. These points were then made more strongly by Miss Agnello in oral submissions, where she stressed that:

- (i) TPR was not under a duty to disclose documents;

- (ii) There was procedure for disclosure before the Tribunal, but even then only where relevant;
- (iii) The application for disclosure of all material was too wide;
- (iv) The s.72 response at Tab 77 was self-explanatory; and
- (v) The targets could have made an application for disclosure if they were so concerned.

87. The Panel considers that Miss Agnello is correct in saying that TPR is not under a general duty to disclose documentation. Rather, as a matter of natural justice, the targets are entitled to disclosure of anything on which the Panel might rely when making its determination. Equally, she is correct in pointing out that the Tribunal has procedures for providing disclosure, whilst the Panel does not.

88. However, it seems obvious to us that in a case where the time scale is as short as this one, and where the documentation and issues are as complicated as they are here, and where the targets are in an unusually difficult position of investigating and responding to the case being put against them, a failure to disclose plainly relevant materials **may** impact on whether the targets have a fair hearing. In such a situation, one would expect TPR to be particularly careful to assist the targets in any reasonable manner to understand the factual background, and thereby avoid any potential criticism.

89. Furthermore, TPR is itself obliged as a public body to put the case fairly. As such, we would expect as a general rule that documents expressly referred to in the leading and most important documents of a case, where the issue in question is as a matter of factual dispute, would in general be disclosed on request. However, we would stress that this is not an absolute rule, and we do not intend that anything we say here should be interpreted as shackling TPR's discretion in such matters.

90. In this case it seems to us that the general disclosure of everything sought by the targets was not necessary for them to be able to respond fairly to the case made against them. We also consider that in light of the case as it finally played out the evidence adduced late did not impact on this issue. However, we did have some serious cause for concern about TPR's refusal to disclose anything as requested by Weil, Gotshal & Manges, and in particular the earlier s.72 responses referred to in the s.72 response at Tab 77. Specifically, the response at A1(a), whilst being apparently intelligible without reference to earlier responses, is clearly:

- (i) Particularly central to this case, as it is the only source of evidence from TPR that LBAM contributed towards LBL's non-seconded staff pensions (directly or otherwise) as we explain below; and
- (ii) Sufficiently undetailed that further clarification could well assist in its understanding.

Furthermore the earlier s.72 responses could well be, as Mr Spink pointed out, precisely the sort of background information which would allow for fuller investigation of the matter.

91. That said, Weil, Gotshal & Manges did manage to find the email chain referred to above at paragraphs 37 *et seq.* Accordingly, it appears to us that in fact they were not placed at a significant disadvantage by the failure to disclose the earlier responses.

92. Accordingly, the failure to disclose the s.72 responses referred to in Tab 77 answer A1(a) appears to us to have been a procedural flaw by TPR, but not a fatal one. The issue of late or non-disclosure did not so affect the targets as to deny them a fair hearing or the opportunity to respond to the case against them.

FSD Requirements:

93. When this issue was first put to the Panel in a letter of 13th August 2010 it appeared to us to be based on an argument that the Panel was

not seized of the matter, and accordingly was one relating to jurisdiction. However, as the argument was developed and expanded in their skeleton argument, further written submissions (dated 8th September 2010) and oral submissions it was apparent that this was not the case. Rather, Mr Spink put the matter as follows:

- (i) The Panel has a wider task than simply determining what might be called liability, i.e. whether to issue an FSD at all. Rather, it must also consider on what terms the FSD is to be issued as against each individual target.
- (ii) Those terms can include specifics as to the total measure of support to be provided, either as a figure or a percentage of the s.75 debt, and the proportions of that support each target should provide, again either as a sum or a percentage. He emphasised that whilst on a proper interpretation the terms must always include such specifics, for his purposes it was sufficient that the terms could do so.
- (iii) In failing to address these two issues TPR has failed to put a case which allows the Panel to come to a conclusion that it is reasonable to issue an FSD against any target.

94. In support of the first point Mr Spink took us to the statutory provisions in question, and in particular to Pensions Act 2004 s.43.

- (i) Section 43(5)(b) clearly requires the Panel to conclude that it is reasonable to impose an FSD on each target individually.
- (ii) It is impossible for an individual target to argue against whether it is 'reasonable' for an FSD to be imposed on it unless and until it knows what that FSD requires it to do. To quote the further written submissions "*Even if one starts by knowing the headline figure (which is the amount of section 75 debt which the scheme employer cannot pay which of course is not known in this case), it is simply not possible to say that it is reasonable to impose on any individual target an obligation that they provide support which is some unquantified portion of that. Why? Because the target does not know what it has to argue against.*".

- (iii) Equally, the requirements of s.43(7)(a), (b) and (d) in relation to considerations of reasonableness clearly envisage different issues of reasonableness *vis a vis* different targets, and will inevitably give rise to different conclusions for different persons. If the different results of these considerations are not utilised, by differentiating between the targets in the obligations that are imposed on them, why have them as identified considerations?

95. Mr Stallworthy and Miss Agnello had agreed between them that he would take the lead in responding to this issue. Mr Stallworthy argued as follows:

- (i) There is a three stage process for FSDs. The first stage is at s.43, which provides for the imposition of an FSD which itself gives rise to the obligation to put in place 'financial support'. This takes one to the second stage under s.45, where 'financial support' is defined as an 'arrangement' complying with s.45(2) and approved by TPR. Finally the third stage, under s.47, is enforcement of the obligation to put in place financial support, by the provision for issuing a contribution notice in cases where there is non-compliance with an FSD.
- (ii) The first stage does not require identification of the specific extent of support to be given, or the proportion to be borne by an individual target. If Parliament had intended it to be specific it would have provided for this in express words, as is the case in ss.39 and 48.
- (iii) It would be positively counter-productive to impose such specifics at the first stage, because not only might the situation change but also because the arrangements put in place might go beyond the targets before the Panel. Even if they did not, why should the Panel pre-judge what is provided for by the statute to be in the hands of the subjects of an FSD (subject to TPR approval), namely how to provide financial support?
- (iv) In fact, if the Panel were to attempt to be more specific, and impose some sort of pre-determined percentage of liability to an

individual target, it would be exceeding its jurisdiction in that it would be seeking to pre-judge TPR's role (on a non-reserved function) under s.45.

96. We consider that Mr Stallworthy's interpretation is to be preferred. The crux of the matter is that imposing an FSD on a target does **not** impose a liability on them. Rather, it puts them in the field of play when the issue of how to achieve financial support is determined and ultimately **thereafter** whether or not to impose liability. Once one recognises this, Mr Spink's concerns fall away. There is nothing unreasonable in making somebody take part in the further process of putting in place financial support, without pre-determining what financial support they should personally ensure is put in place.
97. The fact that different targets will have different considerations of reasonableness as to whether to issue an FSD against them is self evident. But not distinguishing between targets as to what element of financial support they are to be responsible for does not prevent those different considerations being utilised. They are utilised, and will impact differently on different targets, in determining whether they cross the threshold of reasonableness to issue an FSD against them.
98. We also note that all the criteria of reasonableness are also covered by s.47(4) when considering how much liability is imposed ultimately on a target. If the issue of the reasonableness of how much individual liability was to be imposed was pre-judged by us at this stage, why should it be re-judged by us at the latter stage? To turn Mr Spink's argument around, why do that twice?
99. Furthermore, we note that s.43(3)(a) provides for the direction to specify a period during which the financial support is put in place. Assuming the period of time is something more than *de minimis*, matters can and often will change, thereby altering what it would be reasonable for a target to do. To pre-determine, at this stage, what, if

any, share of financial support is to be borne by a particular target which may (as in this case) be the subject of a hugely complex administration, would be to make them an early hostage to fortune. It would also require the panel to make forecasts as to the financial state of the targets in future times, when the statute (in the absence of any clear and express requirement) in fact imposes no such obligation.

100. In summary, we have concluded that when considering whether to impose an FSD on the targets we need only be concerned with the imposition of an FSD *simpliciter*, and need not make a direction giving specific figures or proportions. As such we can make a reasonable determination without TPR having to specify such figures or proportions, and their not doing so does not prevent us considering the substantive question.

SUBSTANTIVE DETERMINATION:

101. In order to impose an FSD the Panel needs to be of the opinion that:
- (i) The employer of the scheme in question is a service company or insufficiently resourced, as per Pensions Act 2004 s.43(2);
 - (ii) The targets are persons falling within s.43(6); and
 - (iii) It is reasonable to do so, having regard to “*such matters as the [Panel] considers relevant including, where relevant*” the matters set out in s.43(7).
102. Although Denton Wilde Sapte and Linklaters both put TPR to proof of the entirety of their claims, in reality none of the targets seriously challenged the fact that LBL was a service company, or that the targets were persons falling within s.43(6). In particular, we reiterate our finding set out above as to the status of LBL as a service company, and consider that the matters set out in Appendix 2 to the Warning Notice sufficiently prove the status of the targets as falling within s.43(6)(c). This leaves the question of reasonableness.

103. We remind ourselves that s.43(7) requires us to consider “*such matters as [we] consider relevant*” including but not limited to:

“(a) the relationship which the person has or has had with the employer (including, where the employer is a company within the meaning of subsection (11) of section 435 of the Insolvency Act 1986 (c. 45), whether the person has or has had control of the employer within the meaning of subsection (10) of that section),

“(b) in the case of a person falling within subsection (6)(b) or (c), the value of any benefits received directly or indirectly by that person from the employer,

“(c) any connection or involvement which the person has or has had with the scheme,

“(d) the financial circumstances of the person...”

Value of the Benefits:

104. We return to the issues of relationship with the employer, connection with the scheme and financial circumstances of the person on a target-by-target basis below. The question of value of the benefits submits to a more general description, as TPR put it that the very nature of Lehman’s integrated business was such that the targets all obtained a number of generalised benefits. In particular TPR stressed the following matters:

- (i) Secondment of employees, thereby allowing the operating companies to make their profits whilst not sharing any of those profits with LBL and without even a 10% uplift.
- (ii) Back-office services provided under the service agreements, albeit with a 10% uplift.
- (iii) General provision of LBL employees as directors, and to strategic oversight committees, both effectively for free (subject to the operating companies’ recharges).
- (iv) Property availability / occupation, whilst the liabilities for those properties remained on LBL and at the same time were removed from impacting on the operating companies’ regulatory capital requirements.
- (v) Allowing intercompany balances to remain outstanding for months at a time.

- (vi) Providing a vehicle through which intercompany payments could be made efficiently.
- (vii) Taking the position of lead company for corporation tax, and nominated company for VAT purposes, thereby making it jointly and severally liable for group VAT.
- (viii) Holding assets for the operating companies in order to reduce their capital requirements.

105. All of these to a degree also feed into the issue of the relationship between the targets and the employer, and in some cases to the financial circumstances of the targets.

106. Before we take the specific issues in turn we make two general points.

- (i) First - the fact that a service is paid for does not render its benefit valueless. Rather, the fact that it is paid for is an element to take into account when determining its impact in the question of reasonableness.
- (ii) Secondly - whilst we are concerned with 'value', and therefore some sort of quantification or assessment of relative value, we do not consider it necessary or appropriate to attribute a precise monetary value on each benefit. Rather, it is an issue which can be looked at as a matter of broad assessment.

107. With those points in mind, we now take the 'benefit' issues in turn:

Secondment, services, uplift and profit sharing:

108. There was a great deal made by the parties of the issues of secondment, service charge, uplifts (or lack thereof) and profit shares (or lack thereof). We have concluded as follows:

- (i) There was a benefit to the operating companies in not having to hire their own staff, and run their own HR departments and the like, in the secondment arrangements.

- (ii) Equally, there was a benefit to the operating companies in not having to provide individually for all the back-office services they effectively contracted out to LBL.
- (iii) Therefore there was 'benefit', the value of which to the operating companies was not inconsiderable and went beyond the simple cost of those benefits.
- (iv) There is no reason to doubt that the profit sharing and costs attributions were anything other than bona fides arrangements. Nor is there any reason to conclude that LBL should have been paid more for the secondees or services it rendered.
- (v) The lack of an uplift on the secondees' costs, and the failure to include LBL in the profit sharing arrangement, reflects the fact that for all practical purposes the secondees were the operating companies' employees. LBL was merely a useful legal structure through which to employ them.
- (vi) Therefore the operating companies paid reasonable sums for the services rendered, albeit that they obtained benefits which went beyond the strict payments they made in value.

However, there was very little benefit to the investment companies from the staffing and back room services provided by LBL, since most of them had few or no staff seconded from LBL apart from the Directors.

109. Our conclusion that the lack of an uplift on secondees' costs reflected the fact that they were treated as the operating companies' own employees also supports two subsidiary conclusions:
- (i) First - that the profit sharing arrangement was a legitimate and fair arrangement; and
 - (ii) Secondly - that the relationship between the operating companies and the seconded employees had more to it in substance than it might appear in strict legal form - i.e. they were treated as and acted as their employers for all practical purposes. This is also reflected in the statutory accounts for the

operating companies where LBL secondees are referred to as their employees.

General provision of directors and oversight:

110. We can see the value of this benefit in theory. The difficulty is identifying the value in practice. Whilst the operating companies clearly had a benefit in that their LBL directors were presumably active (as the operating companies were themselves active) and their operations were more generally overseen, the position for the other investment company targets is far less clear. Furthermore, to the extent that these directors and personnel manning the oversight committees were paid for by the operating companies, in that sense the benefit was provided by (or at least made available by) the operating companies rather than LBL.

Property:

111. For the operating companies and LBHI this was an obvious benefit. In particular, having the asset remaining off their balance sheets clearly assisted with regulatory capital requirements. For the other targets, the issue is again less clear. The fact that they were provided with a postal address for registration is trivial. The fact that they were provided with space in which their 'staff' could operate also appears to be trivial, given that many of them had no secondees at all and, where there were secondees, they may well have already been in occupancy as staff of the operating companies.

112. At the hearing on the second day Mr Spink also produced a document which appeared to show that LBHI had stood surety for some of LBL's liabilities in relation to the property at Canary Wharf. Whilst we were not addressed on this at any length, two points occur to us:

- (i) First - whilst this tends to show that ultimately LBHI had potential liability for the property liabilities, the primary liability fell on LBL.
- (ii) Secondly - again, it tends to emphasise the relationship between LBHI and LBL.

Intercompany balances & payments:

113. We accept Weil, Gotshal & Manges' own evidence that LBL's intercompany receivables averaged 10 months of service charges. Furthermore, LBL was plainly used as a device to assist in the efficient structuring of intercompany payments. Neither of these features of the intercompany relationships are in any way improper. Equally, we have seen nothing to indicate the operation of the intercompany payments and the cash sweep was anything other than entirely proper and the cash sweep just prior to insolvency was simply bad luck. All these features, however, gave the group as a whole, and the operating companies in particular, a benefit of some considerable value.
114. No evidence was presented to us at all about the benefits to the investment companies from the intercompany payments system.

Tax issues:

115. The submissions on these points were relatively sparse. On what we did see, however, it appears that there was on the balance of probability some benefit to the group through this action. Again, however, to what extent this benefited the non-operating companies is entirely unclear.

Asset Parking:

116. There was a benefit to the operating companies in not having to hold additional capital under their regulatory requirements, through the use of LBL holding assets on its balance sheet. Whilst some of the investment companies may have benefited from this, if they were subject to regulatory capital requirements, in most cases they would not have done so.

The Individual Targets:

117. TPR divided the individual targets into three general categories, which we adopt here:
- (i) LBHI - the parent holding company;
 - (ii) LBAM, LBIE and LBEL - the operating companies;
 - (iii) The remaining targets, called by TPR 'the investment targets'.

LBHI:

118. LBHI's relationship with LBL was not only that of the ultimate controlling entity for the entire group; see above at paragraphs 23 and 34. It was also a more direct one with secondment of staff to the LBHI London branch, which is in our view a non-negligible number of employees. It also had at least on occasion direct supervision of LBL's actions - as to which, see paragraph 19 above. Equally it was the guarantor of at least LBL's pension debts and, apparently, at least some of its property related liabilities. Clearly LBHI was closely associated in practice as well as legally with LBL.
119. As the ultimate parent company of the group LBHI obtained, directly and indirectly, substantial benefits from LBL's operations in supporting the Lehman group generally. Everything that the subsidiaries benefited from ultimately benefited LBHI, albeit the benefit might be indirect and diluted. However, we consider that the value of the benefits received by LBHI from LBL were considerable.
120. Its relationship with the Scheme was not only that of, at least potentially, having secondee employee members, but also and far more significantly it was the guarantor of LBL's liabilities and the ultimate source of funding for both the normal and special contributions to the DB scheme set out in paragraph 16 above. Clearly therefore it had an acknowledged obligation to the Scheme.
121. Finally, with regard to its financial circumstances, it is clear that LBHI has significant assets. What is uncertain, as with much of the

Lehmans group, is what the impact of the insolvency will be on those assets and what its liabilities will be.

122. With regard to other possibly relevant circumstances, the most obvious point is LBHI's insolvency. It has been argued by a number of the targets that this should somehow point against the reasonableness of imposing an FSD. It has even been argued, although not by LBHI, that where insolvency has intervened to stop the company administering its affairs so as to deal with the potential imposition of an FSD this goes against the imposition of one. In our view the insolvency of a target does not, in and of itself, go against the imposition of an FSD. There may well be situations where the particular circumstances of an insolvency do so, such as where there are no assets whatsoever available. In general and in principle we consider that insolvency is a situation where an FSD might be necessary and appropriate in order to protect the interests of members. In the case of the Lehman group, given its complexity and multi-jurisdictional nature with consequential uncertainties as to outcomes, we consider that if anything it is more reasonable to impose an FSD on an insolvent target.
123. Taking all these points into consideration, we have determined that it is reasonable in all the circumstances to impose an FSD on LBHI.

The Operating Companies:

124. In this group we treat LBEL and LBIE separately from LBAM.
125. LBEL and LBIE, although undertaking different businesses, appear on the evidence before us to have operated in broadly the same manner and had the same relationship with LBL and the Scheme as each other. In those respects:
- (i) Their relationship with LBL was plainly a close one. The secondment of staff, the provision of back-office services and the general operation of the group alone shows that they operated in a closely integrated fashion. The ultimate

recharging of LBL's costs which had not been picked up by direct, individual recharges further shows how this relationship was viewed by the Lehmans group itself.

- (ii) The value of the benefits obtained by LBIE and LBEL from LBL must also have been very considerable; see paragraphs 104 *et seq* above. In this respect there is a countervailing point on reasonableness that we consider that LBL was paid a reasonable sum for the provision of those benefits, but we also consider that the value of the benefits exceeded the monetary value of the payments made.
- (iii) Their relationship with the Scheme was, in practical if not strictly legal terms, that of employers. Here we consider the lack of any uplift for the secondees to be clearly indicative of how these employees were treated by the Lehman group. They paid for the membership of their seconded employees, and treated those seconded employees as their own employees taking the entirety of the benefits which went with that relationship including all the profits they generated. The only thing they lacked was formal participation in the Scheme. In our view, it is highly relevant to whether it is reasonable to issue an FSD that employers who take the benefit of employees should also ultimately take the burden of their pension promises.
- (iv) In relation to their financial circumstances, it is again clear that they both have significant resources although the impact of the insolvency on those assets and their ultimate liabilities are uncertain.

126. Taking into account all these matters, we have concluded that it is reasonable to impose an FSD on LBEL and LBIE.

127. LBAM is more complicated. As Mr Spink noted:

- (i) It was only incorporated in 2005 and started trading in 2006;
- (ii) It had accumulated losses as at 15th September 2008 of over \$100m;

- (iii) It was dwarfed in comparison with LBIE and LBEL as a part of the Lehmans European and Middle East operations;
- (iv) In its present incorporation we were told that it was hived together by way of an asset sale in 2009 and not the same creature at all as it had been in 2008.

128. In respect to those points, we have concluded as follows:

- (i) Its date of incorporation and trading are relevant to an extent. The fact that it post-dated the closure of the defined benefit element of the Scheme could, in the absence of anything else, define the target's relationship with the Scheme. We deal with this below.
- (ii) Its accumulated losses might also show what the target's financial circumstances are, for the purposes of s.45(3)(d). That said, it is not insolvent and was clearly valuable enough for a third party to purchase it.
- (iii) Subject to a target being of *de minimis* importance, relative size appears to us to be more relevant at stages two or three of the FSD process (i.e. when determining what financial support to put in place, and what contribution notices to issue in the event of default). In this case LBAM was clearly not of *de minimis* importance. For one thing, a 4% contribution to LBL's general costs is plainly beyond *de minimis* in and of itself. To put it another way, 4% of the estimated £148m s.75 debt is just under £6m, which is plainly not *de minimis*.
- (iv) In relation to LBAM's restructuring in 2009, there is nothing we have seen in this regard that renders an FSD less reasonable.

129. Turning back to the statutory considerations:

- (i) LBAM's relationship with LBL was very much as LBIE's and LBEL's. In this regard our conclusion, set out above, that LBAM did undertake responsibility for 4% of LBL's general un-recharged costs, at least in 2008 is highly relevant; see above at paragraphs 37 *et seq.*

- (ii) The value of the benefits obtained from LBL are also very much as LBIE's and LBEL's in principle, although we accept that they are less in absolute terms and took place over a shorter period of time.
- (iii) LBAM's relationship with the Scheme is again as with LBIE and LBEL, although again over a shorter period of time and with fewer secondees and directors. In this regard we note that Mr Spink sought to argue that:
 - (a) LBAM had at most 2 secondee defined benefit members.

In fact, it had at least 1 director in 2006, as its accounts showed, and 2 secondee defined benefit members in 2008. The position prior to 2008 is unknown. However, we do not agree with the point. The moment LBAM had 1 secondee defined benefit member it took on the mantle of employer, in the non-legal sense, of that member, and with the benefit of that member comes the burden.

- (b) We do not know how the general recharge operated, and whether it related to defined benefit costs.

We were given no specific evidence about the detailed working of the general recharge. However, we do know that the secondees' recharge costs included pension costs, because this is stated in their statutory accounts - for example, in LBIE's accounts to 30 November 2007 at Notes to Accounting Policies note 1, page 10, it is recorded that "*The Company's pension obligations are financed by payments to Group funded defined benefit and defined contribution schemes operated by Lehman Brothers Limited. The annual cost of pension arrangements is recharged to the Company in arriving at its operating profit or loss for the year*". There is also a clear statement in answer to question 25 in the response

to TPR's s.72 enquiry at [WN/Tab 77/page 1804] that the 49% of the pension costs relating to LBL's own non-seconded employees were covered by the general recharge of LBL's residual expenses to the operating companies in the ratios set out in the answer to question 1A at [WN/Tab77/page 1795]. This answer includes the 4% attribution to LBAM for 2008 discussed in paragraphs 37 *et seq* above. No evidence has been offered to suggest that contributions to the DB scheme were excluded from this arrangement or that the attributions to the three companies were different.

Mr. Spink argued that there was no specific evidence that LBAM's 4% contribution in 2008 went towards the DB scheme. However, there is clear evidence provided by the Trustees that in 2008 LBL still had at the very least 24 non-seconded employees, who were members of the DB scheme, and who were in fact accruing DB benefits and pensionable service as 'old guarantee' members. This evidence is set out in Tab 12 of the Trustees' Response, which was not objected to by Mr Spink in the preliminary issue. Furthermore, WN paragraph 114 evidences contributions to the DB Scheme in 2008. Given the arrangements made by the Group for recharging all the LBL's residual costs in respect of its own employees to the operating companies, we find it simply implausible that these arrangements did not apply to contributions to the DB schemes or that these were financed under some different key from that given in the answer to question 1A. Even in the unlikely event that none of the DB 24 scheme members benefited from the contributions to the DB scheme made in 2008, because they had no salary accruals, LBAM would still have had an obligation to make such contributions in future years if Lehman's had continued as a going concern.

- (iv) LBAM's financial circumstances are, if anything, positive at the moment and to an extent this is in favour of the issuing of an FSD.

130. Again, taking all these factors into consideration we consider it is reasonable to issue an FSD against LBAM.

The Investment Companies:

131. Here we break this class into two groups:

- (i) LBL's parent companies, Lehman Brothers UK Holdings Ltd and Lehman Brothers Holdings Plc;
- (ii) The remaining targets.

132. Starting with LBL's parent companies:

- (i) There is nothing to indicate that these companies were anything other than passive holding companies operated as conduits for money and control.
- (ii) They have plainly strong and direct relationships with LBL in that they owned it - directly in the case of Lehman Brothers Holdings plc and at one remove in the case of Lehman Brothers UK Holdings Ltd. Lehman Brothers Holdings plc also owes a considerable amount of money to LBL, being its largest debtor with \$1.273m owed. Furthermore, both of them had control of LBL within the meaning of Insolvency Act 1985 s.435(10) as they were "*entitled to exercise, or control the exercise of, one third or more of the voting power at any general meeting of the company [Lehman Brothers Holdings plc] or of another company which has control of it [Lehman Brothers UK Holdings Ltd]*".
- (iii) As holding companies, the value of the benefits that they received from LBL would be minimal save, in their case, for the use of LBL for efficiently transferring money around the group as evidenced by their intercompany debts. That said, they were also the owners (direct and indirect) of the operating companies,

so there would have been an identifiable indirect benefit in the value that their assets (the operating companies) took from LBL.

- (iv) They have no relationship with the Scheme, save through their ownership of and relationship to LBL.
- (v) Their financial circumstances are not so clearly negative as to mitigate against an FSD. Furthermore, their intercompany debtor/creditor relationship with LBL mitigates in favour of an FSD being issued.

133. Overall in relation to LBL's parent companies we have concluded, particularly by reference to their relationship with LBL, that it is reasonable to issue an FSD against them.
134. The remaining targets are a diffuse group. It appears likely to us that there are probably three categories of targets:
- (i) Holding companies - where the target is merely a passive entity for holding other companies in the group;
 - (ii) Asset companies - where the target is merely a passive entity for holding other assets; and
 - (iii) Trading companies - where the target actually engages, or engaged, in trading activities.
135. Our first problem is that we do not know with sufficient accuracy which targets fall into which categories. It may well be that an individual target falls within two or even all three of these categories. The evidence we have on each of them is extremely slender and in some cases approaches vanishing point. One of the better sources of information provided to us are the statutory accounts, which were provided by the Trustees in their Response on 9th August 2010. However, they are by their nature extremely brief and often consist of generic statements which do little to assist. Furthermore, in some cases they were significantly out of date even by reference to 15th September 2008. We say this not as a criticism of the Trustees' evidence but simply by way of identifying its limitations.

136. Our second problem is that even to the extent that we can identify that a target might belong in a particular category, it is impossible on what we have been shown to identify how that target actually operated
137. We have explained above, at paragraphs 34 *et seq*, how the Lehmans group business was operated on an integrated basis. However, within the region and even within trading areas (such as that covered by LBIE) there were degrees of separation of the business. In this respect we refer to Mr Gamester's 1st witness statement at paragraph 24 where he states that:

“However, not all business controlled and managed by LBIE trading teams was actually operated through LBIE as a legal entity. For example, the real estate group located in LBIE was responsible for the real estate activity that was conducted in separate legal entities across the UK group structure, such as the substantial real estate activity in the Thayer subgroup and in subsidiaries of LB UK RE Holdings Limited (so these separate legal entities benefited from their businesses being run by the LBL employees seconded to LBIE). Similarly, the mortgage group located in LBIE was responsible for the mortgage activity carried on in Capstone Mortgage Services Limited, Southern Pacific Mortgage Limited and Preferred Holdings Ltd and their related subsidiaries. It should be noted that some of these separate companies had ‘local’ management teams (such as the Burford property companies in the Thayer subgroup, and the companies in the mortgage group) who were not LBL employees; however, these ‘local’ teams were themselves controlled and managed by LBL employees seconded to LBIE and benefited accordingly.”

138. Mr Gamester went on to expand on this point at paragraph 6 of his 2nd witness statement:

*“Table 1... demonstrates the point I was making at paragraph 24 of my first statement that **many** of the Targets were holding companies or special purpose vehicles used passively to hold and ring-fence a particular revenue-producing asset or transaction at the direction of LBL employees (whether acting as the directors of such Targets or transacting business through such Targets while seconded to LBIE or other UK companies within the Lehman Brothers UK Group). For instance, Thayer Properties Ltd, of which I was a director prior to my retirement from Lehman Brothers, is an example of this.”* (emphasis added).

139. Clearly there were degrees of integration and 'local' separation. This point is made more forcibly by the Response of what can loosely be called the Capstone group of companies, represented by Messrs Taylor Wessing. Whilst TPR decided not to proceed against them, we had sight of their Response and it was apparent from it that they were arguing that they had a significantly separate business to the bulk of the Lehmans London group, and in particular to LBL.
140. Leaving aside the point that LBAM, LBHI, FIN1 and FIN2 have not accepted Table 1 (which set out details of the various targets garnered from public documents including their directors, employees, registered offices and principal trading activities), the problem with the information presented to us by TPR is that it is impossible, outside the operating companies, to tell precisely what any of the other targets actually did and to what extent they were (or were not) integrated into the Lehmans operations as a whole and therefore reliant on / benefiting from LBL in particular. As noted in paragraphs 108 to 116 above, with the possible exception of the Directors provided by LBL, most of the Investment Companies do not appear to have benefited significantly or at all from the other services provided by LBL as listed in paragraph 104 above, mainly because most of them had either no or few secondees from LBL and only a very few of them had any connections with Scheme. The case as put in the Warning Notice is extremely general, and in the widest, least particular format possible. For example, as Messrs Denton Wilde Sapte said in their letter of 2nd July 2020, "*not once does [the Warning Notice] mention by name any of [LB SF No. 1] or the [other 31 companies represented by Denton Wilde Sapte]*".
141. The allegations made against the other targets in the Warning Notice amount to a number of general statements in particular at:
- (i) Paragraph 22, where there are a number of short statements in relation to a total of 7 targets, 1 of which (Capstone) TPR has decided not to proceed against.

- (ii) Paragraph 23, where it makes a generic statement about the remaining targets.
 - (iii) Paragraph 60, where it says that with some exceptions “... *the vast majority of employees based in the UK were LBL employees*”.
142. Furthermore the evidence in relation to their operation amounts to:
- (i) Mr Gamester’s 1st and 2nd witness statements - which themselves do not proceed to individual particulars as to the operation of any targets, with some very limited exceptions of Thayer Properties Ltd and some of the Capstone group companies; and
 - (ii) The registered accounts of a number of them, as provided in the Trustees Response on 9th August 2010.
 - (iii) Some information provided by way of the Trustees’ Response as to numbers of employees and directors.
143. Overall, it appears impossible for us to come to any conclusion, let alone any firm conclusion, on the balance of probabilities as to how these other targets operated in fact. It may well be that they ‘mainly’, or the majority of them or ‘many’ of them, operated on an integrated basis through the use of LBL secondees and/or received other benefits through the ministrations of LBL. The difficulty is identifying which did so and to what extent. It is plainly the case that TPR must prove its case on the balance of probability against each and every target. It is not enough to prove it against a class of targets on average, and thereby catch the entirety of the class.
144. This means that when we come to consider the matters set out at s.43(7) we simply do not know what those factors amount to:
- (i) Relationship with the employer - minimal, with the provision of directors the only significant benefit.
 - (ii) Value of the benefits received from the employer - trivial, and to the extent that there were any benefits actively obtained these

may have been indirectly obtained as they could have come via the operating companies. In particular, to the extent that secondees performed services for them, it strikes us that whilst it could be said that this was 'indirectly' from LBL, it could also be said that it was actually and more significantly from the operating companies.

- (iii) Relationship with the Scheme - quite possibly, even probably, nil, save for the doubly indirect one via the operating companies and thereafter LBL.
- (iv) Financial circumstances - we were given no particularised evidence, with the exception of FIN1 and FIN2, which appear to have such massive liabilities as to mitigate against the imposition of an FSD.

145. In the light of this lack of particularised evidence as to the detailed position of these remaining targets we have concluded that it would not be reasonable to impose an FSD on them.

29 September 2010