Waterfall II Application

No 7942 of 2008

IN THE HIGH COURT OF JUSTICE

CHANCERY DIVISION

COMPANIES COURT

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

(1) ANTHONY VICTOR LOMAS

(2) STEVEN ANTHONY PEARSON

(3) PAUL DAVID COPLEY

(4) RUSSELL DOWNS

(5) GUY JULIAN PARR

(as the joint administrators of the above named company)

Applicants

- AND -

(1) BURLINGTON LOAN MANAGEMENT LIMITED

(2) CVI GVF (LUX) MASTER S.À R.L

(3) HUTCHINSON INVESTORS LLC

(4) WENTWORTH SONS SUB-DEBT S.À R.L

(5) YORK GLOBAL FINANCE BDH, LLC

Respondents

REPLY SKELETON ARGUMENT ON BEHALF OF THE FOURTH RESPONDENT

INTRODUCTION

1. This reply skeleton is not intended to address all of the points made in the SCG's skeleton argument. It focuses only on certain points upon which the Court may find it useful to have Wentworth's response prior to the hearing.

PRINCIPLES OF INTERPRETATION

2. The relevant principles of interpretation are set out at Part 2A of Wentworth's skeleton argument.

3. There are four additional points that should be highlighted in view of the way in which the argument is presented in the SCG's skeleton argument.

4. First, the SCG's approach to interpretation fails to have regard to the language actually chosen by the parties in the release provisions: see, in addition to the authorities cited in Wentworth's skeleton, *Amlin Corporate Member Ltd and othe.rs v Oriental Assurance Corporation* [2014] 2 Lloyd's Rep 561, at [44] *per* Gloster LJ.

5. Second, the arguments developed in the SCG's skeleton argument place a great deal of reliance on the alleged commercial common sense of the CRA and the CDDs from the point of view of the creditors entering into the agreements. This is not a permissible approach when interpreting a contract. This point was made clear by the Court of Appeal in *BMA Special Opportunity Hub Fund Ltd & Ors v African Minerals Finance Ltd* [2013] EWCA Civ 416. Aikens LJ stated as follows (at [24]):

> "*The starting point is the wording of the document itself and the principle that the commercial parties who agreed the wording intended the words used to mean what they say in setting out the parties' respective rights and obligations. If there are two possible constructions of the document a court is entitled to prefer the construction which is more consistent with "business common sense," if that can be ascertained. However, I would agree with the statements of Briggs J, in Jackson v Dear, first, that "commercial common sense" is not to be elevated to an overriding criterion of construction and, secondly, that the parties should not be subjected to "…the individual judge's own notions of what might have been the sensible solution to the parties' conundrum". I would add, <u>still less should the issue of construction be determined by what seems like "commercial common sense" from the point of view of one of the parties to the contract.</u>*" (emphasis added)

6. Third, the SCG's attempt to rely on the decision of Buckley J in *Re WW Duncan* [1905] 1 Ch 307, in support of the argument that a compromise which included the release of non-provable claims would have been contrary to the duties of the Administrators[1], is misplaced. The SCG's argument fails to pay regard to the context of the decision in *Re WW Duncan*. In this regard:

(1) *Re WW Duncan* concerned a gaming broker whose customer made (then) unlawful gaming contracts and placed money with the broker as margin. In the liquidation of the broker, the customers proved for their margin, which the liquidator paid in full by cheque by two dividends. The liquidator required a receipt for the second dividend describing it as:

> "*[T]he amount payable to me in respect of the second and final dividend of 10s. in the pound on and in full discharge of my claim against this company.*"

(2) Buckley J held:

(a) that by the course of dealing between the company and its customers interest at 4 per cent. was paid on the deposits;

(b) that there was an "*implied contract*" by the company to pay interest on the deposits, and that the creditors were entitled to receive out of the surplus interest from the date of the winding-up until the date of payment of the second dividend; and

(c) that there had been no accord and satisfaction of the claim for interest.

(3) Upon holding that there was a contractual right to interest, which supported a right to interest from an insolvency surplus on the remission analysis in *Re Humber Ironworks and Shipbuilding Co* (1869) LR 4 Ch App 643, Buckley J said (at 314-15):

> "*But then it is said that, even supposing that is so, the creditors have released the claim to interest because each creditor has signed a receipt in which he*

[1] The SCG's argument based on the statutory duties of the Administrators is, in any event, wrong: see Wentworth's skeleton argument, at Part D2.8 and [214]-[217].

takes a sum representing a second and final dividend of 10s. in the pound, "being the amount payable to me in respect of the second and final dividend in full discharge of my claim against this company." It is contended that that was a release of the right to interest if it existed.

Now one of these gentlemen, a Mr. Robertson, was asked to sign that, and there is exhibited to one of the affidavits ***a bundle of correspondence which shews this to be absolutely plain - that before the liquidator was going to pay this dividend he knew there was this question in respect of interest, and that as regards Robertson he appended his signature to that form of receipt on the terms that the question of interest should be left entirely open****. Those terms were* ***accepted*** *by the liquidator; but I am asked by counsel for the contributories to say that,* ***notwithstanding that arrangement****, the liquidator intended, by taking this form of receipt, to entrap every other creditor in the concern and get a release from him, when he knew all the time that there was really a question to be determined whether these creditors were entitled to interest or not.* ***I decline to attribute such an intention to any liquidator; it would be a most dishonest thing to do. It is the liquidator's duty to see that the estate in his hands is distributed according to the rights of the parties, not to induce somebody to give away by a slip a right as to which the liquidator knows there is a real question to be determined****. I do not think that the receipts of any of the creditors were taken or given with the intention of precluding this question.* ***Over and beyond that, any creditor who signed a receipt in that form got no consideration at all for giving up his right to interest if he had any.*** *He was entitled to receive the second dividend, 10s. in the pound. It was what he was then known to be entitled to as his share on the distribution of assets in the winding-up of the company, and in respect of that receipt he received no consideration whatever for the release of his right to any further sum, if there was any, that was payable. I do not think there is any doubt that the right to interest was left open.*"

(emphasis added)

(4) The facts which drove Buckley J's decision in *WW Duncan* were, accordingly, a finding that:

(a) There was an express arrangement (documented by correspondence) made prior to (and in contemplation of) the payment of the second dividend and the issue of the relevant receipt by which the liquidator had agreed with creditors to keep open the question of the right to interest from the surplus.

(b) There was no consideration for the release, if the receipt should be construed as a release (which it was not for the above reason).

(c) Buckley J, therefore, rightly regarded as opportunistic the attempt by the members to construe the receipt as a waiver of the right to interest. Hence, he said that, given the arrangement made with creditors, "*it would be a most dishonest thing to do*" for the liquidator to rely on the receipt as a release (as the members alleged was the case). It was on this basis that the members' argument was rejected[2].

(5) Accordingly, *Re WW Duncan* does not admit of any generalisation to the compromises in the present case because there was no prior arrangement made between the creditors and the Administrators, and there is no question in this case of the Administrators taking advantage of creditors via underhand means: the compromise effect by the CDDs and the CRA is clearly one which involved give and take on both sides: see, in particular, Lomas 10/33-34 and 48 (as regards the CDDs) and Pearson 7/18-30, 60 and 120 (as regards the CRA).

7. Fourth, the section on the principles of construction in the SCG's skeleton argument includes a brief reference to the implication of terms into contracts: see Section C(4) of the SCG's skeleton argument. Wentworth notes that the SCG's skeleton argument does not develop any argument based on the implication of terms into the CRA or the CDDs. In particular:

(1) The SCG does not identify, whether with the required degree of precision or at all, the wording of any terms which it contends should be implied into the CRA or the CDDs; and

(2) The SCG does not identify the grounds upon which the Court should imply any terms into the CRA or the CDDs.

8. Accordingly, Wentworth does not understand the SCG to base its case on the implication of terms into the CRA or the CDDs.

---

[2] Had the liquidator in *WW Duncan* sought to construe the receipt as a release, the case would no doubt have fallen into the line of cases following *ex parte James*, in which the Court might have restrained a liquidator for dishonourable conduct. This observation is made to make the connection between the SCG's argument on Issues 34 and 35 in this respect and its case on Issue 36A.

9. Wentworth will, if necessary, contend that no terms should be implied into the CRA or the CDDs in order to alter the clear language of the release clauses.

10. The process of the implication of terms does not permit the Court readily to depart from the natural and ordinary meaning of the words chosen by the draftsman. The Court adopts a strict approach when deciding whether to imply a term into a contract: the touchstone for the implication of a term into a contract remains necessity. In this regard:

(1) The classic principles for the implication of a term were stated by Lord Simon in *BP Refinery (Westernport) Pty Ltd v Shire of Hastings* (1977) 180 CLR 266, in the following terms (at 282-283):

> "*(1) it must be reasonable and equitable; (2) it must be necessary to give business efficacy to the contract, so that no term will be implied if the contract is effective without it; (3) it must be so obvious that "it goes without saying" (4) it must be capable of clear expression; (5) it must not contradict any express term of the contract.*"

(2) In *A-G of Belize v Belize Telecom* [2009] 1 WLR 1988, Lord Hoffmann stated as follows (at [16]-[17]):

> "*The court has no power to improve upon the instrument which it is called upon to construe, whether it be a contract, a statute or articles of association. It cannot introduce terms to make it fairer or more reasonable…*
>
> *The question of implication arises when the instrument does not expressly provide for what is to happen when some event occurs. The most usual inference in such a case is that nothing is to happen. If the parties had intended something to happen, the instrument would have said so. Otherwise, the express provisions of the instrument are to continue to operate undisturbed. If the event has caused loss to one or other of the parties, the loss lies where it falls.*"

(3) The Court of Appeal has recently made clear, following the decision of the Privy Council in *A-G of Belize*, that the touchstone for the implication of a term remains necessity. In *Mediterranean Salvage & Towage v Seamar Trading & Commerce Inc, The Reborn* [2010] 1 All ER (Comm) 1, Lord Clarke MR stated as follows: (at [15]-[18]):

"*Moreover, as I read Lord Hoffmann's analysis, although he is emphasising that the process of implication is part of the process of construction of the contract, he is not in any way resiling from the often stated proposition that it must be necessary to imply the proposed term. It is never sufficient that it should be reasonable.*

...

The significance of both Liverpool City Council v Irwin and the Philips Electronique case is that they both stress the importance of the test of necessity. Is the proposed implied term necessary to make the contract work? That seems to me to be an entirely appropriate question to ask in considering whether a term should be implied on the assumed facts in this case."

(4) In *Eastleigh BC v Town Quay Developments Ltd* [2010] 2 P & Cr 2, Arden LJ made clear that necessity was a requirement for the implication of a term into a contract, at [30]:

"*In my judgment the first point to be made is that, for there to be a requirement that consent should not be refused unreasonably, a high hurdle has to be met. For the implication of terms, it has to be shown that the implied term is necessary as a matter of business efficacy and that the term is obviously required to give effect to the party's intention.*"

(5) In *Geys v Societe Generale* [2013] 1 AC 523, Baroness Hale stated (at [55]):

"*terms are only implied where it is necessary to give business efficacy to the particular contract in question*"

(6) The Court of Appeal has also made clear, in *Jackson v Dear* [2014] 1 BCLC 186, that there is no room for implying a term in circumstances where there are differing views as to the commercial common sense and each view is possible. Rather, there is a requirement that <u>any</u> reasonable person would believe that the provision does not make commercial common sense without the implied term. McCombe LJ addressed the issue as follows (at [22]):

"*Given the starting point, namely the silence of the contract itself, one has to ask whether the consequences would contradict what a reasonable person would understand the contract to mean. As to this, the opinions of reasonable people may well differ in any given set of circumstances. I consider that, even adopting for full value the judge's Proposition (vi), I would take the proper touchstone of that proposition to be the consequences would contradict what "any" (rather than "a") reasonable person would understand the contract to*

mean. As for commercial common sense enabling a choice between alternative interpretations, opinions as to commercial common sense in any given situation may also differ between reasonable people. In such circumstances, there is no room for implication."

(7) In the same case, the Court of Appeal emphasised that where the relevant subject matter is expressly addressed in the contract, it will be very difficult to say that there is also an implied term covering the same ground but going beyond that term: see *Jackson v Dear*, at [30]-[31].

AGREED CLAIM CDDs

11. The SCG contends that its asserted commercial purpose of the Agreed Claim CDDs is supported by the treatment of Client Money Claims under the Agreed Claim CDDs. In particular, the SCG contends that it was "*obviously essential*" that the Client Money Claim "*continued to attract interest*" which would require the preservation of non-provable claims to interest.

12. The SCG is wrong. Client Money Claims do not attract interest following the occurrence of a primary pooling event ("PPE") on the entry of LBIE into administration. In this regard:

(1) Following the occurrence of a PPE pursuant to CASS 7.9.4R and 7.9.6R, LBIE held all client money as part of the client money pool ("CMP") and was bound to distribute that in accordance with clients' "client money entitlements" ("CME").

(2) A client's CME comprised client's "*individual client balance*" (defined in CASS 7, Annex 1) and a client's "*client equity balance*" (defined in the Glossary). A client's CME was to be assessed as at the PPE: *Re Global Trader Europe Ltd (in liq) (No 2)* [2009] Bus LR 1327, at [3] *per* David Richards J; *Re LBIE (client money)* [2010] 2 BCLC 301, 397 at [311] *per* Briggs J; *Re LBIE (client money)* [2011] 2 BCLC 184, 225 at [160]-[161] *per* Arden LJ; *Re MF Global UK Ltd (in special administration)* [2013] EWHC 92 (Ch): at [71]-[74], [90] and [99] *per* David Richards J.

(3) For this purpose, interest on a client's individual client balance included interest to the date of the PPE (CASS 7, Annex 1, paragraph 12(2)). Post-PPE interest earned on the CMP was simply an accretion to the CMP. A client's CME does not accrue interest after the occurrence of a PPE.

(4) Accordingly, as explained in Wentworth's written submissions, it was rational to agree an Agreed Claim in an Agreed Claim Amount postponing only the question of whether that claim was a Client Money Claim or not. If so, it might have been satisfied in full by payment of the Agreed Claim Amount from the CMP.

THE ADMINISTRATORS' SKELETON

Issue 9

13. Wentworth's position in relation to Issue 9 is set out in its skeleton argument.

14. If Wentworth and the Administrators' arguments on Issue 7 are accepted by the Court, then it is Wentworth's case that, since creditors with open financial contracts as at the date of administration had contingent claims against LBIE, which claims crystallised into actual claims upon their accession to the CRA, Statutory Interest runs only from that date.

15. Wentworth notes that the Administrators suggest that a creditor's claim under the CRA is to be characterised as an entirely new claim which comes into existence and becomes actual only upon entry into the CRA.

16. Wentworth will leave the Administrators to develop the impact of this argument on Issue 9.

Issues 34 and 35

17. Wentworth notes that the Administrators will contend that the CRA (i) has the effect of releasing a currency conversion claim even where the creditors' underlying contractual entitlement was in USD and (ii) has the effect of releasing a creditor's right to contend

that statutory interest is payable at the rate applicable under its financial contract, if higher than the Judgments Act Rate.

18. Wentworth has not itself advanced these arguments, and will leave the Administrators to develop them.

ANTONY ZACAROLI QC

DAVID ALLISON QC

ADAM AL ATTAR

South Square

3-4 South Square

Gray's Inn

13 MAY 2015