Waterfall II Application

No 7942 of 2008

<u>IN THE HIGH COURT OF JUSTICE</u>

<u>CHANCERY DIVISION</u>

<u>COMPANIES COURT</u>

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)

<u>Applicants</u>

- 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

<u>Respondents</u>

POSITION PAPER ON BEHALF OF THE FOURTH RESPONDENT

Capitalised terms used but not otherwise defined herein are defined in the Waterfall II Application dated 12 June 2014 (the "Application").

STATUTORY INTEREST: ISSUES 1-9

Issue 1

Whether on the true construction of Rule 2.88(7) of the Rules, Statutory Interest is payable on a simple or compound basis where the rate applicable is the rate specified in section 17 of the Judgments Act 1838? If payable on a compound basis, with what frequency is it to be compounded?

1. Where the rate applicable is the rate specified in section 17 of the Judgments Act 1838 (the "Judgments Act"), Statutory Interest is payable on a simple basis. The second half of the question therefore does not arise.

2. Section 17(1) of the Judgments Act, as amended, provides that "*Every judgment debt shall carry interest at the rate of 8 pounds per centum per annum from such time as shall be prescribed by rules of court until the same shall be satisfied, and such interest may be levied under a writ of execution on such judgment.*"

3. This has always been interpreted as permitting simple interest only, on the basis that "*the primary purpose of an award of interest is to compensate the creditor for having been kept out of his money*", and that "*in the eyes of the law simple interest is generally regarded as adequate compensation*": *Novoship (UK) Ltd v Nikitin* [2014] EWCA Civ 908, per Longmore LJ at [132]-[133] and [140]-[141].

4. This is confirmed by the approach of the courts to the substitution of an alternative rate of interest on judgments expressed in a foreign currency. In that case, s.44A of the Administration of Justice Act 1970 permits the court to order that the interest rate applicable to the debt (being one to which section 17 of the Judgments Act applies) shall be "*such rate as the court thinks fit*". In *Slocom Trading Ltd v Tatik Inc* [2013] EWHC 1201 (Ch), Roth J held that there was no basis under s.44A for imposing a compound rate of interest: "*Section 44A does not disapply s. 17 of the Judgments Act*

1838 in the case of a foreign currency judgment but merely displaces the rate applicable under that statute with a general discretion to determine the rate. I do not think that alone is sufficient to give the court power to order that the rate be compounded: that would be a significant change which would, in my view, require clearer wording" (at [44]).

5. Moreover, there is nothing in the context of Rule 2.88 which supports an argument that it is intended to impose a compound rate.

Issue 2

Whether on the true construction of Rule 2.88(7) of the Rules, Statutory Interest is calculated on the basis of allocating dividends:

(i) first to the payment of accrued Statutory Interest at the date of the relevant dividends and then in reduction of the principal;

(ii) first to reduction of the principal and then to the payment of accrued statutory interest; or

(iii) on the basis of some other sequencing.

6. Payments of dividends (i.e. dividends on proved debts) are to be allocated solely to the reduction of the proved debts. The proved debts consist of principal and (where the debt bears interest) interest accrued up to the date upon which LBIE entered administration: Rule 2.88(1).

7. Interest accruing after the commencement of administration is payable pursuant to express statutory provision. This issue is therefore to be resolved as a matter of statutory interpretation.

8. Rule 2.88(7) permits Statutory Interest to be paid "*from the surplus remaining after the payment of debts proved*", and thus requires the whole of the debts proved to have

been actually paid before any entitlement to Statutory Interest arises. This precludes any part of the amounts paid by way of dividend on proved debts to be attributable to interest accruing after the commencement of the administration.

9. Rule 2.88(7) requires the surplus arising to be used for paying "*interest*" on "*those debts*". This is incompatible with treating any part of the payment made under Rule 2.88(7) as a payment of principal, and incompatible with treating any part of "*those debts*" as not having already been discharged prior to the entitlement to Statutory Interest arising.

10. Rule 2.88(7) permits interest to be paid on those debts "*in respect of the periods during which they have been outstanding since the company entered administration*". As to this:

(1) Rule 2.88(1) prevents any interest accruing after the date the company entered administration from forming part of the provable debt.

(2) Any dividend paid on proved debts cannot, at the time it is paid, be treated as a payment in respect of interest accrued since the date the company entered administration.

(3) The requirement that Statutory Interest be paid on debts in respect of the "*periods*" (plural) that they have been outstanding since the company entered administration envisages that where dividends are paid from time to time, each payment will have reduced the quantum of the proved debt, such that Statutory Interest is payable on that part of the proved debt only up until the time such part is actually paid, from time to time.

(4) This, too, therefore is inconsistent with the suggestion that any part of the proved debt paid, from time to time, can be treated as a payment in respect of Statutory Interest.

11. The Creditor Funds' contention (that dividends should be allocated first to the payment of accrued Statutory Interest at the date of the relevant dividends) is based

upon the old law as it stood prior to the enactment of Section 189 of the Act from which Rule 2.88 is derived (as applied in *Bower v Marris* (1841) 1 Cr. & Ph. 351 (41 E.R. 525) and *Re Lines Bros Ltd (No.2)* [1984] 1 Ch 438).

12. That law is no longer applicable following the enactment of Rule 2.88.

13. The principle applied in *Bower v Marris* is based on the fact that – pre-1986 – the relevant legislation in respect of winding-up made no provision for payment of interest accruing after the commencement of the winding-up.[1] In those circumstances, the principle applied by the courts was that "*a creditor whose debt carries interest is remitted to his rights under his contract; and, on the other hand, a creditor who has not stipulated for interest does not get it*": *Re Humber Ironworks and Shipbuilding Company* (1869) LR 4 Ch App 643, per Giffard LJ at 647.[2]

14. The continued application of the old law would be inconsistent with the fact that section 189 (in the case of liquidation) and Rule 2.88 (in the case of administration) effected a fundamental change to the rights in respect of interest accruing after the commencement of the insolvency proceedings. Thus, in any case where there is a surplus after paying proved debts:

(1) Creditors who otherwise had no right to interest in respect of their provable debts (whether accruing before or after liquidation) were granted, for the first time, the right to interest accruing after the commencement of the liquidation/administration.

(2) Creditors who had an existing contractual entitlement to interest at a rate less than the Judgments Act Rate were granted, for the first time, the right to interest accruing after the commencement of the liquidation/administration at the higher rate specified in the Judgments Act.

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[1] Although successive Bankruptcy Acts had provided an entitlement to statutory interest from a surplus, which involved an increasingly complex set of calculations, the reference to those provisions in the Companies Acts from 1862 to 1948 were construed so as not to apply in relation to a winding-up in which a surplus emerged: see *Re Rolls-Royce Co Ltd* [1974] 1 WLR 1584.

[2] Recent Australian authorities which have applied *Bower v Marris* have similarly done so in the context of there being no statutory basis for payment of interest accruing after the commencement of the liquidation.

(3) All creditors were granted, for the first time, the right to interest accruing after the commencement of the liquidation/administration on the aggregate balance of outstanding principal and interest accrued on that principal up to the commencement of the liquidation/administration. In other words, any outstanding interest accrued up to the date of the liquidation/administration was in effect capitalised and added to the outstanding principal as at that date, and Statutory Interest was payable on the total amount.

(4) Correspondingly, the assets of the debtor company were subjected, for the first time, to the additional liabilities referred to in (1) to (3) above in respect of interest accruing after the date of the liquidation/administration.

15. In light of these substantive changes to the rights of the debtor company and its creditors in respect of interest accruing on proved debts after the commencement of liquidation/administration, it is impossible to analyse the regime imposed under Rule 2.88 as effecting a remittance to creditors of their contractual rights, once a surplus arises.

16. This is supported by the fact that where reference is made to the rights of creditors "*apart from the administration*" it is in the limited context of adjusting the *rate* at which Statutory Interest is payable, but no more.

17. The terms of Rule 2.88(7) do not allow any scope for the contractual rule of appropriation to apply. That rule presupposes a choice between two debts. The rule is that the debtor may appropriate and, if he does not do so, the creditor may do so: *The Mecca* [1897] AC 286, at 293, per Lord Macnaghten. In relation to a debt which bears interest, in the absence of a choice actively made, it is presumed that a creditor would have applied the payment first to accruing interest: *West Bromwich Building Society v Crammer* [2002] EWHC 2618 (Ch), per Neuberger J at [13]-[15]. The effect of Rule 2.88 described above means that, by the time the statutory entitlement to interest accruing after the commencement of the administration arises, there is no longer a choice between two debts, and no room for the application of the contractual rule of appropriation.

18. In addition, the rule applied in *Bower v Marris*, an essential feature of which is that interest is paid in respect of a further period after the proved debt has in fact been paid, is inconsistent with the requirement in Rule 2.88(7) that interest is payable only for such period(s) as the proved debts have been outstanding since the commencement of the administration.

Issue 3

Whether the words "*the rate applicable to the debt apart from the administration*" in Rule 2.88(9) of the Rules refer:

(i) only to a numerical percentage rate of interest; or

(ii) also to a mode of calculating the rate at which interest accrues on a debt, including compounding of interest, such that where a creditor has a right (beyond any right contained in Rule 2.88) to be paid compound interest, whether under an Original Contract or otherwise, the creditor is entitled to compound interest under Rule 2.88(7).

19. The words "*the rate applicable to the debt apart from the administration*" in Rule 2.88(9) refer only to the numerical percentage rate of interest.

20. As noted above in relation to Issue 2, the regime imposed by Rule 2.88 is a self-contained statutory regime which operates (in contradistinction to the pre-1986 law) otherwise than by remitting creditors to their contractual rights upon a surplus arising.

21. Rule 2.88(9) is the sole exception, and is limited in its scope to enabling a creditor whose provable debt carried a contractual right to interest at a *rate* higher than the Judgments Act Rate to claim interest on its proved debt at that higher rate.

22. The use of the word "*rate*" is important. As noted above in relation to Issue 1, the rate of interest applicable under the Judgments Act is a simple rate expressed in numerical terms. Rule 2.88(9) requires a comparison to be made between two rates.

In order to make that comparison, it is necessary that the two rates are comparable. Where the Judgments Act Rate is undoubtedly a 'simple' rate, this requires that the rate with which it is to be compared is also a simple rate.

23. When construing a statute requiring interest to be paid, it is the norm that it is intended to refer to simple interest, and only exceptionally would it be regarded as providing for compound interest: see *Revenue and Customs Commissioners v RSPCA* [2006] EWHC 422 (Ch), per Lawrence Collins LJ at [139]-[145]. Clear words are required to construe a statutory provision for interest as meaning compound interest: *Slocom Trading Ltd v Tatik Inc* [2013] EWHC 1201 (Ch), per Roth J at [44].

24. Rule 2.88(7) requires Statutory Interest to be paid on "*those debts*", i.e. the debts which have been proved. It does not permit interest to be paid on any other sum. Payment of interest on a compound basis would be inherently inconsistent with that requirement, since on a proper analysis, compound interest on a debt involves the payment of interest on a sum *other* than that debt:

(1) Compounding involves the payment of interest on a principal amount periodically increased by the addition of each fresh amount of interest as it becomes due and remains unpaid.

(2) This involves the payment of interest upon interest, i.e. that after each point at which accumulated interest for a particular period is added to the principal sum, thereafter interest accumulates on the original principal sum plus the sum representing accumulated interest: see *Inland Revenue Commissioners v Oswald* [1945] AC 360, per Lord Macmillian (at 373): "*the unpaid interest never ceases to retain its character as interest, although it has from time to time been added to the capital indebtedness and has carried interest in turn*"; and per Lord Porter (at 379): "*Capitalization means no more than that the interest, which continues to be interest, shall be treated together with the capital sum due as itself interest-bearing but does not alter its quality as interest*."

(3) Where a statute provides for payment of interest on a particular debt at a rate, without specifying whether it is simple or compound, then it would be inconsistent with that provision if the basis of payment was compound as opposed to simple: see *Consolidated Fertilizers Ltd v Deputy Commissioners of Taxation* (1992) 107 ALR 456 (Federal Court of Australia). In that case, the relevant statute provided for interest to be paid at a specified rate on "*relevant tax*". Cooper J held, as one of the two reasons why the statute contemplated only simple interest, that "*the only sum upon which interest is to be calculated is the overpayment of the relevant tax*" and, following *Bank of New South Wales v Brown* (1983) 151 CLR 514 (where the High Court of Australia approved the statements in *IRC v Oswald* quoted above) accrued interest retained its character of interest and never acquires the character of "*an amount of relevant tax*" so that compounding was impossible.

Issue 4

Whether the words "*the rate applicable to the debt apart from the administration*" in Rule 2.88(9) of the Rules are apt to include (and, if so, in what circumstances) a foreign judgment rate of interest or other statutory rate.

25. The words "*the rate applicable to the debt apart from the administration*" are not capable of including a foreign judgment rate of interest (unless the creditor had the benefit of a foreign judgment at the commencement of the administration).

26. Whether the words are capable of including any other statutory rate depends upon whether the relevant statutory rate was applicable to the creditor's claim as at the commencement of the administration. If not, then the words are not capable of including such rate.

27. The mere possibility that a statutory right might have become applicable to the creditor's debt, but for the administration, does not entitle the creditor to claim that rate under Rule 2.88(9). For example, the fact that a creditor might have pursued its

claim in a foreign court and received a judgment which would have carried interest at a rate higher than the Judgments Act Rate does not entitle the creditor to claim that rate under Rule 2.88(9).

28. That is because "*the rate applicable to the debt apart from administration*" is to be construed as referring to the rate applicable to the debt pursuant to such rights as existed as at the date of administration. This follows from the fact that the commencement of the administration is the notional date of proof and distribution, such that the obligation to distribute the surplus notionally arises at that same date (as it arises immediately upon the surplus arising following distribution in respect of proved debts): see *Re Dynamics Corporation of America (In Liquidation)* [1976] 1 W.L.R. 757, per Oliver J at 762-764.

29. Any other conclusion would require "*the rate applicable to the debt apart from administration*" to be interpreted broadly enough to include 'the rate applicable by virtue of actions which it would have been open to the creditor to take, after the date of the commencement of administration, if there had been no administration'. It would be wrong to interpret the words in that way:

(1) It would be contrary to the fundamental principle of insolvency law that creditors' individual rights of enforcement are exchanged for a collective enforcement process, via the submission of proofs of debt, which process notionally occurs at the commencement of the liquidation/administration.

(2) It would be premised upon action which a creditor could only take either in breach of the stay on commencing or continuing enforcement proceedings of its own, or pursuant to an exception granted by the Court in the exercise of its discretion to lift the stay. The purpose of that exception is to enable the quantification of claims to be undertaken via court proceedings, where that would be preferable to the determination of the claim by a liquidator or administrator under the proof process. It is not intended to provide an advantage to some only of the creditors so far as Statutory Interest is concerned.

(3) In either case, it would be unfair if the creditor who was able (either in breach of the stay, or with permission of the court) to obtain the benefit of a higher interest rate awarded pursuant to a foreign statute as a result of taking such action, to the prejudice of all other creditors who were bound by the stay.

(4) Moreover, there is no basis for any factual assumption that LBIE would not have paid or defended the claim in circumstances where LBIE had no judgments against it when the administrators were appointed.

Issue 5

Whether, for the purposes of establishing, as required under Rule 2.88(9) of the Rules "*whichever is the greater of the rate specified under paragraph (6) and the rate applicable to the debt apart from the administration*" the comparison required is of:

(i) the total amounts of interest that would be payable under Rule 2.88(7) based on each method of calculation; or

(ii) only the numerical rates themselves,

and in either case, how the total amount of interest is to be calculated when the "*rate applicable to the debt apart from the administration*" varies from time to time.

30. If Wentworth is correct in relation to Issue 3, it follows the comparison required by Rule 2.88(9) is of the numerical rates.

31. It is important to appreciate the possibility that both the Judgments Act Rate and the rate applicable apart from the administration may vary over time.

32. In order to cater for that eventuality, if Wentworth is correct in relation to Issue 3, the comparison required by Rule 2.88(9) is of the weighted average of the variable interest rates, both (a) where the Judgments Act Rate varies over the period of time to

which Statutory Interest relates and (b) where the rate applicable to the debt apart from the administration varies over that period.

33. If Wentworth is wrong in relation to Issue 3, such that the "*rate applicable to the debt apart from the administration*" can include a compound rate, then Wentworth accepts that a comparison of the Judgments Act Rate (simple) with the rate applicable apart from the administration (compound) is not conducted simply on the basis of a comparison of the headline numerical rate.

34. In order to conduct a proper comparison, in that event, it is necessary to identify a weighted average simple rate – over the relevant period of time for which interest is outstanding – which equates to the compound rate (as it varies over time) applicable under the contract. It is only in this way that a proper comparison of the two rates, on a like for like basis, can be undertaken.

Issue 6

Whether, for the purposes of establishing, as required under Rule 2.88(9) of the Rules, "*whichever is the greater of the rate specified under paragraph (6) and the rate applicable to the debt apart from the administration*", the amount of interest to be calculated based on the latter is calculated from:

(i) the Date of Administration;

(ii) the date on which the debt became due; or

(iii) another date.

35. Wentworth contends that when calculating interest at the rate applicable apart from administration, the amount of interest is to be calculated only from whichever is the later of the date on which the debt became due and the Date of Administration.

Issue 7

Whether Statutory Interest is payable in respect of an admitted provable debt which was a contingent debt as at the Date of Administration from:

(i) the Date of Administration;

(ii) the date on which the contingent debt ceased to be a contingent debt (including in circumstances where the contract was "closed out" after LBIE entered administration); or

(iii) another date,

having regard to whether:

(i) the contingent debt remained contingent at the time of the payment of:

(a) the final dividend; or

(b) Statutory Interest; and/or

(ii) (to the extent applicable) the Joint Administrators revised their previous estimate of the contingent debt by reference to the occurrence of the contingency or contingencies to which the debt was subject.

36. Statutory Interest is payable only from the date upon which the contingent debt ceased to be a contingent debt.

37. Pursuant to Rule 2.88(7) Statutory Interest is payable on proved debts "*in respect of the periods during which they have been outstanding since the company entered administration*".

38. The requirement that interest is payable for such periods as the proved debts "*have been outstanding*" has the consequence, first, that interest ceases to run on a proved

debt, or upon such part of it, when that debt, or part, is paid. This is unlikely to be controversial.

39. The requirement has the second consequence that interest is payable only from the later of the Date of Administration or the date upon which the debt became due (e.g., if a contingent debt, the date upon which the contingency arose).

40. Where a debt fell due for payment prior to the Date of Administration, then it is clear that no interest is payable under Rule 2.88(7) for any period *prior* to that date. (To the extent that debt carried an entitlement to interest, interest accrued but unpaid prior to that date will form part of the provable debt under Rule 2.88(1).)

41. Where, at the Date of Administration, the debt had not yet fallen due, because it was contingent upon the happening of some future event, then as a matter of ordinary language, such debt could not be said to be "*outstanding*" until such time as the contingency occurred.

42. This makes sense as a matter of principle. As noted under Issue 1 above, the primary purpose of an award of interest is to compensate the creditor for having been kept out of its money: see *Novoship (UK) Ltd v Nikitin* [2014] EWCA Civ 908. Wherever a creditor has not in fact been kept out of its money, because its entitlement to be paid any money has not yet arisen, then the purpose behind an award of interest for that period is absent.

43. As noted above, the general rule, in both liquidation and administration, is that the proof and distribution process notionally occurs on the date of the commencement of the liquidation or administration. It is for this reason that claims are valued as at that date: see *Re Dynamics Corporation of America (In Liquidation)* [1976] 1 W.L.R. 757, per Oliver J at 762-764.

44. This principle is, however, subject to exception where rigid adherence to it would not properly give effect to the *pari passu* nature of the distribution required in a winding-up: see, for example, *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147, per Lord Hoffmann at [29]-[33].

45. One example is where – at the date of the commencement of the insolvency proceedings – the existence or value of a debt is uncertain, and thus subject to the estimation process in the rules, because it is subject to a contingency, but the contingency has occurred by the time at which a distribution is to be made to creditors. In those circumstances, the court applies hindsight, to value the debt based upon what has actually happened, as opposed to relying upon an estimation which is now known to be wrong.

46. A further example, from *Wight v Eckhardt* itself, is that someone who was a creditor at the commencement of the winding-up, but has ceased to be one since then as a result of subsequent events, should be excluded altogether from subsequent distributions.

47. In each case, the necessary adjustment is made to give effect to the underlying *pari passu* principle: *Wight v Eckhardt*, at [32].

48. The Rules recognise the possibility of adjustment to the value of a contingent debt, by reason of circumstances occurring after the Date of Administration: Rule 2.81(2) requires a contingent debt to be valued for the purposes of proof, and for that value to be revised by reference to any change of circumstances or information later becoming available. Rule 2.81(2) provides that the amount provable in the case of such a debt is the estimate for the time being.

49. Although the payment of Statutory Interest is not itself part of the *pari passu* process in respect of provable debts, it is nevertheless carried out on a *pari passu* basis as between all creditors entitled to participate in the surplus. Rule 2.88(8) specifically requires that all interest payable under Rule 2.88(7) ranks equally whether or not the debts on which it is payable rank equally (in recognition of the fact that there may be insufficient surplus – after payment in full of proved debts – to satisfy all creditors' claims to Statutory Interest in full).

50. Accordingly, the rationale for applying an adjustment to the principle of valuation and distribution as at the commencement of the liquidation or administration applies equally in relation to the payment of Statutory Interest upon contingent debts.

51. The necessary adjustments apply in this context as follows:

(1) If, at the time the administrator makes a payment to creditors in respect of Statutory Interest, the contingency in respect of one creditor (Creditor A) has not occurred, and it is now clear that it will never occur,[3] then there is in fact no debt due to Creditor A at all. It follows that there is no period of time in which a provable debt has, in fact, been "*outstanding*" for the purposes of Rule 2.88(7). This is so notwithstanding that interim dividends may have been paid to Creditor A before it became clear that the contingency would never occur, those dividends having been based on an estimate as to the value of Creditor A's contingent claim.

(2) It would clearly be unfair to those who were in fact creditors for any further distribution, whether of principal or Statutory Interest to be paid to Creditor A.

(3) If, at the time the administrator makes a payment to creditors in respect of Statutory Interest, the contingency in respect of another creditor (Creditor B) has not occurred, but its occurrence remains a possibility, then although Creditor B might at some point in the future still become an actual creditor, there is as yet no period of time during which Creditor B has been kept out of its money. It follows that there is no period of time during which Creditor B's provable debt has been "*outstanding*" for the purposes of Rule 2.88(7).

(4) The fact that Creditor B is entitled to submit a proof for the estimated value of its contingent debt, and is thus entitled to payment in respect of it, does not mean that the debt has thus been "*outstanding*" since the Date of Administration. The process of estimation does not alter the character of the debt. It merely "*aims to assess the likelihood of the occurrence of the relevant contingency and the amount likely to become due on such occurrence … It is essentially a process of putting a present value on possible future events or*

3 For example, under a derivative contract which was open as at the Date of Administration, all transactions have been closed out but – due to the direction of market movement in the meantime – has resulted in no sum due to the counterparty.

outcomes."[4] In particular, it does not alter the fact that the debt is not in fact due.

(5) If, at the time the administrator makes a payment to creditors in respect of Statutory Interest, the contingency in respect of another creditor (Creditor C) has occurred at some point after the Date of Administration, then Creditor C's proof will have been adjusted to reflect the actual value of its debt in light of the known facts including the occurrence of the contingency. Statutory Interest is payable on Creditor C's debt only for the period between the occurrence of the contingency and payment in full of the proved debt. This follows from the treatment in respect of Creditors A and B above, since Creditor C's debt was not in fact outstanding at any time prior to the date upon which the contingency occurred.

[4] *Re MF Global (UK) Ltd* [2013] EWHC 92 (Ch) per David Richards J, at [54].

Issue 8

Whether Statutory Interest is payable in respect of an admitted provable debt which was a future debt as at the Date of Administration from:

> **(i) the Date of Administration;**
>
> **(ii) the date on which the future debt ceased to be a future debt; or**
>
> **(iii) another date**
>
> **having regard to whether the future debt remained a future debt at the time of the payment of:**
>
> **(i) the final dividend; or**
>
> **(ii) Statutory Interest.**

52. Statutory Interest is payable on future debts from the Date of Administration.

53. A future debt differs from a contingent debt, first, because it is certain to fall due for payment at some point (whereas a contingent debt may not) and, second, because the Insolvency Rules make specific provision for discounting the value of a future debt which remains a future debt as at the date of declaration of a dividend, to take account of the time value of money.

54. As to the first point, a debt which is certain to become payable in the future can properly be described as "*outstanding*" from the time of its creation, since from that time (and thus by definition at the Date of Administration) it is and remains payable at some point in the future. Rule 2.105(2), for example, which deals exclusively with future debts, uses the same word "*outstanding*" in a context which can only include debts which are still payable only in the future. The word is likely to have the same meaning in relation to future debts in both rules (Rule 2.88 and Rule 2.105).

55. As to the second point, Insolvency Rule 2.105(2) requires that for the purpose of dividend, the amount of the future creditor's admitted proof shall be reduced by applying the formula $X/1.05^n$, where "*n*" is the period beginning with the "*relevant date*" (which in the case of LBIE is the Date of Administration) and ending on the date on which payment of the debt would otherwise be due. This has the effect that the amount paid to the creditor by way of future dividend reflects (admittedly on a fairly rough and ready basis) the value of the debt as at the Date of Administration. It is consistent with the operation of Rule 2.105(2) in these circumstances that if a surplus arises then Statutory Interest should be payable to the future creditor from Date of Administration.

Issue 9

Whether a creditor's accession to the CRA (and, in particular, the effect of clauses 20.4.3, 24.1, 25.1 and 62.4 of the CRA) would impact upon the answers to questions 7 and 8 above and, if so, how.

56. The creditor's accession to the CRA results in the termination of open contracts, and thus causes the occurrence of the contingency which makes the debt an actual one. Accordingly, statutory interest is payable only from the date of accession to the CRA.

MASTER AGREEMENTS: ISSUES 10-27

Issue 10

Whether, on the true construction of the term "Default Rate" as it appears in the ISDA Master Agreement, the "relevant payee" refers to LBIE's contractual counterparty or to a third party to whom LBIE's contractual counterparty has transferred (by assignment or otherwise) its rights under the ISDA Master Agreement.

57. The 'relevant payee' refers to LBIE's original contractual counterparty.

58. In general, an assignee cannot recover more from the debtor than the assignor could have recovered: Chitty on Contracts, at 19-074; *Dawson v Great Northern & City Ry Co* [1905] 1 KB 260, 273-274, *per* Stirling LJ. The purpose of the principle is to prevent the assignment from prejudicing the debtor: *Linden Gardens v Lenesta Sludge Disposals* (1993) 57 BLR 57 (CA), at p.80-81, *per* Staughton LJ.[5]

59. The principle applies to the right to interest as much as to any other right of the assignor. The purpose of a right to interest is to compensate the person entitled to payment for having been kept out of its money.[6] The calculation of interest by reference to the cost of funding of the particular counterparty entitled to payment reflects the fact that it is that counterparty which has been kept out of its money. An assignee of the right to payment has at no time been kept out of its money, but has purchased the right to payment in the knowledge that it is outstanding. It would be contrary to the purpose of the right to interest to allow the assignee to calculate the amount of interest payable by reference to *its* cost of funding.

60. In the face of this principle, clear wording would be required in the ISDA Master Agreement to entitle an assignee of LBIE's contractual counterparty to recover more by way of interest than LBIE's contractual counterparty could have recovered. There is no such clear wording in either the 1992 or 2002 ISDA Master Agreement. On the

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5 This comment of Staughton LJ remains good law despite the Court of Appeal's decision being overturned by the House of Lords: see *Offer-Hoar v Larkstore Ltd* [2006] 1 WLR 2926.

6 *Novoship (UK) Ltd v Nikitin* (above).

contrary the terms of the agreements indicate that the 'relevant payee' refers only to the original counterparty.

61. Under both versions of the Master Agreement, there is an express prohibition on assignment of rights under the agreement without the counterparty's consent, save only where the assignment is pursuant to a consolidation, amalgamation or merger with another entity or where the assignment is of all or part of the party's interest in any amount payable to it from a Defaulting Party under Section 6(e).[7]

62. The prohibition on assignment provides an important protection for each party. Many features of the ISDA Master Agreement expose the parties to each other's credit risk. The prohibition on assignment of rights without consent protects each party from exposure to the credit risk of third parties other than their specifically chosen counterparty.

63. An important example of the way in which a party is exposed to the credit risk of its counterparty is in relation to exposure to the counterparty's cost of funding wherever payment from one to the other is based on that concept: see, for example, the definitions of Default Rate, Loss, Non-Default Rate and Termination Rate.

64. The protection afforded by Section 7 would be greatly reduced if "*relevant payee*" meant any third party to whom the right to payment under Section 6 was assigned. Each party would be exposed to the credit risk of an unlimited constituency of third parties to whom their counterparty might assign the right to payment under Section 6(e). The fact that the draftsman of the ISDA Master Agreement has carefully restricted the ability of the parties to assign their interest to others thus indicates that the "*relevant payee*" is intended to be limited to the original counterparty.

65. The definition of Default Rate was materially the same in the 1987 ISDA Interest Rate and Currency Exchange Agreement 1987 (the "1987 ISDA Agreement") the predecessor to the 1992 ISDA Master Agreement). In the 1987 ISDA Agreement, however, there was no exception to the prohibition on assignment of rights under the agreement without consent so as to permit assignment of the amount due under

[7] Section 7 of each of the 1992 and 2002 ISDA Master Agreements.

Section 6(e). There was no question therefore, under the 1987 ISDA Agreement, of "*relevant payee*" meaning anyone other than someone with whom a party chose to contract, i.e. the original counterparty or someone to whom rights under the agreement were assigned with consent.

66. The User Guide to the 1992 ISDA Master Agreement indicates that the reason for adding the second exception to Section 7 (enabling the transfer of the amount due under Section 6(e)) was solely "*to allow for certain transactions in the market-place in which a party transfers amounts payable to it from a Defaulting Party under Section 6(e) as part of another financing transaction*". In other words, there is no suggestion that the exception was intended to widen each party's exposure to the credit risk of anyone to whom the other party might transfer its right to be paid under Section 6(e).

67. Any other conclusion would lead to perverse results. First, it would result in the amount of the relevant payer's liability to pay interest under Section 6(d) necessarily changing upon each successive assignment of the right to payment under Section 6(e). This is so whether the relevant payer is the Defaulting Party or the Non-Defaulting party (given that Section 6(e) envisages a payment obligation arising either way). Second, it would provide an original counterparty who had a strong credit rating (and thus a lower cost of borrowing) with a perverse incentive to extract greater value from its rights under Section 6(e) than it was itself entitled to, by transferring that right to someone with a poor credit rating (and thus a higher cost of borrowing) and splitting the increased interest recovery with the transferee.

68. The conclusion is supported by the terms of Section 7(b) of both the 1992 and 2002 ISDA Master Agreements (which permit assignment of rights payable under Section 6(e)):

(1) Under the 1992 ISDA Master Agreement, an assignment is permitted by a party of "*any amount payable to <u>it</u> from a Defaulting Party*". Thus, an assignee can only acquire such amounts as the original counterparty would have been entitled to. An amount in respect of interest is payable to the

original counterparty only to the extent that it is certified as constituting the cost to *it* of funding the relevant amount.

(2) Under the 2002 ISDA Master Agreement, a party is entitled to transfer its interest in any Early Termination Amount "*payable to it by a Defaulting Party, together with any amounts payable on or with respect to that interest...*" The purpose of the additional words referring to interest was to "*make clear*" that amounts payable with respect to interest are also assignable (see the User Guide to the 2002 ISDA Master MA, paragraph II.H). The additional words do not alter the fact that the right to interest must exist in the hands of the original counterparty for it to be capable of being subject to an assignment, and the right to interest in the hands of the original counterparty depends upon a certification of *its* cost of funding the relevant amount.

Issue 11

On the true construction of the term "Default Rate" as it appears in the ISDA Master Agreement, what meaning should be given to the phrase "*cost (without proof or evidence of any actual cost) to the relevant payee (as certified by it) if it were to fund or of funding the relevant amount*"? In particular

(i) can this cost:

a) only be ascertained with reference to the actual or asserted cost of the payee to fund or of funding the relevant amount by borrowing the relevant amount (and if so whether such borrowing should be assumed to have recourse solely to the claim that it is funding or to the rest of the relevant payee's unencumbered assets and, if the latter, whether the cost of funding should include the cost to the relevant payee of incurring additional debt against its existing asset base); or

b) be ascertained in other ways, including with reference to funds which might be raised by way of equity investment in the payee and, if so:

i. in what ways might the costs be ascertained; and

ii. how would the cost be calculated in such circumstances?

(ii) should the cost of funds be calculated based on:

a) the cost to the relevant payee of funding a claim against LBIE;

b) an average cost of funding the relevant payee's asset base; or

c) (if different) the cost of raising general corporate funding?

69. The expression "*if it were to fund or of funding the relevant amount*" requires the counterparty to certify the "*cost*" to it of notionally, or actually, raising funds in an amount equal to the relevant amount. The use of the word "*cost*" indicates that the

expression refers to such amount as the counterparty would be *required* to pay in funding the amount. In other words, where there are a range of amounts (all other things being equal) it refers to the lowest amount which the counterparty would be required to pay over the relevant period. Any amount over and above the lowest amount that a relevant payee would be required to pay represents, not a *cost*, but an amount paid voluntarily.

70. So far as Issues 11(i) and 11(ii) are concerned, the answer differs depending on whether the relevant payee is, on the one hand, a Credit Institution or a Financial Institution and, on the other hand, another type of entity such as a fund or corporate.

71. In relation to Credit Institutions and Financial Institutions (which will be referred to generically as "banks" in the following sub-paragraphs):

(1) The expression "*cost… if it were to fund… the relevant amount*" has a generally understood meaning in the banking derivatives market (i.e. among bank counterparties to ISDA Master Agreements), namely that it means the bank's own 'cost of funds'.

(2) The phrase 'cost of funds' is a concept generally understood in the banking market to mean the weighted average of the interest payable on all borrowings divided by their total notional amount.

(3) A bank, whose business it is to lend and borrow money, will usually not fund a particular asset with a particular item of borrowing. On the contrary, it will regard any liability incurred as a proportionate part of its overall borrowing required to fund the whole of its asset base. Accordingly, the cost "*if it were to fund*" the relevant amount would not be the cost of the next incremental increase in its lending up to the value of the relevant amount, but would be the same as its 'cost of funds' as that term is defined above.

(4) In the rare case where a bank actually does go out and borrow funds to match the particular relevant amount for which its counterparty is in default, then Wentworth accepts that the "*cost… to… it… of funding the relevant amount*"

would be the actual cost incurred (subject to the definition of 'cost' referred to in paragraph [69] above).

(5) The fact that there is a generally understood meaning among banks as to the cost of funding is reflected in empirical evidence of the cost of funding which banks have generally claimed in the insolvency of various Lehman entities: see the witness statement of Robert Sabin Bingham exhibiting information compiled by Zolfo Cooper LLC as to the cost of funding claimed in respect of certain ISDA Master Agreement claims in relation to the insolvent estates of Lehman Brother Holding Inc and Lehman Brothers Special Financing Inc.

(6) Wentworth will rely on expert evidence of banking practice in support of the above sub-paragraphs.

72. In relation to funds and corporate entities:

(1) The expression "*cost … if it were to fund … the relevant amount*" refers simply to the cost which the relevant entity would incur if it were to acquire the relevant amount - subject to the definition of 'cost' referred to above; and the expression "*cost … of funding … the relevant amount*" refers to the cost which the relevant payee in fact incurred in acquiring the relevant amount, subject again to the definition of 'cost' referred to above; in either case, it refers only to the cost of the relevant payee of funding the relevant amount.

(2) For example, assuming that other terms are materially the same, if a fund or corporate has a choice to borrow from different lenders at 3%, 4% or 5%, then its 'cost' is the amount it has to pay at 3%, and certification of the amount based on 4% or 5% would – so far as the excess over 3% be concerned – be certification of something which was not a cost to it.

Issue 12

Whether the "*cost (without proof or evidence of any actual cost) to the relevant payee (as certified by it) if it were to fund or of funding the relevant amount*" is to be calculated based on obtaining:

(i) overnight funding;

(ii) term funding to match the duration of the claim to be funded; or

(iii) funding on some other basis (and if so, what basis).

73. As noted above, in relation to banks, "*cost... if it were to fund... the relevant amount*" refers to the bank's own 'costs of funds'" which is itself expressed as an annualised rate from a weighted average calculation across all of the bank's funding sources except capital.

74. In relation to the (rare) case of a bank that actually borrowed money to fund the relevant amount, and in relation to funds and corporate entities, save that the expression "*cost … if it were to fund or of funding the relevant amount…*" requires the relevant payee to identify the lowest amount which it was, or would be, required to pay (see the answer to Issue 11 above), there is no further gloss or restriction on the meaning of the expression, as a matter of definition. Accordingly, the cost may be calculated on the basis of overnight funding, term funding or any other basis provided that it complies with the over-arching requirement that it represents the lowest cost to the counterparty (and reflects changes in available rates over the period of funding).

75. The Default Rate is defined as "*a rate per annum equal to*" the cost to the relevant payee of funding the relevant amount, to which is added 1% per annum. The rate so arrived at is then to be compounded daily under Section 6(d)(ii). In order to comply with the requirement for daily compounding the "*rate per annum equal to*" the cost of funding must itself be arrived at without including any element of compounding when calculating the cost of funding to the relevant payee. Any other result would involve 'double-compounding', which is inconsistent both with the requirement that the

relevant rate of interest be compounded daily and the underlying principle that interest is intended to compensate a party for being kept out of its money.

76. Accordingly, wherever the relevant payee's cost of funding is based on a stated annual rate of interest in respect of term borrowing with less than yearly compounding, the "*rate per annum equal to the cost…*" is to be based on the stated annual rate of interest and not the effective annual rate of interest derived from that stated rate.

Issue 13

Whether the "*cost (without proof or evidence of actual cost) to the relevant payee (as certified by it) if it were to fund the relevant amount*" should be calculated:

(i) by reference to the relevant payee's circumstances on a particular date; or

(ii) on a fluctuating basis taking into account any changes in the relevant circumstances (and, if so, whether the benefit of hindsight applies when taking into account such changes).

77. The "*cost [etc]*" should be calculated on a fluctuating basis, taking account of changes in the relevant circumstances of the relevant payee.

78. For example, if the rate per annum equivalent to the cost of funding to a relevant payee for the first year the relevant amount was outstanding was 'X%', but for the second year the rate per annum equivalent to its cost of funding was '½ X%', then the Default Rate for the first year is different to that for the second year.

79. The Default Rate means "*a rate per annum equal to the cost [etc]…*", to which is added 1% per annum. Accordingly, irrespective of how a particular counterparty calculates its cost of funding the relevant amount, the Default Rate must be expressed as an annual percentage rate, i.e. a rate derived from the cost of funding as certified by the relevant payee.

80. Interest is payable for the period from the Early Termination Date until the date of payment (Section 6(d)(ii) of the 1992 ISDA Master Agreement, and Section 9(h)(ii)(2) of the 2002 ISDA Master Agreement).

81. Neither the 1992 nor the 2002 ISDA Master Agreement contains any requirement as to the time at which the Default Rate is to be calculated or certified (in contrast to the requirement that the amount payable under Section 6(e) is to be calculated and stated to the counterparty on or as soon as reasonably practicable following the occurrence of an Early Termination Date: Section 6(d)(i)).

82. In circumstances where the relevant payee has actually incurred the cost of funding the relevant amount, that cost can only be known, and the per annum rate to be derived from it can thus only be calculated, at the end of the period.

83. Similarly, where the relevant payee has not actually incurred the cost of funding the relevant amount, the cost if it were to have funded the relevant amount can only be known, and the per annum rate to be derived from it can thus only be calculated, at the end of the period.

84. In either case, when calculating the cost – at the end of the period – of funding the amount for that period, the true cost can only be captured by calculating the cost from time to time on a fluctuating basis. To adopt any other approach would not capture the true cost, and would be inconsistent with the underlying purpose of an award of interest, to compensate the payee for being kept out of its money.

85. To take the example referred to above, if the cost of funding was based on a snapshot of funding for the first year, the resulting calculation would greatly overstate the cost to the relevant payee, and would not reflect accurate compensation for the payee being kept out of its money. Conversely if it was based on a snapshot of funding during the second year, it would understate the cost, and thus fail adequately to compensate the payee for being kept out of its money.

Issue 14

Whether a relevant payee's certification of its cost of funding for the purposes of applying the "Default Rate" is conclusive and, if not, to what it is subject. In particular whether, in order for a payee's certification to be deemed conclusive, a relevant creditor is under any duty to act:

(i) reasonably;

(ii) in good faith and not capriciously or irrationally; or

(iii) otherwise than in its own interests.

86. The relevant payee's certification is not conclusive. The relevant payee's discretion to certify its cost of funding is limited (a) by the requirement that it is a certification of the "*cost*" to the relevant payee, as that expression is defined above in relation to question 11, and (b) by obligations of good faith and rationality.

87. So far as (a) is concerned, the obligation on the relevant payee is to certify the "*cost*" to it if it were to fund or of funding the relevant amount. For the reasons set out in response to Issue 11 above, the expression "*cost*" refers to the lowest amount at which the relevant payee could fund the relevant amount.

88. So far as (b) is concerned, it is clearly established that in the absence of very clear language to the contrary a contractual discretion must be exercised in good faith and not arbitrarily or capriciously: *British Telecommunications plc v Telefónica O2 UK Ltd* [2014] UKSC 42, per Lord Sumption JSC at [37]; *Paragon Finance plc v Nash* [2002] 1 WLR 685 , paras 39–41, per Dyson LJ; *Socimer Bank Ltd v Standard Bank Ltd* [2008] 1 Lloyd's Rep. 558, per Rix LJ at [66].

89. The relevant payee will be found to have contravened this requirement if it acted unreasonably "*in the sense of conduct or a decision to which no reasonable person having the relevant discretion could have subscribed*": *Gan Insurance Co Ltd v Tai Ping Insurance Co Ltd (No.2)* [2001] 2 All ER (Comm) 299, per Mance LJ at [64].

Issue 15

If the answer to question 14 is that the relevant payee's certificate of its cost of funding is not conclusive and one of the requirements (i) to (iii) set out in that question applies, where does the burden of proof lie in establishing, and what is required to demonstrate, that a relevant payee has or has not met such requirement?

90. The burden lies on the party challenging the certificate.

91. In light of the two limitations on the relevant payee's discretion (noted in answer to Issue 14 above) what is required to be shown (in order to challenge the certificate) is that it falls outside the range of reasonable certifications that any counterparty in the position of the relevant payee could make as to the lowest amount at which it could fund the relevant amount.

92. The precise content of what is required in order to challenge a certificate will depend on the circumstances of each particular case.

Issue 16

Whether only the relevant payee (in accordance with the meaning of such term determined pursuant to question 10 above) or another party (whether authorised by the relevant payee or not) can provide certification of the cost of funding and, if the former, what the position should be if the relevant payee is not capable of providing such certification (for example because it has been wound up or dissolved).

93. The definition of "*Default Rate*" in both the 1992 and 2002 ISDA Master Agreement requires the relevant payee to certify its cost of funding.

94. If the relevant payee (as defined in answer to question 10 above, namely the original counterparty) has assigned the amount payable to it under Section 6(e), it remains the case that it is for the relevant payee to certify its cost of funding. Whether the assignee is entitled to certify the relevant payee's cost of funding in right of the

relevant payee will depend upon the terms of any agreement made between assignor/assignee.

95. The fact that the relevant payee has been wound up does not render it incapable of certifying its cost of funding. It is difficult to envisage circumstances in which the relevant payee is incapable (either itself or through the agency of another) to certify its cost of funding the relevant amount. If such circumstances exist, and there has been and can be certification by the relevant payee of its cost of funding, then the court will put itself in the shoes of the relevant payee to determine what decision it would have made had it exercised its discretion properly: see *Socimer Bank Ltd v Standard Bank Ltd* [2008] 1 Lloyd's Rep. 558, per Rix LJ at [65].

Issue 17

In circumstances where the relevant payee has not incurred any actual costs, what principles should be applied in determining the asserted costs "*if it were to fund […] the relevant amount*".

96. See the answer to Issue 11 above.

Issue 18

Whether the power of a party under Section 7(b) of the 1992 ISDA Master Agreement to transfer any amount payable to it from a Defaulting Party under Section 6(e) without the prior written consent of that party included the power to transfer any contractual right to interest under that agreement.

97. Yes, but contractual interest is that to which the assignor was entitled (see the answer to Issue 10 above)

Issue 19

Whether the answer to questions 10 to 18 above (or any of them) is different if the underlying Master Agreement is governed by New York rather than English law.

98. The answer to each of questions 10 to 18 is the same if the underlying Master Agreement is governed by New York law. Wentworth will rely on expert evidence in this regard.

Issue 20

Whether, in calculating the amount of interest due under section 3(4) of the German Master Agreement, it is possible (and if so, in what circumstances and to what extent) to include an amount in respect of "further claims for damages" ("Damages Interest Claim") so that this would constitute part of "*the rate applicable to the debt apart from the administration*" for the purposes of Rule 2.88(9)

99. The translation of Clause 3(4) of the German Master Agreement is as follows:

> "*If a party fails to make a payment in due time, interest shall accrue on the amount outstanding, until such amount is received at a rate which shall be equal to the interbank interest rate charged by prime banks to each other for call deposits at the place of payment and in the currency of the amount outstanding for each day on which such interest is to be charged, plus the interest surcharge referred to in Clause 12 sub-Clause (3). The right to make further claims for damages is not hereby excluded.*"

100. Clause 12(3) provides:

> "*The interest surcharge provided for in Clause 3 sub-Clause (4) shall be 2.00% pa.*"

101. In these respects, the German Master Agreement reflects Section 288 of the German Civil Code (Default Interest), of which the official translation is as follows:

"*(1) Any money debt must bear interest during the time of default. The default rate of interest per year is five percentage points above the basic rate of interest.*

(2) In the case of legal transactions to which a consumer is not a party the rate of interest for claims for payment is eight percentage points above the basic rate of interest.

(3) The obligee may demand higher interest on a different legal basis.

(4) The assertion of further damage is not excluded."

102. The third paragraph of Section 288 accordingly permits a claim for "*higher interest*" on a "*different*" legal basis to that provided in the first and second paragraphs, which specify a default rate for consumers (5% above the basic rate) and non-consumers (8% above the basic rate). The specified rates are simple rates. Compounding of default interest is prohibited by Section 289 of the German Civil Code. The current basic rate is minus 0.73 and is determined by the Deutsche Bundesbank, pursuant to Section 247, from time to time.

103. The ability to demand "*higher interest on a different legal basis*" refers to the freedom of contract recognised under German law. That same freedom permits the agreement of a lower rate of interest than the basis rates prescribed. In this respect:

(1) The *principle of the freedom of contract* stems from the principle of the autonomy of the individual, which is derived from articles 1 and 2 of the German Constitution, as held by the German Constitutional Court *(BVerfG)*.[8] Even though the entire German Civil Code is preconditioned on this principle, it is not explicitly stated in the German Civil Code. However, Section 311 of the German Civil Code is often cited when reference to this principle is made.[9]

8 BVerfG, *decision* dated 19 October 1993, 1 BvR 567/89, NJW = 1994, 36 (38.).

9 *Oelzen* in: Staudinger Kommentar zum BGB, 2009 edition, Einleitung zum Schuldrecht, no. 49.

(2) The German Federal Court (*BGH)* decided[10] that the statutory default rate is not a mandatory provision, and that the creditor and the debtor may generally agree freely upon a default interest rate by virtue of the principle of the *freedom of contract*.[11]

104. The third paragraph of Section 288 in permitting a claim for "*higher interest*", which is a rate applied to a principal sum, contrasts with the fourth paragraph, which provides for damages to be proved as a matter of fact and subjects recovery to other limitations imposed as a matter of the general law on damages. The fourth paragraph simply reserves the right to claim "*further damage*" for default.

105. Such a reservation is required to make clear that the right to default interest under paragraphs (1) and (2) of Section 288 and paragraph (3), if applicable, is not exhaustive of the remedies for a default in payment.

106. A right to claim "*further damage*" is distinct from the right to default interest. This is apparent from Section 288 which clearly distinguishes between default interest at one of two specified rates (paragraphs 1 and 2) and further damage (paragraph 4). The distinction is emphasised by the distinct expressions for each concept in the German language:

(1) "*Basiszinssatz*" (basic rate of interest);

(2) "*Verzugszinssatz*" (default rate of interest);

(3) "*Geltendmachung weiteren Schadens*" (assertion of further damage)

107. The German terms for interest rate, whether basic or default, imply a right to interest expressed as a rate to be applied to a principal sum. The German term for damages

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10 BGH, *decision* dated 28 April 1988, II ZR 57/87 = NJW 1988, 1967.

11 Even though the principle of the freedom of contract is unwritten in the German Civil Code, it is still one of the most fundamental and important principles of German Civil Law. In the jurisprudence of the German Constitutional Court, the principle is derived from, and protected by, Art. 1 and 2 of the German Constitution, see BVerfG, *decision* dated 19 October 1993, 1 BvR 567/89, NJW = 1994, 36 (38).

does not imply this; rather, it implies a claim to damages to be proven on the facts in the light of the loss suffered.

108. That a right to claim "*further damage*" is distinct from a right to default interest is apparent from the basis for such a claim:

(1) The further damages claim is determined by applying the principles set forth in Section 249, and following, of the German Civil Code.

(2) Pursuant to these principles, the claimant is to be placed in the same position as if the contract would have been performed.[12]

(3) The amount required to compensate the creditor is determined using the principle of restitution.[13]

(4) The debtor must compensate the creditor as if the breach would not have occurred, which is a factual question, established on a case-by-case basis.

109. In particular, a claim pursuant to this provision requires the claimant to prove that loss was caused, which involves both a question of factual causation and legal causation as to the scope of liability; and that, as applicable, there was proper mitigation on the part of the claimant.

110. By contrast, a claim for default interest under paragraphs 1 and 2 of Section 288 of the German Civil Code involves no such elements. The rate specified is simply applied to the principal sum.

111. Clause 3(4) of the German Master Agreement is to be construed in the light of Section 288 of the German Civil Code. The first sentence is a variation of the default rate specified, which variation is in accordance with the principle of freedom of contract, explained above.

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12 *Löwisch / Feldman* in: Staudinger Kommentar zum BGB, 2014 edition, § 286, no. 189.

13 *Löwisch / Feldman* in: Staudinger Kommentar zum BGB, 2014 edition, § 286, no. 189.

112. The second sentence of that clause ("*The right to make further claims for damages is not hereby excluded.*") replicates the wording of the fourth paragraph of Section 288 of the German Civil Code. The word "*hereby*" emphasises that the purpose of that sentence is simply to reserve the right to claim for "*further damage*".

113. There is accordingly no basis for saying that a right to claim for "*further damage*" can constitute part of "*the rate applicable to the debt apart from the administration*" for the purpose of Rule 2.88(9):

(1) The essential characteristics of a claim for "*further damage*" under German law distinguish that concept from the concept of "*the rate applicable to the debt*", as that concept applies under English law for the purpose of Rule 2.88(9):

(a) The claim for "*further damage*" under German law is not a "*rate*" – a term which implies a mathematical ratio, naturally expressed as a percentage of the principal.

(b) Such a claim is also not "*applicable to the debt*". Any claim for damage is freestanding and is not capable of application to the debt to produce an amount payable from the surplus as Statutory Interest.

(2) It would be surprising if "*further damage*" were to be construed as a rate, or part thereof, for the purpose of Rule 2.88(9). The "*further damage*", as explained above, does not in any way correspond to the concept of a rate of interest, as that concept is understood under German law.

Issue 21

If the answer to question 20 is that a further claim for damages can be included as part of the "*rate applicable to the debt apart from the administration*" for the purposes of Rule 2.88(9), how in such circumstances is the relevant rate to be determined?

114. In view of the answer to Issue 20, Issue 21 does not arise.

Issue 22

Whether each of:

(i) default rate pursuant to clause 9.1 of the FBF Master Agreement and the AFB Master Agreement;

(ii) the "*Late Interest Rate*" as such term is defined in the AFTB Master Agreement; and/or

(iii) "*Late Payment Interest*" as such term is defined in the AFTI Master Agreement,

are capable of being a "*rate applicable to the debt apart from the administration*" for the purposes of Rule 2.88(9).

115. Wentworth agrees that each of the contractual interest rates identified at (i)-(iii) above are capable of being a "*rate applicable to the debt apart from the administration*" for the purposes of Rule 2.88(9).

116. It should be noted that, as a matter of French law, compound interest will only be payable by a party if (i) it is expressly provided for by the terms of the contract, and (ii) the interest has been due for at least a year: see Article 1154 of the French Civil Code. Article 1154 is part of French public order and its operation cannot be excluded by the parties.

117. The AFTB Master Agreement does not provide for the compounding of the Late Interest Rate. Accordingly, the interest is payable on a simple basis unless otherwise agreed in the Schedule.

118. The AFTI Master Agreement does not provide for the compounding of the Late Payment Interest. Accordingly, the interest is payable on a simple basis unless otherwise agreed in the Schedule.

119. In addition, the French court retains the power, pursuant to Articles 1152 and 1231 of the French Civil Code, to reduce the interest payable by the defaulting party in circumstances where the interest rate provided for in the contract is excessive.

<u>Issue 23</u>

Whether the "party" that receives the interest referred to in question 22 above pursuant to the FBF Master Agreement, the AFB Master Agreement, the AFTB Master Agreement and the AFTI Master Agreement refers to LBIE's original contractual counterparty or to a third party to whom LBIE's original contractual counterparty has transferred (by assignment or otherwise) its rights under the relevant agreement.

120. Wentworth's position is as follows:

(1) Pursuant to Article 1692 of the French Civil Code, the assignment of a claim includes the ancillary rights to such claim. Accordingly, the assignment of the claim by the original counterparty will, save where contrary provision is made in the assignment agreement and provided all the formalities and requirements necessary for the enforceability of the assignment have been duly performed in accordance with French law, operate so as to transfer to the assignee the right to claim statutory interest pursuant to Rule 2.88(9).

(2) As a matter of French law, an assignee of a claim cannot recover more from the debtor than the assignor could have recovered. This principle applies to the right to interest as much as to any other right of the assignor.

(3) The purpose of a right to interest as a matter of French law is to compensate the person entitled to payment for having been kept out of its money. The calculation of default interest pursuant to the FBF Master Agreement and the AFB Master

Agreement by reference to the "*overnight financing rate of the Party*", Late Interest pursuant to the AFTB Master Agreement by reference to the rate of the European Central Bank for "*supplying liquidity to the beneficiary of the late payment*" or "*the average of the overnight rates that would be offered to the beneficiary of the late payment*", and Late Payment Interest pursuant to the AFTI Master Agreement by reference to "*EONIA for the period in question*" or "*the average of the daily rates to which the recipient of the payment has access during the relevant period*" reflects the fact that it is the counterparty which has been kept out of its money. It would be contrary to the purpose of the right to interest to allow the assignee to calculate the amount of default interest payable by reference to the assignee's particular circumstances as opposed to that of LBIE's original contractual counterparty.

(4) In light of the above matters, it would require the clearest wording in the contract between LBIE and the original contractual counterparty to entitle an assignee to recover more by way of default interest than LBIE's original contractual counterparty. The FBF Master Agreement, the AFB Master Agreement, the AFTB Master Agreement and the AFTI Master Agreement do not contain any such wording.

(5) Accordingly, the default interest rate payable under each of the FBF Master Agreement, the AFB Master Agreement, the AFTB Master Agreement and the AFTI Master Agreement is to be calculated by reference to the relevant rates applicable to the original contractual counterparty.

Issue 24

Whether the terms

(i) **"*overnight financing rate of the Party*" in clause 9.1 as it appears in the FBF Master Agreement and the ABF Master Agreement;**

(ii) **"*average overnight rates that would be offered to the beneficiary*" as it appears in the AFTB Master Agreement;**

(iii) **"*the average of the daily rates to which the recipient of the payment has access during the relevant period*" as it appears in the AFTI Master Agreement,**

should only be ascertained with reference to the actual or asserted cost of the payee or may be ascertained in other ways.

The FBF Master Agreement and the AFB Master Agreement

121. The parties to the FBF Master Agreement and the AFB Master Agreement will commonly specify a rate in the Schedule to the relevant agreement. In circumstances where they have not done so, Clause 9.1 makes provision for the rate of default interest payable in the event of a delay in payment by one of the parties.

122. Wentworth contends that the words "*overnight refinancing rate of the Party entitled to receive the relevant amount*" in Clause 9.1 mean:

(1) for Euro denominated agreements (which will form the vast majority of the relevant agreements), the EONIA rate (the Euro Overnight Index Average) for the period in question; and

(2) for non-Euro denominated agreements, the equivalent rate to EONIA for the applicable contractual currency for the period in question.

123. Accordingly, the rate is to be ascertained by reference to the published rates for EONIA for Euro denominated agreements and the equivalent rate to EONIA for non-Euro denominated agreements. It is not to be ascertained by reference to the rate asserted by the contractual counterparty.

AFTB Master Agreement

124. The parties to the AFTB Master Agreement will commonly specify a rate in the Schedule to the relevant agreement. In circumstances where they have not done so, Appendix IA makes provision for the rate of default interest payable in the event of a delay in payment by one of the parties.

125. The rate payable pursuant to Appendix IA for Euro denominated agreements (which will form the vast majority of the relevant agreements) is the highest rate charged by the European Central Bank for supplying liquidity to the contractual counterparty.

126. Wentworth contends that the rate payable pursuant to Appendix IA for non-Euro denominated agreements is the rate of the equivalent institution to the European Central Bank for the contractual currency.

127. Accordingly, the rate is to be ascertained by reference to the published rates of the European Central Bank for Euro denominated agreements and the rate published by the equivalent institution to the European Central Bank rate for the non-Euro denominated agreements. It is not to be ascertained by reference to the rate asserted by the contractual counterparty.

AFTI Master Agreement

128. The parties to the AFTI Master Agreement will commonly specify a rate in the Schedule to the relevant agreement. In circumstances where they have not done so, Section I of the Appendix makes provision for the rate of default interest payable in the event of a delay in payment by one of the parties.

129. The rate payable pursuant to the Appendix for Euro denominated agreements (which will form the vast majority of the relevant agreements) is the EONIA rate; and

130. Wentworth contends that the rate payable pursuant to the Appendix for non-Euro denominated agreements is the equivalent rate to EONIA for the applicable contractual currency for the period in question.

131. Accordingly, the rate is to be ascertained by reference to the published rates for EONIA for Euro denominated agreements and the equivalent rate to EONIA for non-Euro denominated agreements. It is not to be ascertained by reference to the rate asserted by the contractual counterparty.

<u>Issue 25</u>

Whether only the "party" pursuant to question 23 or another party authorised to act on behalf of the "party" can provide determination and notification of its cost of funding.

132. French law permits a party to appoint a third party to perform certain tasks or to carry out calculations or determinations on its behalf. The terms of any appointment would need to comply with the formal requirements imposed as a matter of French law.

133. Accordingly, provided the terms of the appointment comply with the formal requirements as a matter of French law, the "*party*" is able to appoint another party to determine and notify the relevant amount of default interest payable under the French Master Agreements.

<u>Issue 26</u>

What is the applicable standard, if any, by reference to which any statement by the party as to its "*overnight refinancing rate*", "*average overnight rates*" and "*average of daily rates to which it has access*" is constrained?

134. Wentworth repeats its response to Issue 24 above. Accordingly the default interest rates applicable to the FBF Master Agreement, the AFB Master Agreement, the AFTB Master Agreement and the AFTI Master Agreement are to be ascertained by reference to the relevant published rates.

135. Alternatively, to the extent that the party has an ability to notify a different rate to those identified in the response to Issue 24 above (which is denied), Wentworth contends as follows:

(1) Article 1315 of the French Civil Code provides that a person who claims the performance of an obligation must prove it. Accordingly, LBIE is entitled to require evidence of the calculation of the default rate which is claimed.

(2) Pursuant to French law a calculation, certification or determination made by a party may not be found conclusive by a French court if fraudulent, incorrect, arbitrary, made otherwise than in good faith, or not supported by objective evidence. Such a calculation, certification or determination will be regarded as no more than prima facie evidence of the matter calculated, determined or certified. The French Court may determine the applicable rate in such circumstances.

Issue 27

Whether, and if so how, the answers to questions 10 to 28 would be impacted where the "relevant payee" is:

(i) a Credit Institution or Financial Institution;

(ii) a Fund Entity; or

(iii) a corporate or other type of counterparty.

136. The extent to which the answers would be impacted where the relevant payee is a Credit Institution or Financial Institution is identified in response to the particular Issue above.

CURRENCY CONVERSION CLAIMS: ISSUES 28-33

Issues 28-30

28. Whether, and if so how, the calculation of a Currency Conversion Claim should take into account the Statutory Interest paid to the relevant creditor by the Joint Administrators.

29. Whether there exists a non-provable claim against LBIE where the total amount of interest received by a creditor applying the Judgments Act Rate on a sterling admitted claim, when converted into the relevant foreign currency on the date of payment, is less than the amount of interest which would accrue applying the Judgments Act Rate to the original foreign currency claim.

30. Whether there exists a non-provable claim against LBIE where the total amount of interest received by a creditor applying a "*rate applicable to the debt apart from the administration*" on a sterling admitted claim, when converted into the relevant foreign currency on the date of payment, is less that the amount of interest which would accrue applying the "rate applicable to the debt apart from the administration" to the original foreign currency claim.

137. The calculation of a Currency Conversion Claim (on the assumption that one exists) should take into account the Statutory Interest paid to the relevant creditor by the Joint Administrators.

138. Specifically, the Currency Conversion Claim should be calculated as the difference (if any) between:

(1) the amount of the provable debt, in its original foreign currency, together with the amount (if any) in the foreign currency of interest to which the creditor would have been entitled pursuant to its contract; and

(2) the foreign currency equivalent of all distributions made to the creditor in respect of its provable debt and Statutory Interest.

139. The basis for the Currency Conversion Claim is as follows. The creditor is owed a debt payable in a foreign currency. The debt is converted into sterling solely for the purposes of proof. If and when all provable debts and Statutory Interest on them are paid in full, the foreign currency creditor is remitted to its contractual right to be paid in the foreign currency which is unaffected save to the extent that distributions have pro tanto discharged the debt. See: *Re Lines Bros Ltd* [1983] Ch 1, 20-21; *Waterfall I [2014] EWHC 704 (Ch)* at [88]-[94] and [110]-[111]; *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147 at [26]-[27].

140. On the assumption that the creditor has a contractual right to interest, its right to be paid in a foreign currency relates both to principal and interest. To the extent, therefore, that the distributions from the insolvency process, whether in respect of principal or interest, when converted into the foreign currency at the point of payment, leave a shortfall in respect of the creditor's foreign currency entitlement, then it has a Currency Conversion Claim.

141. The corollary is that the foreign currency equivalent of every payment made to the creditor from the insolvency process (whether in respect of principal or interest) discharges pro tanto its contractual entitlement to be paid in the foreign currency. Thus, for example, if a foreign currency creditor with no contractual entitlement to interest received less than the foreign currency amount of its contractual entitlement to principal by virtue of the payment of its proved debt, but more than the foreign currency equivalent of its contractual entitlement when the receipt of the foreign currency equivalent of Statutory Interest at 8% from the Date of Administration is taken into account, it would be absurd to regard that creditor as continuing to have a Currency Conversion Claim.

Issues 31 and 32

31. Whether:

(i) in relation to a GMSLA for which the "Base Currency" is a currency other than sterling, a Currency Conversion Claim can arise in respect of the "Base Currency" if the schedule to that agreement states that paragraph 10 of that agreement will only apply if LBIE's counterparty is the "Defaulting Party";

(ii) in relation to a GMRA for which the "Base Currency" (as distinct from the "Contractual Currency") is a currency other than sterling, a Currency Conversion Claim can arise in respect of the "Base Currency" if the schedule to that agreement states that paragraph 10 of that agreement will only apply if LBIE's counterparty is the "Defaulting Party"; and

(iii) in relation to other master agreements, a Currency Conversion Claim can arise if the relevant contractual terms state that the termination and close-out netting provisions which would result in a payment obligation in a non-sterling currency by one party to the other do not apply other than upon the default of LBIE's counterparty.

32. If the answer to question 31(i), (ii) and/or (iii) is in the negative, whether a Currency Conversion Claim can arise (and if so in what circumstances) in respect of such a GMSLA, GMRA or other master agreements.

142. The foundation of a Currency Conversion Claim is an entitlement – usually pursuant to contract – to be paid an amount in a foreign currency.

143. In relation to certain agreements (referred to in more detail below), on the true construction of those agreements, the creditor has no entitlement to be paid any amount in a foreign currency, and thus (in the absence of any non-contractual right to be paid in a foreign currency) no Currency Conversion Claim.

144. Wentworth has on 25 July 2014, pursuant to paragraph 2 of the order of David Richards J dated 26 June 2014 in respect of the Application, provided redacted copies of the following agreements to the other parties to the Application:

(1) a GMSLA for which the "*Base Currency*", as defined therein, is a non-sterling currency;

(2) a prime brokerage agreement ("PB"); and

(3) a margin lending agreement ("MLA").

145. The PB, MLA and GMSLA were entered into between LBIE and the same counterparty in each case.

146. The relationship between, and effect of, these agreements is as follows:

(1) The PB is the basic document governing the relationship between LBIE and its counterparty.

(2) The PB was supplemented by the MLA as regards loans of margin by LBIE to its counterparty.

(3) The GMSLA was entered into for the purpose of stock lending by LBIE to its counterparty. The GMSLA was intended to be, and was, used only for such loans, even though, on its face, the GMSLA envisages loans of securities by Party A or Party B.

(4) The Schedule to the GMSLA subjected its terms to terms of the MLA and modified the following provisions of the GMSLA, amongst others:

(a) The Event of Default and close-out provisions at paragraph 10 are modified such that: "*Paragraph 10 of this Agreement will only apply if Party B is the Defaulting Party*", i.e. if LBIE's counterparty is the "*Defaulting Party*" and not if LBIE is the Defaulting Party.

(b) The termination provision at paragraph 9.2 is modified to not apply to "*Loans of Loaned Securities*".

(c) Paragraph 10, if it applied, would entitle LBIE's counterparty to close-out all transactions on LBIE's default and calculate a close-out amount denominated in a foreign currency. Such amount would thus give rise to an entitlement to be paid in a foreign currency. The disapplication of paragraph 10 thus prevents such an entitlement from arising.

(5) Paragraph 9.2, if it applied, would entitle LBIE's counterparty to terminate particular transactions and to calculate an amount due upon termination of the transaction, payable in a foreign currency. To the extent that this resulted in a payment due to the counterparty it would thus give rise to an entitlement to be paid an amount in a foreign currency. The disapplication of paragraph 9.2 prevents such an entitlement from arising.

(6) The disapplication of the right to terminate under paragraph 9.2 of the GMSLA is to be read together with the disapplication of the simultaneous delivery obligations under paragraph 8.4 (which would otherwise favour the Borrower, LBIE's counterparty) and the terms of the MLA, to which paragraph 1 of the Schedule subjects the GMSLA as regards collateral and margin.

(7) Taken together, the effect is that the LBIE's counterparty's (i.e. the Borrower's) right to recover collateral and/or invoke a netting process on LBIE's failure to redeliver collateral is removed, leaving it only with the right under clause 5(d) of the MLA. That right is to recover any excess collateral once all of its obligations to LBIE have been satisfied.

(8) Critically, the counterparty's right is merely the right to recover collateral. It is not a right to be paid any amount in a foreign currency. Moreover, if LBIE fails to comply with the obligation to deliver collateral, the counterparty's right to recover damages is not a right to be paid in a foreign currency.

(9) Accordingly, LBIE's counterparty has no entitlement under any netting or payment provisions of the GMSLA, the MLA or the PB, which would have resulted in an entitlement to be paid in any foreign currency, and thus can have no Currency Conversion Claim.

147. Wentworth is confident that the above fact pattern will be true of a substantial number of other arrangements, whether involving a GMSLA, GMRA or other master agreement.

Issue 33

Whether a Currency Conversion Claim can be established by a creditor where the creditor's right is derived from a transfer (whether or not by way of legal assignment) by LBIE's original counterparty (or any assignee of the original counterparty) which only transferred:

(i) the provable debt;

(ii) the right to receive a dividend on the provable debt; or

(iii) the Agreed Claim Amount defined as a numerical amount in a CDD

and, if not, whether either the original counterparty or the assignee is capable of having a valid Currency Conversion Claim.

148. Issue 33 is premised upon an assignment limited, on its true construction, to an assignment of only either:

(1) the provable debt;

(2) the right to receive a dividend payable on that debt; or

(3) the Agreed Claim Amount, if defined as a numerical amount in a CDD;

such that, in the case of a foreign currency debt, the right to be paid in the relevant foreign currency is retained by the assignor, and the assignee of the dividend payable on that debt has no entitlement to be paid in a non-sterling currency as regards the rights assigned and hence no basis for a Currency Conversion Claim.

149. In those circumstances, the assignor likewise has no non-provable Currency Conversion Claim.

150. As noted above in relation to Issues 28-30 above, the Currency Conversion Claim is a claim in debt, and enables the creditor to recover the shortfall between the full amount of the debt expressed in the foreign currency and the foreign currency equivalent of the amounts recovered by way of dividend on the provable debt.

151. Where the creditor has assigned the provable debt, it will by definition not suffer any such shortfall, and thus has no basis for pursuing a Currency Conversion Claim.

EFFECT OF POST-ADMINISTRATION CONTRACTS: ISSUES 34-38

Issue 34

Whether a creditor's Currency Conversion Claim has been released in circumstances in which the creditor entered into either:

(i) a Foreign Currency CDD incorporating a Release Clause;

(ii) a Sterling CDD incorporating a Release Clause; or

(iii) the CRA.

152. The templates of the CDDs have, as explained in the tenth witness statement of Anthony Lomas, developed over time. Mr Lomas exhibits only the current templates. Those are largely of no assistance because (save for a few CDDs specifically tailored to particular circumstances) the current templates contain a provision expressly preserving Currency Conversion Claims (to the extent that such claims exist): see, for example, clause 2.4 of the first template that is exhibited by Mr Lomas at AVL10, p625. As explained by Mr Lomas, this new provision was added to recent CDDs in order to procure creditors to execute the CDDs.

153. Wentworth's case on Issue 34 is focused on prior versions of the CDD templates, which contained a "Release Clause" (in the terms set out in the definition of that expression in the schedule to the Application) and which did not expressly preserve an ability to bring a Currency Conversion Claim.

154. The language of a Release Clause cannot be construed in a vacuum, but must be construed in the context of the relevant CDD as a whole.

<u>(i) A Foreign Currency CDD incorporating a Release Clause</u>

155. Wentworth does not contend that a Foreign Currency CDD has the effect of waiving a Currency Conversion Claim provided that the foreign currency specified in the CDD is the same as the contractual currency.

(ii) A Sterling CDD incorporating a Release Clause

156. A Sterling CDD (based on an earlier CDD template than those exhibited by Mr Lomas) incorporating a Release Clause (i.e. a clause in materially identical terms to the release clause wording identified in the Application) is appended to this Position Paper. References below to the Sterling CDD are to that contract.

157. Wentworth contends that the Sterling CDD operates so as to release any Currency Conversion Claim:

(1) Clause 2.1 of the Sterling CDD provides that "*the Creditor shall have an Admitted Claim in an amount equal to the Agreed Claim Amount*".

(2) the Agreed Claim Amount is a sum expressed in Sterling ("*£18,070,281*") and the Admitted Claim is defined as "*an unsecured Claim of a creditor of the Company which qualifies for dividends from the estate*".

(3) Clause 2.2 of the Sterling CDD then states that that claim (i.e.£18,070,281) is the Creditor's "*entire claim*" against LBIE.

(4) Clause 2.3 of the Sterling CDD (which is in materially the same terms as the Release Clause cited in the Application) is a general release clause framed in the widest possible terms:

"*save solely for the Admitted Claim, the Creditor and [LBIE] and the Administrators, are hereby each irrevocably and unconditionally released and forever discharged from any and all losses, costs, charges, expenses, Claims (including all Claims for interest, costs and orders for costs), demands, actions, causes of action, liabilities, rights and obligations (including those which arise hereafter upon a change in the relevant law) to or against each other and howsoever arising, whether known or unknown, whether arising in equity or under common law or statute or by reason of breach of contract or in respect of any tortious or negligent act or omission (whether or not loss or damage caused thereby has yet been suffered) or otherwise, whether arising* *under the Creditor Agreement or not, whether in existence now or coming into existence at some time in the future, and whether or not in the contemplation of the Creditor and/or [LBIE] and/or the Administrators on the date hereof;"*

(5) Thus it can be seen that Clause 2.3 releases, save solely for the "*Admitted Claim*", all other "*Claims*" "*howsoever arising*" including under the "*Creditor Agreement*" from which the claim against LBIE is derived. The term "Claims" is very widely defined. The Court will give effect to the language of a general release to compromise non-fraud claims, including future and unknown claims: see *BCCI v Ali* [2002] 1 AC 251, at [27] per Lord Nicholls; *Mostcash plc v Fluor Ltd* [2002] BLR 411, at [46]-[61] per Chadwick LJ; *Priory Caring Services Ltd v Unpaid Systems Ltd* 129 Con LR 81, at [59]-[67] per Rix LJ.

(6) Clause 2.4 of the Sterling CDD then precludes the Creditor from taking any steps to claim for any debt in respect of the "*Claims*" released pursuant to Clause 2.3:

"*the Creditor will not take any steps to prove for, or to Claim for, any debt in the Administration (or other insolvency process) of [LBIE], or otherwise bring any Claim, action, demand or issue (or continue) any Proceedings against [LBIE] and/or the Administrators (or any of them) in any jurisdiction in respect of any and all Claims and matters as are referred to in Clause 2.3 above.*"

(7) The distinction there drawn between "*prove*" and "*Claim*" indicates that the release and waiver is not limited to otherwise provable claims and is not limited for the purpose of proving.

(8) Accordingly, as a matter of construction, any right to be paid in a foreign currency under the Creditor Agreement (i.e. the foundation of a Currency Conversion Claim) has been released by the terms of the Sterling CDD and can no longer be asserted against LBIE.

(iii) The CRA

158. Wentworth does not contend that the terms of the CRA itself give rise to a waiver of a Currency Conversion Claim.

159. Wentworth understands, however, that a large number of creditors that acceded to the CRA subsequently entered into a CDD in order to agree the amount of their claims under the CRA against LBIE: see paragraph 63 of the tenth witness statement of Anthony Lomas.

160. A CDD entered into by a CRA signatory (based on an earlier CDD template than those exhibited by Mr Lomas) is appended to this Position Paper.

161. Wentworth contends that the combined effect of the CRA and the CRA CDD is to release any Currency Conversion Claim:

(1) Clause 4.2.3 of the CRA releases "*all Claims…in respect of any Financial Contract*".

(2) The term "*Claim*" is defined in the CRA in the widest possible terms (e.g., "*a claim in law or in equity of whatsoever nature…*") and would include a currency conversion claim.

(3) Clause 4.4.2 of the CRA provides that the "*Released Claims*" of Creditors are "*exchanged for*" the right:

(a) to have their contractual position "*determined on the basis set out in this Agreement*";

(b) to claim "*as a new obligation of [LBIE] their Net Financial Claim (if any)*"; and

(c) to *“an Ascertained Claim (if any) for such amount as is determined under this Agreement”*.

(4) The CRA CDD operates to provide a streamlined procedure for agreeing those claims which are exchanged for the Released Claims under Clause 4.4.2 of the CRA. In this regard:

(a) Clause 2.1.1 of the CRA CDD provides that “*the Minimum Net Financial Claim shall be limited to, and in an amount equal to, the Minimum Net Financial Claim Amount*”;

(b) The Minimum Net Financial Claim is a sum expressed in Sterling (“*£22,634,579*”);

(c) Clause 2.1.2 of the CRA CDD provides that this sum shall constitute an Ascertained Claim against LBIE. The CRA defines an Ascertained Claim as “*an ascertained, unsecured claim in the winding-up of the Company or any distribution of the Company’s assets generally to its unsecured creditors*”).

(5) This means that £22,634,579 will constitute the obligation of LBIE to the creditor under Clause 4.4.2(ii) of the CRA and the Ascertained Claim under Clause 4.4.2(iii) of the CRA.

(6) Accordingly, as a matter of construction, any right to be paid in a foreign currency under the Creditor Agreement (i.e. the foundation of a Currency Conversion Claim) has been released by the combined effect of the CRA and the CRA CDD.

Issue 35

Whether a creditor's claim to Statutory Interest has been released in whole or in part in circumstances in which the creditor entered into either:

(i) a CDD incorporating a Release Clause; or

(ii) the CRA.

(i) A CDD incorporating a Release Clause

162. Wentworth's case relates to CDDs entered into prior to the introduction of specific language preserving rights in respect of statutory interest (as described in paragraphs 66-73 of Mr Lomas' 10th witness statement). The Sterling CDD appended to this Position Paper is an example of such an agreement, and the points below are made with reference to the appended Sterling CDD.

163. Wentworth contends that the CDDs operate so as to release the creditor's contractual entitlement to interest, such that Statutory Interest is payable to it at the Judgments Act Rate:

(1) Clause 2.3 expressly releases "*all claims for interest…whether arising under the Creditors Agreement or not, whether in existence now or coming into existence at some time in the future, and whether or not in the contemplation of the Creditor and/or [LBIE] on the date hereof*";

(2) this operates so as to release any contractual right to interest under the Creditors Agreement; and

(3) accordingly, for the purpose of Rule 2.88(9), the higher of the Judgments Act Rate or the rate applicable apart from the Administration is the Judgments Act Rate (because the creditor has no continuing contractual right to interest).

(ii) The CRA

164. Wentworth contends that the CRA operates so as to release the creditor's contractual right to interest accruing after the date its financial contract was closed-out, such that Statutory Interest is payable to it (for that period[14]) only at the Judgments Act Rate:

(1) Clause 4.2.3 releases "*all Claims…in respect of any Financial Contract*".[15]

(2) "*Claim*" is defined sufficiently broadly (e.g., "*a claim in law or in equity of whatsoever nature…*") to include a contractual right to interest.

(3) Clause 4.4.2 provides that the "*Released Claims*" of Creditors are "*exchanged for*" the right:

(a) to have their contractual position "*determined on the basis set out in this Agreement*";

(b) to claim "*as a new obligation of [LBIE] their Net Financial Claim (if any)*"; and

(c) to "*an Ascertained Claim (if any) for such amount as is determined under this Agreement*".

(4) Each "*Net Financial Claim*" is based on the "*Close-Out Amount*" under the creditor's Financial Contract: see clause 25.1 and clause 24.2. Such amount is generally calculated as of the date of termination of the contract. Where, for example, the claim arises out of an ISDA Master Agreement which was terminated at or around the Date of Administration, then the Close-Out Amount consists of the amounts payable under Section 6(e) of the ISDA Master Agreement, calculated as of the Early Termination Date (or as soon as practicable thereafter). In the case of any open contracts, the CRA provides

14 To the extent that the creditor is entitled pursuant to its contract to claim interest on any liability of LBIE which is a constituent element in the calculation of its Close Out Amount (e.g. in relation to "*Unpaid Amounts*" under the 1992 ISDA Master Agreement), such right is preserved by the CRA and thus falls outside the scope of Wentworth's argument on Issue 35.

15 Except for Modified Claims – but these relate only the Asset Claims to Trust Assets.

expressly that the Close-Out Amount is to be determined as at the "*Open Contract Termination Date*" (which relates to the date on which the relevant creditor acceded to the CRA: see clause 20.4.2).

(5) The "*Close-Out Amount*" (and thus the "*Net Financial Claim*") accordingly does not include interest accruing after the date on which the relevant contract was closed out.

(6) It follows that the combination of the release of all Claims and the fact that the replacement claim does not include a right to interest accruing after the date of the close out of the contract, that the signatory to the CRA has released its right to such interest.

(7) Although Clause 25.1 of the CRA preserves the right to interest on the Net Financial Claim to the extent provided for by Rule 2.88, it does not preserve any contractual right to interest which is otherwise released by the CRA.

(8) Accordingly, for the purposes of Rule 2.88(9) the Judgments Act Rate is necessarily higher than the "*rate apart from administration*" because any contractual right the creditor might have had to a rate higher than the Judgments Act Rate has been released.

Issue 36

If a CDD or the CRA has the effect of releasing a Currency Conversion Claim, Statutory Interest claim or other non-provable claims, whether such release(s) should in the circumstances be enforced.

165. The Creditor Funds have made a general assertion that issues of rectification, estoppel and *ex parte James* may arise in relation to Issue 36. The Creditor Funds have not, however, provided any further detail in respect of how these arguments are to be developed or how it is said that they give rise to points of general application that are suitable for determination as part of the Application.

166. Wentworth is unable to set out its position on Issue 36 until it understands the case that it will be required to meet. Accordingly, Wentworth presently intends to respond to any arguments raised by the Creditor Funds when it files its Reply Position Paper.

167. It should be noted that Wentworth remains concerned that Issue 36 is likely to raise wholly fact specific enquiries between the Administrators and each party to a relevant CDD, and thus cannot appropriately be determined as part of the Application. In these circumstances, and as made clear at the directions hearing on 25 June 2014, Wentworth continues to reserve the right to object to the inclusion of Issue 36 in the Application at all.

Issue 37

How are claims to be calculated where a CDD (or any other agreement pursuant to which an unsecured claim is agreed or admitted) compromises a number of claims, with differing rates of interest applicable or in different currencies, without indicating how the agreed or admitted claim amount in the CDD (or any other agreement) derives from and relates to those underlying claims?

168. Wentworth contends that, in circumstances where it is not possible to ascertain how the agreed or admitted amount in the CDD (or other agreement) derives from and relates to the underlying claims, the claims are to be calculated on a pro rata basis by reference to the underlying claims.

Issue 38

Whether (and if so in what circumstances) Part VII of the CRA, which specifies that claims of acceding creditors are to be calculated in US dollars, is capable of giving rise to a Currency Conversion Claim

169. The CRA is not capable of giving rise to a Currency Conversion Claim in circumstances where the creditor did not have a Currency Conversion Claim prior to entry into the CRA.

170. The foundation of the Currency Conversion Claim is that it involves the "*re-assert[ion]*" of the "*underlying contractual obligation*" by creditors: see the judgment of David Richards J in the Waterfall I judgment, at [90], [94] and [110]. That means the underlying contractual rights of creditors as at the Date of Administration, not such rights as the creditors agree with the administrators as part of the process of establishing claims for the purpose of distribution within the administration.

171. The purpose of Clauses 24 and 25 of the CRA is to agree the value of the claims for the purpose of entitling the creditor to receive a distribution from LBIE's assets. The conversion of claims into dollars is for administrative convenience only. It would be

contrary to the commercial purpose of the CRA for it to be construed as creating a Currency Conversion Claim for the very first time where no such claim existed at the time of administration:

(1) the time of administration is the cut-off date for the determination of claims for the purpose of ensuring a *pari passu* distribution of LBIE's assets to its creditors; and

(2) the acts of the administrators in agreeing the level of unsecured claims under the CRA cannot have the effect of creating new non-provable liabilities against the insolvent estate which is to be divided between creditors according to their rights at the time of administration.

172. Wentworth also contends that a CDD is not capable of giving rise to a Currency Conversion Claim in circumstances where the creditor did not have a Currency Conversion Claim prior to entry into the CDD.

COMPENSATION FOR TIME TAKEN TO DISCHARGE NON-PROVABLE CLAIMS: ISSUE 39

Issue 39

Whether a creditor entitled to Statutory Interest, Currency Conversion Claims and/or other non-provable claims is entitled to any form of compensation for or in respect of the time taken for such claim to be discharged and, if so, whether such compensation is to be taken into account as part of the correct methodology for calculating Statutory Interest and/or the distribution of the surplus, or should take the form of interest at the Judgments Act Rate, damages for loss, restitution or another form.

173. A creditor entitled to Statutory Interest, Currency Conversion Claims and/or other non-provable claims is not entitled to any form of compensation for or in respect of the time taken for such claim to be discharged.

174. Compensation for the late payment of any sum (i.e. interest) is recoverable only where the creditor has a pre-existing statutory or contractual right to it. The Creditor Funds have identified no such right in relation to the claims identified in Question 39.

ANTONY ZACAROLI QC

DAVID ALLISON QC

ADAM AL-ATTAR

South Square

3-4 South Square

Gray's Inn

19 September 2014