

Claim No. 7942 of 2008

**IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT**

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

**SECOND WITNESS STATEMENT OF
ANDREA ZAMBELLI**

I, **Andrea Zambelli**, of CarVal Investors GB LLP (*CarVal*) of 25 Great Pulteney Street, London, W1F 9LT will state as follows:

1. I am a Managing Director of CarVal and have held the role of Investment Manager within the Global Corporate Securities team since 22 May 2008. In this role, I have reviewed in excess of 100 claims filed in the LBIE administration.
2. The purpose of this statement is to supplement and respond to the evidence relating to Issue 7 in Section F of the eleventh witness statement of Anthony Victor Lomas (*Lomas II*).
3. Terms capitalised but not otherwise defined have the meaning given to them in Lomas 11.

4. Save where I have indicated otherwise, the contents of this witness statement are matters within my personal knowledge and are true. Where matters are not within my own personal knowledge, I identify the source and I confirm that they are true to the best of my knowledge and belief.
5. Attached to this witness statement marked *AZ2* is an exhibit containing copies of the documents to which I refer below. Except where otherwise indicated, references to page numbers below are to pages of exhibit *AZ2*.
6. This statement is without prejudice to the Senior Creditor Group's position as to whether any particular claim is contingent or outstanding at any point in time or as to how any such claim should be quantified or valued for the purposes of admission to proof. Where in this statement I proceed on the basis that a particular claim may be contingent, I do so for the purpose of responding to Lomas 11 only. This statement should not be treated as acceptance by the Senior Creditor Group that such claims are to be regarded as contingent or as not being outstanding from the Date of Administration. For simplicity, where I discuss interest calculations I do not take into account the effect of the rule in *Bower v Marris*.

Introduction

7. Issue 7 concerns the date from which Statutory Interest is payable in respect of admitted provable debts which were contingent debts as at the Date of Administration. I understand that on Issue 7:
 - i. The Senior Creditor Group and York's position is that Statutory Interest runs from the Date of Administration.
 - ii. The JAs and Wentworth's position is that Statutory Interest runs only from the date on which a contingent debt became (according to the JAs) an "*actual debt*" (and was due and payable) or (according to Wentworth) ceased to be a contingent debt (and was due).
8. This statement is divided into two sections:

- i. The first section contains worked examples of contingent claims. These examples are designed to supplement and expand upon the example given in Section F of Lomas 11.
 - ii. The second section sets out six general factual points relating to Issue 7, illustrated by claims held or previously held by entities managed by CarVal. The evidence given is based on information held by CarVal. However, because CarVal owes duties of confidentiality in respect of LBIE claims held or formerly held by it, I have generally presented the examples on an anonymised basis, save where information is already in the public domain.
9. The examples upon which I focus in this statement are principally intended to reflect or illustrate claims arising pursuant to prime brokerage (*PB*) agreements between LBIE and creditors. This is for two reasons. First, I understand from my experience of reviewing claims against LBIE that a substantial number of claims against LBIE arise from PB agreements. Second, I understand from my experience of reviewing claims against LBIE that many PB agreements were closed out some time after the Date of Administration, or were not closed out at all pursuant to the terms of the relevant financial contract.¹ The JAs and Wentworth say that such claims were contingent claims prior to close out with the result, they say, that Statutory Interest does not run until such debts became due and payable or due. This is likely to have particularly significant consequences for creditors holding such claims.

Section I: Worked Examples

10. Lomas 11 at [42-43] gives an example of a hypothetical creditor with a claim that would have been worth £10m if the relevant financial contract had been closed out on the Date of Administration. The Lomas 11 creditor closed out his financial contract on 15 September 2012, when the close out amount was £12m.

¹ In this statement I use the expression “close out” to refer to the exercise of a formal termination right under an agreement such as a PB agreement.

11. Lomas 11 says that creditors may benefit from closing out financial contracts such as PB agreements after the Date of Administration, and implies that it might therefore be considered unfair for interest in respect of claims arising from such agreements to run from the Date of Administration.
12. In this section I explain that, in scenarios other than that described in Lomas 11, creditors do not benefit from (and indeed may suffer loss as a result of) closing out their financial contracts after the Date of Administration, which loss will be increased if interest in respect of claims arising from such agreements does not accrue from the Date of Administration.
13. I supplement the Lomas 11 example (the *Increased Creditor*) with the position of four other creditors, each with a general unsecured claim that would have been worth £10m if closed out on the Date of Administration. Although these creditors are hypothetical, they are based on my experience of reviewing claims against LBIE and are indicative of issues arising from real claims.
14. The situation of these creditors is presented, in so far as possible, in the same format as that used in Lomas 11 for the Increased Creditor. The calculations I have performed with respect to these scenarios are attached at page 1.
15. The first of these creditors (the *Benchmark Creditor*) closed out a PB agreement with LBIE on the Date of Administration. The value of the Benchmark Creditor's claim is £10m. With Statutory Interest from the Date of Administration of £4.8m, calculated on the same assumptions as used in Lomas 11, the Benchmark Creditor's overall recovery in respect of principal and interest is £14.8m, regardless as to whose argument succeeds on Issue 7.
16. The second creditor had its general unsecured claim under a PB agreement valued pursuant to the CRA (the *CRA Creditor*). This creditor acceded to the CRA on 31 January 2010. The value of the CRA Creditor's unsecured claim under the PB agreement (in respect of securities to which it had an unsecured claim) would have been £12m had the PB agreement been closed out as at 31 January 2010. However, under the CRA, the CRA Creditor's claim is valued

as at the business day before the Date of Administration, giving a claim of £10m. The position with respect to the CRA Creditor is that:

- i. If interest is only treated as accruing from the date of accession to the CRA, the CRA Creditor is entitled to Statutory Interest of only £3.7m, with an overall recovery of £13.7m (£1.1m less than the Benchmark Creditor, despite the fact that the CRA Creditor's claim has been valued on the same basis).²
 - ii. If interest accrues from the Date of Administration, the CRA Creditor is in the same position as the Benchmark Creditor.
17. The third creditor is the *Cash Creditor*. The value of the Cash Creditor's claim is an outstanding cash balance of £10m in its PB account³ in respect of which the Cash Creditor was a general unsecured creditor of LBIE. Like the Increased Creditor, the Cash Creditor closed out its PB agreement with LBIE on 15 September 2012. Unlike the Increased Creditor, this results in no change to the value of its claim. The position with respect to the Cash Creditor is that:
- i. If interest is only treated as accruing from the date of close out, the Cash Creditor is entitled to Statutory Interest of only £1.6m, and an overall recovery of £11.6m (£3.2m less than the Benchmark Creditor).
 - ii. If interest accrues from the Date of Administration, the Cash Creditor is in the same position as the Benchmark Creditor.
18. The fourth creditor is the *Decreased Creditor*. Like the Increased Creditor, the Decreased Creditor closed out its PB agreement with LBIE on 15 September 2012. Unlike the Increased Creditor, this results in a loss, because the value of the claim decreased from £10m to £8m. While such a decrease in the value of a claim is more likely for creditors who closed out in the early part of the Administration, a close out on 15 September 2012 is assumed here

² I assume for simplicity that valuations as at the Date of Administration and as at the business day before the Date of Administration were the same.

³ I have used PB accounts as an example, but the same issue would arise under any type of agreement pursuant to which a creditor has a general unsecured claim against LBIE for cash.

for ease of comparison with the Lomas 11 example.⁴ The position with respect to the Decreased Creditor is that:

- i. If interest is only treated as accruing from the date of close out, the Decreased Creditor is entitled to Statutory Interest of only £1.3m, and an overall recovery of £9.3m (£5.5m less than the Benchmark Creditor).
 - ii. If interest accrues from the Date of Administration, the Decreased Creditor is entitled to Statutory Interest of £3.8m (compared to the Benchmark Creditor's entitlement of £4.8m), and a total recovery of £11.8m (still £3m less than the Benchmark Creditor).
19. I make the following additional observations with regard to the examples set out above:
- i. The Benchmark Creditor's and the CRA Creditor's claims against LBIE share the same underlying economics as at the Date of Administration. However, if interest runs from the date of close out, the CRA creditor is worse off than the Benchmark Creditor by £1.1m.
 - ii. The Decreased Creditor, if interest runs from the date of close out, is worse off in three respects when compared to the Benchmark Creditor. First, the Decreased Creditor suffers a reduction of £2m in the close out value due to the late close out. Secondly, Statutory Interest would not accrue at all on the amount by which the value of the close out amount fell. Thirdly, Statutory Interest would not accrue until the date of close out.
 - iii. More generally, if interest runs from the date of close out, all Creditors in the examples are worse off than the Benchmark Creditor. Only the Increased Creditor will benefit from having a higher claim. Even the Increased Creditor in the example given in Lomas 11 will, as Lomas 11 acknowledges, receive a lower total recovery where its claim is

⁴ I expand below on the circumstances in which the value of a claim might decrease as a result of closing out after the Date of Administration.

valued on and Statutory Interest accrues from the date of close out than it would have received where its claim is valued on and Statutory Interest accrues from the Date of Administration.

20. When considering the practical effect of the various possible approaches to when interest accrues on claims, the illustrations should reflect the position of all creditors affected by the question, including those who have been substantially disadvantaged as a result of closing out after the Date of Administration, and not solely creditors in the position of the Increased Creditor.

Section II: General Factual Observations

21. In the paragraphs which follow, I set out six factual matters which may be relevant when considering the practical effect of the various possible approaches to when interest accrues on claims.⁵
- i. First, I explain why a creditor (like the Decreased Creditor) who has closed out a PB agreement after the Date of Administration may have crystallised a smaller, rather than a larger, claim against LBIE as a result.
 - ii. Second, I explain that in many cases a creditor who declined to close out, or delayed in closing out, a PB agreement after the Date of Administration did so to avoid potentially prejudicing a proprietary claim for the return of assets by LBIE while awaiting confirmation from LBIE as to whether assets held in its PB account had been rehypothecated, rather than in the hope or expectation of benefiting from a fluctuation in the value of its claim.
 - iii. Third, I explain why, in many cases, creditors pursuant to PB agreements (both those who closed out a PB agreement after the Date of Administration and those who did not do so) had a contractual claim

⁵ Certain of these matters may be relevant to claims arising from forms of agreements entered into by LBIE other than PB agreements (such as, for example, GMSLA agreements, Securities Lending agreements or Master Custody agreements) pursuant to which LBIE had obligations to return assets to counterparties on demand or to deliver assets to counterparties on particular dates.

for breach of contract against LBIE as at the Date of Administration, or shortly thereafter.

- iv. Fourth, I explain that some creditors had substantial cash balances in prime brokerage or other accounts, which LBIE was able to use from the Date of Administration regardless as to whether the relevant agreements were closed out.
- v. Fifth, I explain that under the CRA certain assets in respect of which clients held general unsecured claims were valued as at the last business day before the Date of Administration, taking no account of increases in market value or of corporate actions (including dividend or coupon payments) in respect of assets after that date.
- vi. Finally, I explain that under the CRA interest on a Net Financial Liability owed to LBIE by a creditor determined pursuant to the CRA was required to be paid by the creditor from the Date of Administration.

Effect of Closing Out After the Date of Administration on Quantum of Claims

22. The example given in Lomas 11 at [42] refers to a creditor who closed out a claim on 15 September 2012 and whose claim increased in value between the Date of Administration and 15 September 2012, due to (for instance) the impact of the creditor's entitlements in respect of coupon and dividend payments that accrued between the Date of Administration and 15 September 2012.
23. I note that markets for assets generally fell between the Date of Administration and mid-March 2009, as illustrated by the charts attached at pages 2-4, which show the performance of the S&P and FTSE indices during this period.
24. I cannot comment on the economics of each claim against the LBIE estate. However, I am aware of several claims where a close out after the Date of Administration resulted in a valuation lower than it would have been had the relevant contract been closed out on the Date of Administration.

25. The Court should not therefore proceed (as Lomas 11 might be taken to suggest) on the premise that creditors who closed out a PB agreement after the Date of Administration, or who did not close out at all pursuant to the terms of the relevant financial contract, have as a result generally increased the quantum of their claims against LBIE. In many cases, the position is likely to be the contrary.

Reason for Not Closing Out

26. I am unable to comment on why each LBIE creditor chose to close out agreements with LBIE when they did.
27. However, when LBIE entered administration many creditors with claims arising from PB agreements were concerned simply to secure the return of the assets in their PB accounts, and to avoid taking steps that might prejudice their position. I am aware of this from my experience in reviewing claims, from press reports referring to steps taken by creditors seeking the return of assets, and from applications made to the Court by certain creditors seeking orders against LBIE with respect to their assets.⁶
28. I attach an example of a LBIE PB agreement (the *IPBA (Charge) Agreement*), at pages 5-54. The Witness Statement of David Philip Ereira dated 14 July 2009 (*Ereira 2*) states at [21] that most PB agreements entered into by LBIE took this form. Ereira 2 explains in detail at [21-28] the rights of each party under the PB agreements used by LBIE.⁷ Broadly, a creditor of LBIE with an IPBA (Charge) Agreement had a proprietary right to securities in its PB securities accounts which had not been rehypothecated by LBIE. However, if LBIE had exercised its right of rehypothecation under a IPBA (Charge) Agreement, the proprietary right to the rehypothecated assets was

⁶ See for example *RAB Capital Plc & RAB Capital Market (Master) Fund v Lehman Brothers International (Europe)* [2008] EWHC 2335 (22 September 2008). This was an application by RAB Capital to list an application for the return of RAB's assets. The listing application was rejected by the Court. See also *Four Private Investment Funds v Lomas et al* [2008] EWHC 2869 (24 November 2008), where the four funds applied for an order that the JAs provide information in respect of the funds' securities held by LBIE. The application was refused.

⁷ I focus here on the IPBA (Charge) Agreement, but similar issues may arise under other agreements conferring proprietary rights to assets on creditors, such as Master Custody agreements.

(arguably) lost, leaving the client with contractual rights against LBIE (including a contractual right to require the return of its assets).

29. For many months following the Date of Administration, the JAs were unable to inform creditors with assets in accounts governed by IPBA (Charge) Agreements whether or not their securities had been rehypothecated (Ereira 2 [56-63]). If such creditors closed out their IPBA (Charge) Agreements when there was a prospect that their assets had not been rehypothecated they risked crystallising an unsecured claim against the LBIE estate and losing any proprietary claim they might have to securities which had not been rehypothecated. The absence of information made it very difficult for creditors to decide on the best or most prudent course regarding close-out.
30. Exchanging a potential proprietary claim for an unsecured claim was an extremely unattractive option in circumstances where:
- i. First, if a proprietary claim could be established there was a prospect of securing the return of the securities⁸ to the creditor, who could then retain them or monetise them for their full market value.
 - ii. Second, for a considerable period following LBIE's entry into administration, creditors who gave up their proprietary rights in exchange for a crystallised unsecured claim faced the prospect of a very significant shortfall. Creditors during 2008 and 2009 were anticipating that LBIE would pay unsecured claims only at a very substantial discount to their value. The JAs did not give any projections of likely recoveries for creditors until April 2011, when their 5th Progress Report gave an indicative recovery range of 52p to 83p in the pound. The Progress Reports did not project a possible surplus until March 2013.
 - iii. Third, it was likely that there would be a lengthy delay in the payment of general unsecured claims. I note that, based on the claims I have

⁸ Although proprietary rights to cash did not generally arise under standard form IPBA (Charge) Agreements, client money claims (i.e. proprietary claims) in respect of cash balances could arise under other types of agreements.

handled, LBIE made payments in respect of proprietary claims before it started making distributions to general unsecured creditors.

31. Therefore, in the early days of the LBIE Administration, although I cannot give evidence as to individual creditors' motivations, it was logical for creditors to wait to obtain confirmation from LBIE as to whether their assets had been rehypothecated before closing out IPBA (Charge) Agreements and thereby crystallising claims which might be treated as unsecured creditor claims. In such circumstances, the reason creditors waited to close out in many cases was likely to be LBIE's inability to identify in a timely fashion whether or not assets deposited with it by clients had been rehypothecated, rather than an attempt by creditors to game fluctuations in the market or benefit from the accrual of receipts such as dividend or coupon payments in order potentially to increase the quantum of their claims.

Claims Arising On or Shortly After Date of Administration

32. In many cases, creditors pursuant to PB agreements (both those who subsequently closed out a PB agreement after the Date of Administration and those who did not) had a contractual claim for breach of contract against LBIE as at the Date of Administration, or shortly thereafter.
33. The IPBA (Charge) Agreement provided amongst other things that:
- i. Securities held in the customer's PB securities account were held for the customer by LBIE as custodian, unless LBIE had exercised its right to transfer those securities to itself for its own use (a process known as rehypothecation) (see clauses 17 and 11).
 - ii. Cash held in the customer's PB cash account represented a claim in respect of which the customer was a general creditor of LBIE (see clause 5.2).
 - iii. LBIE was required, on reasonable request by the customer, to repay to the customer cash or securities equivalent to those in its accounts subject to certain exceptions (for example, where the payment would result in a deficit under the margining arrangements applicable to the

accounts) (see clause 7). Where securities requested by the customer had been rehypothecated LBIE might, pending delivery by it of equivalent securities, pay cash into the customer's PB cash account when payment of equivalent securities was due, then debit that cash once equivalent securities had been paid (see clause 11.4 and 11.5).

- iv. Where an Event of Default occurred (including where an Act of Insolvency occurred with respect to LBIE and a Default Notice was served by the customer), the non-defaulting party might terminate the agreement with effect from the time of the Event of Default (see clause 13.1). Upon such termination, clause 13 provided a mechanism for the determination of a close out sum.
34. It is my understanding that from its entry into administration, LBIE was unable to fulfil its contractual obligations, in particular its obligation to deliver cash and securities to PB clients when requested to do so. My understanding is derived in particular from public statements LBIE made to the effect that it was not in a position to fulfil its contractual obligations, including in *Ereira 2* and in the First Witness Statement of Steven Anthony Pearson, dated 6 October 2008 (*Pearson 1*). I understand that LBIE's entry into administration may therefore have itself constituted an anticipatory repudiatory breach of contract by LBIE.
35. After LBIE entered administration, many creditors holding assets in prime brokerage accounts requested, as they were contractually entitled to do pursuant to the provisions described at paragraph 33.iii above, that LBIE return those assets to them. *Pearson 1* explains at [10] that "*since the appointment [of the JAs] we have received many claims from LBIE's counterparties ... the majority of those counterparties which have made claims have sought the return of monies and/or assets which they believe LBIE holds on their behalf*"⁹. It may be the case that other creditors who would have

⁹ I note that, during the early period of the LBIE administration, in my experience the JAs generally referred to assets in respect of which there were creditor claims as 'trust' assets or as assets 'held on behalf of creditors' whether or not creditors had proprietary (as opposed to contractual) claims to the assets. My understanding is that this reflected the JAs' uncertainty as to whether assets had been rehypothecated, and thus as to whether creditors' claims were proprietary or contractual in character.

requested the return of their assets did not do so as a consequence of LBIE's public statements about its inability to deliver assets in response to such requests.

36. Where LBIE failed to pay cash or deliver securities to PB customers in response to requests for payment or delivery, that failure constituted a breach of contract.
37. In some cases, I believe creditors have had a claim for breach of contract against LBIE arising on such a basis admitted. For example, I am aware of at least one claim which was asserted against LBIE not on the basis of a contractual close out or pursuant to the CRA but rather on the basis of breach of contract by LBIE in failing to deliver assets to the creditor.¹⁰
38. In other cases, creditors may have formally closed out contracts with LBIE after causes of action for breach of contract had accrued. For example, the original holder of a claim now held by CarVal contacted LBIE on 18 September 2008 and again on 20 September 2008 requesting the return of its assets. Only after these requests were not complied with did the creditor commence the formal close out process.
39. If the JAs' and Wentworth's position on Issue 7 is correct, it would appear that creditors will not receive Statutory Interest for periods of time after the Date of Administration (but before any formal close out) during which LBIE was failing to perform its contractual obligations to those creditors (including its obligations to deliver securities or cash) and the creditors therefore had an outstanding claim against LBIE for breach of contract.

Creditors' Pre-Close Out Cash Balances

40. I am aware from claims I have handled that some creditors held significant cash balances in accounts held with LBIE from the Date of Administration.

¹⁰ This claim arose under a securities lending arrangement, rather than a PB relationship.

41. LBIE had the benefit of, and was able to invest (or otherwise use) the cash credited to cash accounts during the period from the Date of Administration until the date of the formal close out of the relevant agreements.
42. The effect of the JAs' and Wentworth's position on Issue 7 appears to be that creditors will not receive Statutory Interest for periods of time after the Date of Administration during which LBIE was able to use cash held in cash accounts.

Valuation of Assets under the CRA

43. Lomas 11 explains at [36] that claims to Net Financial Claims (as defined in the CRA) as crystallised by the CRA constitute one of the two categories of claims treated as contingent by the JAs. Lomas 11 goes on to say at [41] that if Statutory Interest is payable on contingent claims from the Date of Administration, creditors could potentially receive both Statutory Interest and the benefit of a higher claim amount.
44. I believe that this is incorrect with respect to Net Financial Claims in so far as they relate to rehypothecated securities or short positions, cash (given that no post-Date of Administration interest is provable), or non-proprietary claims to assets valued under the CRA after the Date of Administration that depreciated in value after the Date of Administration.
45. Unsecured claims in respect of rehypothecated securities held pursuant to a PB agreement or short positions were not valued by the JAs by reference to the value of the assets on a date on or after the creditor's accession to the CRA (or on the date of close out of the PB agreement, where such close out had occurred). Rather, in accordance with clause 20.4.3 of the CRA, they were valued as at the last business day before the Date of Administration (namely 12 September 2008). The Circular that accompanied the proposal of the CRA to creditors (attached at pages 55-91) explained at I-15 that the rationale for valuing rehypothecated long positions as of that date was that LBIE used the value of the rehypothecated long positions to obtain financing that was then provided to clients as margin debt.

46. The Close Out Amount (as defined in the CRA) in respect of such claims was calculated taking no account of payment or delivery obligations of LBIE (including interest payment obligations) which became payable or deliverable on or after the Date of Administration (see clause 20.4.3 (ii) and clause 20.4.7 of the CRA). This meant that unsecured claims in respect of rehypothecated securities or cash were valued without reference to increases in the market value of such securities, dividend or coupon payments received in respect of such securities, or interest accrued in respect of such cash, after the Date of Administration but before the date of the creditor's accession to the CRA.
47. It is therefore clear that PB claims subject to the CRA that relate to rehypothecated securities, short positions or cash do not raise the issue identified by the example given by Mr Lomas in paragraph [42]. On the contrary, if Statutory Interest does not begin to run until the date of accession to the CRA, but the claim value is determined by reference to the value on 12 September 2008, certain creditors will:
- i. not be compensated for the time value of money between those two dates by an award of interest; and
 - ii. not receive any uplift in value of their assets between those two dates.

Interest on Net Financial Liabilities under the CRA

48. Finally, I note that pursuant to clause 25.2 of the CRA, interest on a Net Financial Liability owed to LBIE by a creditor determined pursuant to the CRA was required to be paid by the creditor from the Date of Administration. However, as I understand it, Wentworth's position is that LBIE would not be required to pay interest to a creditor from the Date of Administration in respect of a Net Financial Claim owed to a creditor by LBIE.

Statement of Truth

I believe that the facts stated in this witness statement are true.

Signed 

Andrea Zambelli

Dated 22 December 2014

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**SECOND WITNESS STATEMENT OF
ANDREA ZAMBELLI**



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