



Party: Applicant
Witness: Anthony Victor Lomas
Statement No: 12
Exhibit: "AVL12"
Date: 20 August 2015

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

No. 7942 of 2008

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

TWELFTH WITNESS STATEMENT
OF
ANTHONY VICTOR LOMAS

I, **Anthony Victor Lomas**, of PricewaterhouseCoopers LLP ("**PwC**") of 7 More London Riverside, London, SE1 2RT, say as follows:

- 1 I am a Partner in the firm of PwC of the above address and am one of the joint administrators (the "**Joint Administrators**") of Lehman Brothers International (Europe) (in administration) ("**LBIE**"). I am authorised to make this witness statement on behalf of the Joint Administrators.
- 2 I make this witness statement in relation to the amended application for directions issued on 13 May 2015 on behalf of the Joint Administrators pursuant to paragraph 63 of Schedule B1 to the Insolvency Act 1986 (the "**Application**").
- 3 There is now produced and shown to me marked "**AVL12**" a paginated bundle of documents, to which I shall refer. Save where otherwise stated, page references in this witness statement are to the contents of this exhibit. References to a "Rule" are to a

provision of the Insolvency Rules 1986, as amended. Terms capitalised but not otherwise defined have the meaning given to them in the Application.

- 4 Save where otherwise stated, this witness statement is made from facts and matters that are within my own knowledge. The financial information and analysis, including the examples and illustrations, in this witness statement and in the annex in Exhibit AVL12 have been prepared by the staff working for the Joint Administrators on the LBIE administration.

Background to this witness statement

- 5 The Joint Administrators estimated, as at 14 March 2015, that the surplus funds likely to be available in the LBIE estate after payment in full of the senior creditors' proved debts were in the range of £6.01bn to £7.59bn (the "**Surplus**") (see the Joint Administrators' Thirteenth Progress Report for the period from 15 September 2014 to 14 March 2015 at pages 21 to 72 of AVL12).
- 6 The Insolvency Rules 1986 provide at Rule 2.88(7) that any surplus remaining after payment of debts proved shall, before being applied for any other purpose, be applied in paying statutory interest on those debts in respect of the periods during which they have been outstanding since the relevant date ("**Statutory Interest**").
- 7 Rules 2.88(9) and 2.88(6), taken together, provide the rate at which Statutory Interest is to be paid. Statutory Interest is payable at:
- 7.1 the rate pursuant to the Judgments Act 1838 (8% for the period relevant to the Application, the "**Judgments Act Rate**"); or
- 7.2 the "*rate applicable to the debt apart from the administration*" if it is higher.
- 8 A significant proportion of LBIE's debts arise under the 1992 and 2002 editions of the ISDA Master Agreement (each an "**ISDA Master Agreement**"). There are 854 creditors holding admitted claims in the LBIE estate part or all of which arise under an ISDA Master Agreement or associated Long Form Confirmation (the "**LBIE ISDA Creditors**"). These claims of the LBIE ISDA Creditors (each an "**ISDA Claim**") represent approximately £4.4bn of £12.2bn of LBIE's total admitted claims, subject to operation of set off within a minority of those claims. Based on claims and assignments notified to the Joint Administrators, the First to Fourth and Sixth Respondents hold approximately 65% of the ISDA Claims, with approximately £1.1bn being held by the First to Third Respondents collectively (the "**Senior Creditor Group**"), approximately £1.6bn by the Fourth Respondent ("**Wentworth**") and approximately £0.1bn by the Sixth Respondent ("**Goldman Sachs International**"). The Fifth Respondent is not actively participating in this part of the Application. Further references in this witness statement to the Respondents do not

include reference to the Fifth Respondent. In addition to its ISDA Claims, Wentworth also holds the entirety of the subordinated debt owed by LBIE in an amount over £1.25bn.

- 9 Issues 11 to 13 and 27 (the “**Default Rate Issues**”) concern the proper construction and effect of the contractual right to interest under ISDA Master Agreements which provide that, in the event that a party defaults in the performance of a payment obligation, it will be required to pay interest on the overdue amount at the Default Rate (“**Default Interest**”). The Default Rate is defined in ISDA Master Agreements as “*a rate per annum equal to 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 plus 1% per annum*”. The Default Rate is considered to be a “*rate applicable to the debt apart from the administration*” for the purposes of Rule 2.88(9).
- 10 The LBIE ISDA Creditors contend for different constructions of the Default Rate and until the correct construction of the Default Rate is determined by the Court, the likely quantum of claims to Default Interest in respect of ISDA Claims remains unclear. Some LBIE ISDA Creditors contend that they can establish claims to Default Interest at rates significantly in excess of the Judgments Act Rate. Such claims would, depending on their quantum, have the potential to increase LBIE’s liability for Statutory Interest significantly.
- 11 The Court’s determination of the correct construction of Default Rate will set the parameters in accordance with which the LBIE ISDA Creditors may certify their cost of funding for the purposes of establishing a claim for Statutory Interest. Should it be determined that a creditor’s certification may include any cost (to the extent that such cost exists) in raising equity finance (as distinct from debt finance), or that certain approaches to calculating the cost of borrowing are permissible as a matter of principle (in accordance with either the Senior Creditor Group’s or Goldman Sachs International’s construction), Statutory Interest may be due at a rate significantly in excess of the Judgments Act Rate. Alternatively, should it be determined that a creditor’s certification must be limited to the lowest cost of funding available to a counterparty (in accordance with Wentworth’s construction), it is likely that all or the substantial majority of the claimants in respect of Default Interest in respect of ISDA Claims will certify a cost of funding of lower than the Judgments Act Rate. For illustrative purposes, should the ISDA Claims of the LBIE ISDA Creditors be awarded Statutory Interest at the Judgments Act Rate of 8% simple, total liability for Statutory Interest payable in respect of the ISDA Claims will be approximately £1.7bn, accruing from 15 September 2008. The Joint Administrators estimate that, should all LBIE ISDA Creditors certify their Default Rate to be 8%, 12% or 18% compound, the total Statutory Interest entitlement of these creditors would be approximately £2.1bn, £3.7bn and £6.8bn respectively.
- 12 It follows that the Court’s determination of the Default Rate Issues will impact significantly on the potential extent of the LBIE estate’s liability for Statutory Interest which will in turn

have a consequential effect in respect of the amounts that will ultimately be available for non-provable claims including currency conversion claims, which rank behind the payment of Statutory Interest.

- 13 The Joint Administrators have considered making interim distributions to creditors of the LBIE estate on account of their Statutory Interest entitlement but cannot do so, in part because, pending the outcome of the Default Rate Issues, the Joint Administrators cannot accurately calculate the maximum value of claims to Statutory Interest. Reserving in respect of the maximum potential amount of such claims, without resolution of the Default Rate Issues, would result in only a *de minimis* amount being available from the surplus for distribution.

The Joint Administrators' position paper and the purpose of the annex to this witness statement


- 14 The Joint Administrators had not previously developed a position in respect of the Default Rate Issues but, having reviewed the stated positions of the Respondents, the Joint Administrators believe it is now necessary to do so. The Joint Administrators believe there are alternative approaches and arguments as to the correct construction of Default Rate which are not presently being presented to the Court or are not being fully developed or explained by the Respondents. Consistent with the approach adopted in earlier hearings, in these circumstances, the Joint Administrators consider it necessary to develop such positions for the Court.
- 15 In particular, there are a wide range of approaches a LBIE ISDA Creditor might use when certifying its Default Rate, even where this is limited to a cost of borrowing, and in the evidence that is required in support of the certifications.
- 16 In order to assist the Court, the Joint Administrators' team has conducted an analysis of some of the possible approaches to performing a Default Rate calculation by using some of the methodologies the permissibility of which is now before the Court. This analysis is described in the Annex to this Witness Statement at pages 1 to 20 of AVL12 (the "**Annex**"). The Annex is intended to assist in the illustration of some of the more significant practical implications of adopting particular methodologies, including the associated impact this might have on the LBIE estate's liability for Statutory Interest and the Joint Administrators' distribution of the Surplus. The Annex analyses a number of approaches which the Joint Administrators believe might be adopted by LBIE ISDA Creditors when calculating their respective cost of borrowing for the purposes of their Default Rate certifications (each a "**Scenario**"). The impact of each Scenario has been modelled by reference to five anonymised LBIE ISDA Creditors (each an "**Example Counterparty**"). The analysis illustrates a range of potential Default Rates which each Example Counterparty might seek to certify, should it calculate its cost of borrowing using the approach modelled in each

Scenario. The analysis in the Annex is intended to be illustrative only. The Court is not being asked to make any decision in relation to any of the Example Counterparties.

STATEMENT OF TRUTH

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

Dated 20 August 2015



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Anthony Victor Lomas

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