IN THE COURT OF APPEAL **Appeal Refs: 2016/4213; 2016/4216; 2017/0043**

ON APPEAL FROM THE HIGH COURT

CHANCERY DIVISION

COMPANIES COURT

DAVID RICHARDS LJ [2016] EWHC 2131 (Ch) ("Supplement Judgment")

HILDYARD J [2016] EWHC 2417 (Ch) ("Waterfall IIC Judgment")

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

B E T W E E N

(1) WENTWORTH SONS SUB-DEBT S.A.R.L.

(2) YORK GLOBAL FINANCE BDH, LLC

Appellants

- and -

(1) ANTONY VICTOR LOMAS

(2) STEVEN ANTHONY PEARSON

(3) PAUL DAVID COPLEY

(4) RUSSELL DOWNS

(5) JULIAN GUY PARR

(THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION))

(6) BURLINGTON LOAN MANAGEMENT LIMITED

(7) CVI GVF (LUX) MASTER S.A.R.L.

(8) HUTCHINSON INVESTORS, LLC

Respondents

SUPPLEMENTAL ISSUES 1(A), 2, 3 AND 5
SENIOR CREDITOR GROUP'S REPLY SUBMISSIONS

A. INTRODUCTION

1. This skeleton argument is filed on behalf of the Senior Creditor Group in reply to the submissions filed by York (in respect of Supplemental Issues 1(a) and 2) and Wentworth (in respect of Supplemental Issues 3 and 5). It assumes that the Court is familiar with the main issues raised on the various appeals, and is intended to be read after the skeleton arguments filed by the parties in support of the appeals.

B. SUPPLEMENTAL ISSUE 1(A)

> "*Whether, and in what circumstances, the words 'the rate applicable to the debt apart from the administration' in Rule 2.88(9) of the Rules include, in the case of a provable debt that is a close out sum under a contract, a contractual rate of interest that began to accrue only after the close-out sum became due and payable due to action taken by the creditor after the Date of the Administration.*"

2. This issue arises out of David Richards LJ's determination (Issue 4/Declaration (x)) that the interest rate applicable to a hypothetical judgment or actual judgment obtained after the Date of Administration cannot be a rate applicable to the debt for the purpose of Rule 2.88. The Senior Creditor Group is appealing that aspect of the *Waterfall IIA* decision (and these submissions are made without prejudice to the Senior Creditor's position on Issue 4)[1], but maintains that Hildyard J's decision on Supplemental Issue 1(a) was in any event correct: provided that the relevant rate of interest is one to which a creditor had an existing contractual entitlement (whether contingent or otherwise) as at the Date of Administration, it can be the applicable rate for the purpose of Rule 2.88. [A1/3/4] [A2/19/13]

3. Supplemental Issue 1(a) is in practice concerned with whether contractual interest rates, in particular the Default Rate accruing on close out sums arising under the 1992 and 2002 ISDA Master Agreements (the "**Master Agreements**")[2], are a

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1 If that appeal succeeds, the Senior Creditor Group agrees with York (see paragraphs 35-38 of York's skeleton argument concerning Supplemental Issue 1(a) ("**York 1(a) Submissions**")) that the answer to Supplemental Issue 1(a) is as set out herein, albeit for different reasons (see the Senior Creditor Group's appeal submissions on Issue 4 at [50] and [51]). [A2/19/12] [A1/12/24]

2 The Senior Creditor Group has focussed in this Skeleton Argument on the ISDA Master Agreements, as they are most relevant master agreements in the LBIE administration

"*rate applicable to the debt apart from the administration*" within the meaning of Rule 2.88(9). The issue proceeds (see the *Waterfall IIC Judgment* at [480(6) and (7)]) on the basis that: [A2/2/122]

(1) Both the right to the close-out sum, and the right to interest on that close-out sum, were rights under a pre-administration contract which existed (and were binding on LBIE) as at the Date of Administration; and

(2) There exists a pre-condition to the running of contractual interest which is not satisfied until after the Date of Administration (the fulfilment of which may involve action by the creditor, but could equally involve action by a third party or an event which occurs automatically, such as automatic termination following an event of default or the effluxion of a specified period of time).

4. Whether or not Issue 4 was correctly determined, the Senior Creditor Group seeks to uphold the Judge's conclusion that such contractual interest rates are a "*rate applicable to the debt apart from the administration"* within the meaning of Rule 2.88(9) for the reasons that he gave: see the *Waterfall IIC* Judgment at [453]-[529]. [A2/1/14-15] As the Judge accepted, his conclusion follows from and is supported by (i) the terms of relevant provisions in the Master Agreements; (ii) the Court's determination of Issues 6 – 8 in *Re Lehman Brothers International (Europe) (In administration)* [2015] EWHC 2269 (Ch) ("Waterfall IIA"), and (iii) the language of Rule 2.88(9).

The prospective or contingent nature of the debt arising under the Master Agreements

5. For current purposes, the effect of the relevant provisions of the Master Agreements is the same whether focussing on the 1992 or 2002 ISDA Master

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and for the purpose of this appeal. However, the same analysis applies to the French Master Agreements. The position in relation to the German Master Agreements will be addressed separately in the appeal to be heard in connection with Part C. These submissions do not address interest claims under other agreements (such as, for example, prime brokerage agreements) where different issues may arise.

[A2/24/5]
[A2/25/5]
[A2/2/119
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Agreement (see Sections 5 and 6 thereof, and the summary of the relevant provisions at [478] and [479] of the Judgment). As a consequence:

(1) Where Automatic Early Termination has been specified in the Schedule to a Master Agreement, any early termination amount owed to the Non-defaulting Party is a future debt as at the date of administration (since it is due but only becomes payable once a calculation statement has been provided[3]).

(2) Where no Automatic Early Termination has been specified, any early termination amount owed to the Non-defaulting party is a contingent debt as at the date of administration (since it only becomes due if and when an Early Termination Date is specified and, thereafter, is only payable once a calculation statement has been provided).

6. In either case, the early termination amounts arise from rights under a pre-administration contract which existed (and were binding on LBIE) as at the Date of Administration. They are provable in LBIE's administration[4] and accrue interest from the date of LBIE's administration at the higher of the Judgments Act Rate and the Default Rate (being the rate applicable to such early termination amounts apart from the administration)[5].

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3 The distinction between monies becoming due and payable for the purpose of the Master Agreements has been repeatedly recognised by the Court of Appeal: see, for example, *Videocon Global Ltd v Goldman Sachs Int* [2016] EWCA Civ 130 at [53]-[57].

4 Being a debt or liability to which LBIE may become subject after the Date of Administration by reason of a contractual obligation incurred before that date: see Rule 13.12(1)(b) of the Rules. To this end, Mr Justice Briggs held in *Anthracite Rated Investments (Jersey) v Lehman Brothers Finance* [2011] 2 Lloyd's Rep 538 at [122] that *"[T]he provisions of Section 6(e) of the Master Agreements … gave the issuers distinct contractual rights to contingent early close-out payments from LBF"*. It is a question of fact whether or not a proof submitted by such a Non-defaulting Party relates to its rights in respect of the early termination amount owed under Section 6(e) or its rights to payment / delivery under open transactions together with any Unpaid Amounts (albeit one that should be readily determinable by reference to whether or not an Early Termination Notice has been given).

5 Whether the debt is a future or contingent debt (see above), in order to submit a proof of debt in respect of an early termination amount, in practice a calculation statement will usually have been provided and (where necessary) an Early Termination Date will need to have been designated. In other words, by the time a proof of debt is submitted, the debt will be neither contingent nor future.

Issues 6-8

7. This conclusion follows from the *Waterfall IIA* decision and determination of Issues 6-8, namely:

   (1) Whether in relation to contingent and future debts, interest under Rule 2.88(7) and (9) at the Judgments Act Rate is calculated from the date of administration or the date that the contingent debt ceased to be subject to a contingency or the future debt became payable (Issue 7-8); and

   (2) Whether in relation to contingent and future debts, the "*rate applicable to the debt apart from the administration"* is calculated from the commencement of administration or from the date that the contingent debt ceased to be subject to a contingency or the future debt became payable (Issue 6).

8. David Richards J held in respect of such issues that "*in the case of both future and contingent debts, interest is payable under rule 2.88(7) from the date that the company entered into administration, not from the date (if any) on which any such debt fell due for payment in accordance with its terms. The parties are agreed that it follows that the comparison under Issue 6 is between judgment rate and the rate applicable apart from the administration, in each case from the date of administration"* (at [225]) (emphasis added).[6] [A1/2/55]

9. The Default Rate applicable to any early termination amount owed to a Non-defaulting Party is therefore "*the rate applicable to the debt apart from the administration"*, since the creditor had an existing contractual right to payment of interest at the Default Rate at the time when the administration commenced. This right to interest was an existing right, forming part of the rights and obligations of the parties under their contract, applicable in respect of any future or contingent debt as from the point at which the debt became due. The "*rate*

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[6] This determination was supplemented by the Judge's later decision in respect of Supplemental Issue 1(c), where he held that, in a case where contractual interest first starts to run on a proved debt at some point after the Date of Administration, the "*rate applicable to the debt apart from the administration*" for the purposes of Rule 2.88(9) is zero from the Date of Administration to the date when contractual interest first starts to run. In other words, although interest at such a rate has to be calculated from the Date of Administration for the purposes of comparison with the Judgment Act Rate, it will be calculated at zero until it starts to run. No party is appealing in respect of that decision.

applicable to the debt apart from the administration" is, in the case of future and contingent debts, the rate (if any) which applies to such debts when they become due and payable.

The Judge's analysis

10. The Judge's analysis of Supplemental Issue 1(a) was consistent with the above (see [525] of the *Waterfall IIC Judgment*). None of York's arguments on this appeal demonstrates any error. [A2/2/132]

11. First, as a matter of language, Rule 2.88(7) requires the identification of the rate of interest applicable to a debt apart from the administration. David Richards J concluded at [115] of the *Waterfall IIB Judgment* that that language "*directs attention to the contractual entitlement of the creditor if there were no administration*". On the assumption that the Court's decision on Issue 4 was right, it is necessary therefore to identify the rate of interest applicable by virtue of existing contractual (or statutory) entitlements which would be payable on the debt apart from the administration. That is the rate "*in fact*" applicable (*Waterfall IIA Judgment* at [177]). [B1/2/28] [A1/2/43]

12. The word accruing is not used in Rule 2.88(7) and, contrary to York's 1(a) Submissions at [29], the ordinary meaning of the language "*the rate applicable to the debt*" does not require there to be a rate of interest "*already accruing on the relevant debt*". Such an approach would either require the addition of language to the rule, or would be an unjustifiably narrow interpretation of the language used. It is not supported by the reference in the White Paper preceding the introduction of Rule 2.88 (see York's 1(a) Submissions at [20]): the use of the word "*applies*" is equally consistent with an applicable contingent or future right to interest based on existing contractual rights as it is to a presently accrued right to interest. The fact that future and contingent debts are provable under the Rules suggests that any future or contingent right to interest based on an existing contractual entitlement should be treated as an applicable rate for the purpose of Rule 2.88(9). [A2/19/10] [A2/19/5]

13. Secondly, David Richards J's decision in respect of Issue 4 does not mandate an alternative conclusion. In this regard, the central dispute of substance between

the parties at first instance (and on this appeal) in respect of Issue 4 was correctly recognised by the Judge in the *Waterfall IIC Judgment* at [517] as being: [A2/2/130]

> *"…whether or not there is a meaningful distinction for present purposes between, on the one hand, a rate of interest the entitlement to which arises by virtue of a judgment obtained after the date of administration, and, on the other hand, a rate of interest prescribed by contract as applicable to a contractual entitlement contingently or prospectively available to a non-defaulting party but which has not been triggered prior to the date of administration and which cannot be crystallised and/or quantified without further action by that non-defaulting party after that date (for example, by designating an Early Termination Date and/or then taking steps to establish a particular rate of interest)."*

14. Assuming that David Richard's analysis in respect of Issue 4 is upheld, the Judge's conclusion that there is such a distinction for the purpose of Rule 2.88(7) (see [518]-[521] of the *Waterfall IIC Judgment*) would be correct: [A2/2/131]

(1) Issue 4 was not concerned with future or contingent contractual rights to interest applicable to future or contingent contractual debts. It was concerned with rights to foreign judgment rate interest in respect of a hypothetical judgment which the creditor had not obtained by the date of the administration and may never have obtained (see *Waterfall IIA Judgment* at [173] and [243(iv)]). In other words, in Issue 4 the court was being asked to consider whether the "*rate applicable to the debt apart from the administration"* could be determined not only by reference to a creditor's existing contractual or other rights to interest (or other compensation for delayed payment) as at the commencement of the administration, but also by reference to any rights which the creditor could have acquired, or did in fact acquire, pursuant to (and solely by virtue of) a judgment obtained *after* the date of administration; [A1/2/42]

(2) It was in this context (and not in the context of contractual or other rights to interest with an existing legal foundation) that David Richards J held that "*The words "the rate applicable to the debt apart from the administration" cannot be read as including a hypothetical rate which would be applicable to a debt if the creditor took certain steps*" but that "*the rate applicable to the debt apart from the administration is to be determined by reference to the rights of the creditor as at the commencement of the administration*": *Waterfall IIA Judgment* at [177] and [181]; [A1/2/43]

(3) [16]-[19] of York's 1(a) Submissions take the reference to "*rights*" of the creditor in the *Waterfall IIA Judgment* at [180] and [181], and suggest (without any justification) that they must mean "*present and accrued rights of the creditor to receive interest on the relevant debt*." But that is not what David Richards J said, nor an appropriate interpretation of the reference to "*rights*". The only logical and necessary distinction drawn by David Richards J in the context of Issue 4 is between rights to interest, or other compensation for delayed payment, which have an existing legal foundation as at the date of administration on the one hand (pursuant to, for example, a contract, or a statute that provides for interest on the debt proved) and rights to interest, or other compensation for delayed payment, which have no existing legal foundation as at the date of administration on the other (because they are solely dependent on a hypothetical judgment which has not yet been obtained); and [A2/19/4] [A1/2/43]

(4) York suggests that there is "*no material difference, as a matter of principle or policy, between a creditor taking steps subsequent to the Date of Administration to obtain a judgment based on his contractual rights and taking steps subsequent to the Date of Administration by serving a demand*" because in both instances the creditor is seeking to rely on existing contractual rights "*in order to obtain greater rights*": see York's 1(a) Submissions at [32]. However, as the Judge found at [518] of the *Waterfall IIC Judgment*, there is a difference: "*[t]he distinction lies in the source of the right or entitlement, and the existence or not of that source as at the date of administration.*" Assuming Issue 4 to have been correctly determined, that distinction (between the possibility of a right and the existence of a right: see [521]) is clear. For the purpose of Rule 2.88(9), the creditor is already entitled to interest at the relevant rate as a matter of contractual entitlement. It is not gaining greater rights: it is invoking or relying on its existing rights in circumstances where the necessary pre-condition to exercising those rights is subsequently fulfilled. There is no principle or policy which suggests that this is wrong, or which should prevent the creditor from being able to rely on such a future or contingent right to interest in the context of Rule 2.88(9). [A2/19/11] [A2/2/131] [A2/2/131]

15. Thirdly, York now argues that the 'apart from the administration' counter-factual in Rule 2.88(9) "*requires consideration of the position if there had been no administration*" (York's Issue 1(a) Submissions at [33]). It suggests that, where the relevant event of default is the administration, the rate applicable has to be identified "*as if there had been no such default*". [A2/19/11]

16. This is a new argument not raised before the Judge, and is self-evidently wrong. In this instance, it is tantamount to saying "*assume that the debt is not due – what is the applicable interest rate*?" That is plainly the wrong approach: the aim of Rule 2.88(9) is to identify the rate otherwise applicable to the provable debt during the period of the administration. It makes no sense to assume for the purpose of identifying the rate applicable apart from the administration that the debt is not due and therefore there is no alternative interest rate. The debt in this instance is a provable debt that the company has to pay, and the counterfactual required by Rule 2.88(9) has to proceed on the basis that the debt has become due (whether or not because, in any given instance, the relevant event of default was the occurrence of the administration itself or some other event).

17. Finally, the general submission that any rate must already be accruing on the debt as at the Date of Administration is an uncommercial and unrealistic construction of Rule 2.88(9).

18. As a matter of common sense, the rate in fact applicable to any claim for an early termination amount is, apart from the administration, the Default Rate. The Judge's analysis of the *Waterfall IIA Judgment*, and interpretation of Rule 2.88(9), as set out above, accords with that common sense conclusion.

19. York's analysis does not accord with common sense, and leads to the conclusion that a creditor is deprived of any right to interest payable at the Default Rate (if higher than the 8% Judgments Act rate) notwithstanding the self-evident purpose of Rule 2.88(9). York provides no argument as to why its interpretation of Rule 2.88 makes sense or would otherwise be likely to reflect the intention of the statutory draftsman.

20. Furthermore, York's submissions, if correct, would appear to be applicable not merely to rights to interest at the Default Rate under the Master Agreements, but to all and any contractual rights to interest that were future or contingent at the date of administration. This is misconceived:

(1) To require the rate to be one that was in fact applicable and accruing as at the Date of Administration would mean that, even in the event of a surplus of assets sufficient to pay post-administration interest, and a contractually applicable rate of interest for part of the period after the Date of Administration, there could never be a rate applicable to any future or contingent debt apart from the administration. That would be contrary to one of the basic objectives of insolvency law (per The Cork Report at para 191) of encouraging the fulfilment of financial obligations where possible; and

(2) It might also suggest that a staggered contractual rate (where, for example, the rate increases from zero or a very low rate after a set period of time to more than 8% after the Date of Administration) would not fall within Rule 2.88(7) despite the creditor's undoubted contractual right to interest at that rate[7]. That cannot be correct.

21. York's appeal in respect of Supplemental Issue 1(a) should therefore be dismissed.

C. SUPPLEMENTAL ISSUE 2

"Whether and (if so) in what circumstances and in what manner a Currency Conversion Claim can arise from the discharge of a debt by way of set-off pursuant to Rule 2.85(3)"

22. Issue 2 is a relatively narrow issue in light of two existing and fundamental propositions (both of which are consistent with the Judge's analysis and the arguments raised on appeal by York).

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7 At first instance, all parties were agreed that the rate applicable to the debt apart from the administration may be a floating or variable rate: it does not have to be fixed: see the *Waterfall IIC Judgment* at [529].

23. First, if a creditor with a claim denominated in a foreign currency does not receive through the proof process dividends which fully satisfy its underlying foreign currency denominated rights, he has a non-provable claim for the shortfall (see the Court of Appeal decision in *Waterfall I* [2015] Ch 1)[8].

24. Secondly, the operation of insolvency set-off does not remove a foreign currency creditor's underlying entitlement to be paid the net balance of his claim in a foreign currency. Specifically:

(1) Set off in an administration is governed by Rule 2.85. Rule 2.85(6) provides that "*Rules 2.86 to 2.88 shall apply* ***for the purposes of this Rule*** *in relation to any sums due to the company which – (a) are payable in a currency other than sterling*" (emphasis added). Thus, for the purposes of the set-off required by Rule 2.85, foreign currency claims are converted into sterling at the exchange rate applicable as at the date of the administration and the relevant claim and cross-claim are set off.

(2) However, save insofar as necessary to effect the set-off, the creditor's rights are unaffected. This is reflected in the judgment of Moore-Bick LJ in the Court of Appeal in *Waterfall I* [2015] Ch 1 at [250], where he stated (emphasis added):

> "*Such a set-off operates by reference to the value of the claim and cross-claim at the date of the winding up order and is effective to discharge the company's debt pro tanto. As a result the foreign creditor obtains full value for his debt at the time of payment, albeit through the mechanism of conversion into sterling (as indeed he would if he were to execute on assets held in this country).* ***It does not follow that the outstanding portion of the obligation should cease to be denominated in the relevant foreign currency***"

See also *Re Kaupthing Singer & Friedlander Ltd* [2010] Bus LR 1500 at [32] and [34].

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8 Although Supplemental Issue 2 asks "*in what manner a Currency Conversion Claim can* ***arise***", a Currency Conversion Claim simply reflects the unpaid balance of a claim denominated in a foreign currency which has not been paid and discharged by the proof process.

25. Supplemental Issue 2 therefore relates only to the separate and discrete issue as to whether a Currency Conversion Claim can arise in respect of that part of a debt which is discharged by way of set-off in an administration pursuant to Rule 2.85(3). The answer turns on the construction of Rule 2.85, and whether:

(1) The Judge was correct to conclude that "*although the set-off account is taken as at the date of the administrator's notice, the creditor's claim is discharged, to the extent of the set-off, as at the Date of Administration"* (Supplemental Judgment at [43]); or [A2/1/12]

(2) As York argues, under the rules, set-off in an administration only operates as at the date of the notice under Rule 2.95 (see York's Supplemental Issue 2 submissions at [40]-[45]).

26. The Senior Creditor Group would emphasise two points:

(1) The potential existence of Currency Conversion Claims as a consequence of set-off may give rise to greater complications in multi-currency cases. However, it is unclear to what extent there are multi-currency or other issues arising in relation to the administration of LBIE. Most creditors with multi-currency claims are likely to be subject to some form of single currency contractual netting/close-out arrangement (as in the case of the Master Agreements). As Briggs LJ observed in the Court of Appeal in *Waterfall I* [2015] Ch 1 at [159] – [160], given the variety of circumstances in which such issues may arise, these are precisely the type of issues that should be resolved on a case by case basis by the Courts if and when such cases arise and that would be the appropriate forum in which to deal with such scenarios, if indeed they exist.

(2) The position adopted by York may give rise to a difference between the effects of set-off in an administration and its effects in a liquidation. This arises because all liquidations are (in principle at least) distributing, such that the rules of insolvency set-off are immediately applicable. By contrast, not all administrations are distributing, such that the rules of insolvency set-off are not applied unless and until a notice of intention to

distribute is given under Rule 2.95 and the account is expressed to be taken as at that date.

27. However, the Senior Creditor Group opposes York's argument that a Currency Conversion Claim arises even in circumstances where the debt owed to the company and the debt owed by the company are both denominated in the same foreign currency (see York's Supplemental Issue 2 Submissions at [58]-[63]). Such an argument is surprising and, in the Senior Creditor Group's view, incorrect. It cannot sensibly reflect the intended legal effect of insolvency set-off pursuant to the Rules where there are equal and opposite claims existing in the same currency. Furthermore, the effect of insolvency set-off operating as York contends would suggest that, logically, the company would have an outstanding and unsatisfied claim against the creditor arising from that part of the debt which had been subject to administration set-off that was equal to the Currency Conversion Claim i.e. there would be equal and opposite claims representing the shortfall in payment received as a consequence of set-off.

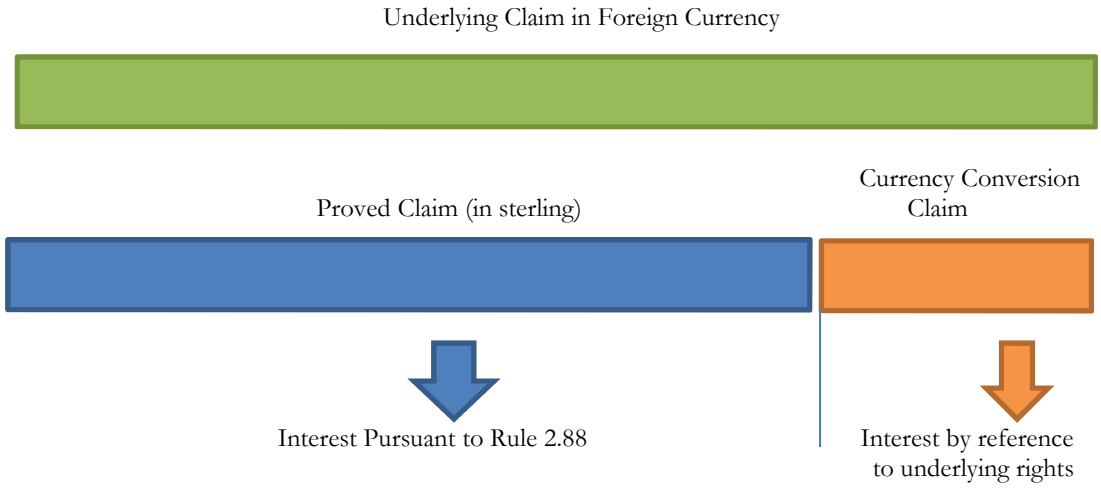
D. SUPPLEMENTAL ISSUE 3

"Whether, and if so to what extent, a non-provable claim to interest on a currency conversion claim can be reduced by interest received by the creditor pursuant to Rule 2.88 on its proved debt"

28. This Issue was answered in the negative by David Richards LJ in the Supplemental Judgment at [48]-[54]. [A2/1/13]

29. The Senior Creditor Group agrees: there is no scope for any such reduction because the entitlement to interest on the proved debt under Rule 2.88 is a statutory entitlement (enjoyed on a *pari passu* basis) which does not satisfy (and cannot be used to satisfy) any contractual or other entitlement of a creditor to interest in respect of its Currency Conversion Claim on which no interest has been paid under Rule 2.88.

30. As set out in the Senior Creditor Group's submissions of 20 May 2016 at [9] (addressing Declaration (vi) - Interest on non-provable claims), the position can be usefully illustrated in diagrammatical form:



31. Wentworth raises very similar arguments on appeal to those which were addressed and dismissed by the Judge[9], and maintains that there should be "*a limited form of offset between the non-provable claim for interest on the currency conversion claim and Statutory Interest received pursuant to Rule 2.88…*" (Wentworth's Supplemental Issue 3 Submissions at [2]). According to Wentworth (*ibid*): [A1/3/3] [A2/18/2]

> *"The non-provable claim to interest should be reduced by Statutory Interest received by the creditor pursuant to Rule 2.88 on its proved debt, if and to the extent that the total interest that would be received by the creditor relating to the period after the Date of Administration (including Statutory Interest and interest on its Currency Conversion Claim) exceeds the creditor's contractual right to interest on its foreign currency debt (i.e. exceeds, when converted into the relevant foreign currency at the date received, the interest which the creditor would have been entitled to receive for that same period on its foreign currency debt had that debt not been converted into sterling at the Date of Administration)."*

32. This is incorrect. In determining Supplemental Issue 3, it is necessary to take into account the nature of currency conversion claims and the basis on which interest is paid under Rule 2.88:

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[9] Wentworth's appeal in this respect will obviously become unnecessary if it succeeds in its appeal against the Judge's finding that a creditor with an interest bearing foreign currency debt has a non-provable claim to interest on any Currency Conversion Claim i.e. Declaration (vi) of the Order of 9.10.15 relating to the *Waterfall IIA Judgment*. The Senior Creditor Group seeks to uphold that Declaration: see its submissions of 20 May 2016 at [5]-[20]. [A1/3/3]

(1) Statutory interest under Rule 2.88 is paid on the sterling proved debt as compensation for the delay in payment of that sum (described as the "*essential point*" by the Judge at [53]). "*It is unconnected with any right to interest under the contract or to the lack of any such contractual right, save for the purpose of determining the rate at which statutory interest is to be paid*" (Supplemental Judgment at [52]). The proved debt is the sterling sum calculated by conversion of the amount of the foreign currency claim into sterling at the rate prevailing at the Date of Administration: Supplemental Judgment at [53]. It is not paid on the underlying claim in its foreign currency amount. [A2/1/13] [A2/1/13] [A2/1/13]

(2) Currency Conversion Claims exist because, once the process of proof (and the payment of statutory interest) has run its course, the foreign currency creditor reverts to his unsatisfied contractual rights and is entitled to payment of any outstanding amount: see the *Waterfall IIA Judgment* at [168] "*It is a case where the creditor is remitted to his contractual rights*"[10]. More specifically, Currency Conversion Claims exist because "*it would be contrary to principle and justice that the debtor, or the shareholders receiving the surplus, should be able to deny the foreign currency claimants their full contractual rights*": *Waterfall I* [2015] Ch 1 at [110]; and "*it is not part of the purpose of that policy* [of admitting to proof as many liabilities as possible] *to disentitle a creditor from the enforcement of a contractual right to the fullest extent where the debtor company has a relevant surplus after payment of provable debts and statutory interest*": *Waterfall I per* Briggs LJ at [154]. [A1/2/41] [A2/1/13]

33. As the Judge concluded, there is no scope for off-setting statutory interest received pursuant to Rule 2.88 on a foreign currency creditor's admitted sterling claim against that creditor's contractual entitlement to interest on a non-provable Currency Conversion Claim. That follows from the discrete rights that a creditor

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[10] At [53] of the Supplemental Judgment, the Judge expressly rejected Wentworth's submission that a Currency Conversion Claim represents that portion of the proved debt that is not satisfied by the payment of dividends. That is because "*[t]he proved debt is the sterling sum and it has been satisfied in full by the dividends.*" [A2/1/13]

has against the insolvent company, and the creditor's rights under the insolvency scheme i.e.

(1) Dividends are paid in satisfaction of the creditor's proved debt;

(2) Interest payable pursuant to Rule 2.88 is payable as a matter of statute as compensation for the delayed receipt of payment of the proved debt;

(3) A non-provable Currency Conversion Claim is a debt reflecting the shortfall in payment of the principal foreign currency debt owed to a creditor; and

(4) A non-provable interest claim is a debt based on underlying rights in respect of the delayed receipt of the Currency Conversion Claim.

34. A creditor with a foreign currency claim is entitled to compensation and payment under the Rules and statutory waterfall in each of the above forms: the fact of receipt of one form of compensation (or payment of part of the debt) does not disentitle it to, or satisfy its right to, payment of another part of the debt due or other form of compensation.

35. The substance of Wentworth's argument (see in particular Wentworth's Supplemental Issue 3 Submissions at [8], and the Supplemental Judgment at [51]) is that there is only one single, indivisible obligation owed to the creditor (the foreign currency obligation) such that "*[a]ny payment, whether by way of dividend or Statutory Interest, is referable to that single indivisible obligation*". It is therefore argued that payment of Statutory Interest pursuant to Rule 2.88 should be taken into account when assessing whether there is any outstanding debt due in respect of interest payable on the currency conversion claim. [A2/18/5] [A2/1/13]

36. As the Judge concluded at [52] and [53] of the Supplemental Issue Judgment, this submission has no merit. [A2/1/13]

37. First, for the purpose of identifying the interest payable in respect of a Currency Conversion Claim, there is a relevant distinction between the proved debt and

the underlying contractual debt (which distinction underlies the existence of currency conversion claims: see the *Waterfall I* judgment). Just as payment in full of the proved debt does not equate to payment in full of the underlying foreign currency debt, so too payment of Statutory Interest on the sterling proved debt does not equate to payment of interest in respect of the unpaid part of the underlying foreign currency debt. Once a Currency Conversion Claim is recognised (such that there is a distinction between when the proved debt has been satisfied, and when any outstanding part of the underlying claim (i.e. the currency conversion claim) has been satisfied), there is necessarily also a distinction between the payment of interest on the proved debt in accordance with Rule 2.88 and interest on the currency conversion claim.

38. Secondly, all creditors are entitled as a matter of statutory right to the payment of Statutory Interest on the proved debt. That is so, whether or not there is any contractual or other right to interest or compensation for delayed payment.

39. As illustrated diagrammatically in paragraph [30] above:

(1) Interest under Rule 2.88 is paid in respect of the sterling proved debt, equally amongst all creditors and regardless of whether they have a contractual right to such interest; and

(2) A creditor who has a Currency Conversion Claim in respect of which it is entitled to interest can assert (and is entitlement to payment of) a non-provable claim for such interest.

40. Thirdly, the above analysis is consistent with the Court's comments in relation to Issue 2A (compensation for delayed payment) and Issue 28 (whether a Currency Conversion Claim should be reduced to take into account Statutory Interest received under Rule 2.88 which exceeds the creditor's underlying contractual entitlement):

(1) The Court held in the *Waterfall ILA* Judgment in respect of Issue 2A (at [169]): [A1/2/41]

"If the contract between the company and the creditor provides for interest on any unpaid part of the [foreign currency debt], the creditor is in my judgment entitled to include such interest as part of his non-provable claim. ***The position of rule 2.88 as a complete code relating to the payment of post-administration interest does not, in my judgment, interfere with the enforcement of his contractual right as part of a non-provable claim. Neither explicitly nor implicitly does it interfere with a creditor's contractual right to interest on a non-provable debt****. The entitlement to interest is dependent on a remission to contractual or other rights existing apart from the administration and it follows that no interest is payable on a currency conversion claim where the underlying foreign currency obligation is not itself interest-bearing"* (emphasis added).

(2) In rejecting the argument that the calculation of a Currency Conversion Claim should take into account statutory interest paid to the relevant creditor pursuant to Rule 2.88, the Court held:

"*The creditor is not receiving that interest in or towards satisfaction of its contractual right to interest and there is no comparison to be made between the foreign currency equivalent of the statutory interest and the foreign currency interest to which it was entitled under its contract." Waterfall IIA Judgment* at [228]. [A1/2/56]

41. Fourthly, there is no unfairness or potential that "*foreign currency creditors stand to benefit from an overpayment to the disadvantage of other non-provable and lower-ranking claims*" (Wentworth's Supplemental Issue 5 Submissions at [9]). On the contrary: [A2/18/5]

(1) A creditor has a statutory right to interest on his proved (sterling) debt pursuant to Rule 2.88, *pari passu* with all other creditors;

(2) A creditor with a claim denominated in a foreign currency may also have a contractual right to interest on the unpaid amount of his non-provable currency conversion claim;

(3) The creditor's statutory right to interest under Rule 2.88 in respect of his admitted claim does not interfere with the creditor's contractual right to interest on his non-provable debt; and

(4) Indeed, if a foreign creditor has to give credit for interest received under Rule 2.88 in calculating its non-provable claim for interest on a currency

conversion claim, then either it will not receive the full amount of statutory interest on its admitted debt to which it is entitled in accordance with Rule 2.88 *pari passu* with all other creditors, or it will not receive full satisfaction of its contractual (or other) entitlements to interest on the unpaid part of its non-provable foreign currency debt[11]. [A2/18/3]

E. SUPPLEMENTAL ISSUE 5

"Whether, to the extent that a creditor has a non-provable claim for interest on a Currency Conversion Claim, such non-provable claim has been released under the terms of the CRA and / or a CDD and if so, whether the Administrators would be directed not to enforce such release(s)"

42. For the reasons given at [62]-[68] of the Supplemental Judgment, the Judge concluded that (i) under the CDDs, such claims had not been released and that, had they been, the Court would direct the Administrators not to enforce such a release ([67]-[68]); but (ii) under the CRA, such claims have been released and that the Court would direct the Administrators to enforce such a release (see [64]-[66] and [69]). [A2/1/15] [A2/1/16] [A2/1/16]

43. The Senior Creditor Group is appealing the Judge's conclusion in respect of the CRA (see its Supplemental Issues Appeal Submissions at [30]-[32]) but supports his conclusion in relation to the CDDs. Any other conclusion would be to give the release contained in the CDDs an entirely uncommercial and unjustifiable construction in light of the function and purpose of the CDDs. [A2/17/14]

44. The arguments made by the Senior Creditor Group regarding the function and purpose of the CDD process, the operation of the statutory scheme, and the role of the Administrator in giving effect to that scheme (see, for example, the Senior Creditor Group's Waterfall IIB Reply Submissions at [55] and its Supplemental

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11 Using the example given by Wentworth at [6] of Wentworth's Supplemental Issue 3 Submissions, the claim for interest on the Currency Conversion Claim is $2 (i.e. 4% on $25 assuming the Currency Conversion Claim is also outstanding for 2 years). The creditor is also entitled (in common with all other creditors, and on a *pari passu* basis) under Rule 2.88 to £8 (8% on £50 for two years) irrespective of its contractual entitlements. The £8 cannot be reallocated to satisfy the debt of $2: that would be unfair to the foreign currency creditor, whose entitlement to the £8 is a statutory entitlement to interest paid only on the proved debt.

Issues Submissions at [25]), support the Judge's conclusion in relation to Supplemental Issue 5). In particular: [A2/17/10]

(1) As the Judge correctly concluded at [67] of the Supplemental Judgment, it would not be plausible in light of the purpose and function of the CDDs to construe the release of "*all Claims to Interest*" as extending to contractual interest on Currency Conversion Claims in circumstances where he had already concluded (in *Waterfall IIB*) that the release did not have the effect of releasing Currency Conversion Claims themselves; [A2/1/16]

(2) Contrary to Wentworth's Supplemental Issue Submissions at [16] and [17], the phrase "*all Claims for interest … whether arising under the Creditor Agreement or not*" (emphasis added) cannot therefore be read literally, since it does not extend to a release of a creditor's claim for statutory interest under rule 2.88 (*Waterfall IIB* [164]). It would make no sense (as Wentworth seems to contend at [20(2)] of its Supplemental Issue Submissions) for the language of Clause 2.3 of the Admitted Claims CDD to exclude "*any claim to interest (save for interest under Rule 2.88) arising under the Creditor Agreement*"; [A2/18/7] [B1/2/40] [A2/18/8]

(3) The Court's determination in *Waterfall IIB* at [131] that it would "*require clear words in the CRA to have the effect of releasing currency conversion claims"* applies with equal force to a release by the CDDs of a right to include interest on any unpaid part of a foreign currency claim as part of a currency conversion claim. No such words exist in the CDDs; and [B1/2/32]

(4) The Judge's construction of the CDD release clause therefore ensures that the CDDs do not unnecessarily and unjustifiably deprive creditors of valuable rights (i.e. non-provable interest on Currency Conversion Claims).

45. Furthermore, had the CDDs on their true construction had the effect of releasing non-provable interest on Currency Conversion Claims, such an effect would have been an inadvertent and unintended consequence of a process initiated by the Administrators, harming the interest of creditors and conferring an unfair benefit

or enrichment on the estate and a windfall for subordinated creditors and shareholders (see for example. the Senior Creditor Group's Supplemental Issues Submissions at [28]). None of the reasons given at [22]-[25] of Wentworth's Supplemental Issues Submissions demonstrate any error of law, and certainly not a decision outside the scope of reasonable decisions available to the Judge. In particular: [A2/17/12] [A2/18/9]

(1) The agreements were not ordinary commercial bilateral agreements but were made by the Administrators in pursuance of their statutory duty to act in the interests of the creditors as a whole: *Waterfall IIB* [184]; [B1/2/45]

(2) The release of a right to claim interest on unpaid parts of a foreign currency claim was entirely irrelevant to the purposes for which the CDDs were proposed: *Waterfall IIB* [184]. Any such release was therefore an unintended and unnecessary consequence of a process initiated by (and until 2014 required by) the Administrators. By definition, the release would extend beyond claims which might form the basis of any proof (being for post-administration interest); [B1/2/45]

(3) The subsequent express carve-out for Statutory Interest in later CDDs is indicative (and clarified) the purpose and function of the CDDs, and the fact that releases cannot have been intended to affect non-provable interest claims in respect of Currency Conversion Claims. As one of the Joint Administrators, Mr Copley, clarified, it had not been the intention of the Joint Administrators in entering into the CDDs that creditors waiver their rights to Currency Conversion Claims (see Copley 1 at [25]);

(4) Comments made (for example, in the draft explanatory statement for the proposed scheme) at a time when (i) the outcome of the LBIE administration (and whether there might be a surplus of assets available to pay proved claims) was unknown and incapable of anticipation; and (ii) the concept of Currency Conversion Claims (let alone interest on those claims) was not being contemplated by the Administrators or creditors, do not provide a basis to conclude that enforcing the releases would be fair or just. On the contrary, if the Administrators had considered that the

CDDs could have the effect for which Wentworth now contends, they would have drawn attention to it in their website postings concerning the CDDs: *Waterfall IIB Judgment* at [184]; [B1/2/45]

(5) The enforcement of any releases of a right to include interest on unpaid parts of a foreign currency claim as part of a Currency Conversion Claim would involve an unintended discrimination between different creditors (i.e. those who entered into CDDs, and those who did not) for no reason in any way connected with the purposes of the administration or the best interests of creditors as a whole; and

(6) If the releases in respect of non-provable rights are enforced, the estate will benefit. The consequence will be that the estate does not have to pay claims that, but for the releases, would have had to have been met before any surplus could be returned to subordinated creditors or shareholders. The unfair harm suffered by certain creditors therefore translates directly into an unjustified windfall to subordinated creditors and shareholders which is contrary to that stipulated for in the statutory regime and which they have no entitlement to expect under that regime.

46. The Judge was therefore correct to hold (see the Supplemental Judgment at [68]) that he would have directed the Administrators not to enforce any release of non-provable interest on Currency Conversion Claims had the CDD releases extended to such claims. [A2/1/16]

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28 February 2017

IN THE COURT OF APPEAL **Appeal Ref: 2017/0043**
ON APPEAL FROM THE HIGH COURT
CHANCERY DIVISION
COMPANIES COURT
DAVID RICHARDS LJ [2016] EWHC 2131 (Ch)
HILDYARD J [2016] EWHC 2417 (Ch) Judgment")

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)
AND IN THE MATTER OF THE INSOLVENCY ACT 1986

SENIOR CREDITOR GROUP'S REPLY SKELETON ARGUMENT (SUPPLEMENTAL ISSUES)

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