IN THE HIGH COURT OF JUSTICE **No. 7942 of 2008**

CHANCERY DIVISION

COMPANIES COURT

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) ANTHONY 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)

Applicants

-and-

(1) BURLINGTON LOAN MANAGEMENT LIMITED
(2) CVI GVF (LUX) MASTER S.A.R.L.
(3) HUTCHINSON INVESTORS LLC
(4) WENTWORTH SONS SUB-DEBT S.A.R.L.
(5) YORK GLOBAL FINANCE BDH, LLC
(6) GOLDMAN SACHS INTERNATIONAL

Respondents

ADMINISTRATORS' SKELETON ARGUMENT FOR 9 OCTOBER 2015 PTR

INTRODUCTION

1. This skeleton argument is filed on behalf of the joint administrators (the "Administrators") of Lehman Brothers International (Europe) ("LBIE") in advance of the pre-trial review of Tranche C of the Waterfall II Application. The issues which comprise Tranche C of the Waterfall II Application are identified at paragraph 42 below.

2. Tranche C concerns generic issues arising out of the construction and effect of ISDA Master Agreements and other market standard agreements. In particular, the Tranche C issues relate to the calculation of interest under master agreements entered into by LBIE and certain of its counterparties. The issues arise in circumstances in which there is a substantial surplus in LBIE's administration after paying or providing for the provable debts owed by LBIE in full. The Administrators estimate that the surplus is in the region of £7 billion.

3. The effect of rule 2.88 of the Insolvency Rules 1986 is that contractual interest for periods up to the commencement of the administration is provable but post-administration contractual interest is not. Instead, interest is payable on all proved debts, whether or not they carried any entitlement to interest, from the commencement of the administration[1] to the date of payment or payments of the proved debts. It is this latter category of interest which is termed "statutory interest" and it is payable out of the surplus remaining after payment of the debts proved before such surplus is applied for any purpose[2].

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[1] It was held, in Waterfall II, Tranche A that statutory interest accrues on all debts, including contingent and future debts, from the commencement of the administration. It is possible that, as regards future and/or contingent debts, that ruling will be subject to appeal.

[2] This is subject to the possibility of the Supreme Court reversing the Court of Appeal's decision in Waterfall I which determined that LBIE's liabilities under certain subordinated debt agreements are subordinated to the payment by LBIE of statutory interest. Even if the Supreme Court reverses the Court of Appeal's decision, there will still be a surplus after payment in full of the subordinated debt which will be applied in paying statutory interest.

4. Statutory interest, which is payable in accordance with rule 2.88(7) of the Insolvency Rules 1986, is payable at "*the greater of [the rate specified in section 17 of the Judgments Act 1838 on the date when the company entered administration]* ***or the rate applicable to the debt apart from the administration***" (emphasis added) (rule 2.88(9)).

5. The Judgments Act rate on the date when LBIE entered into administration was, as it is now, 8% simple, per annum.

6. Whilst the Judgments Act rate has continuously been significantly in excess of sterling market rates of interest since LBIE entered into administration in 2008, its creditors may nevertheless seek to establish that the rate applicable to their debts apart from the administration leads to a higher claim for interest than that calculated at 8% simple. The determination of the Tranche C issues will assist the Administrators to assess such claims with reference to the master agreements which are the subject matter of this part of the Waterfall II Application.

PRE-READING

7. The Administrators respectfully invite the Court to pre-read the following, in order of priority (references in square brackets being to the trial bundles unless they are in the form [PTR/], in which case they are to the PTR bundle):

   (1) the PTR skeleton arguments;

   (2) the draft Re-Amended Application [PTR/2];

   (3) the 11th (in particular, section L), 12th and 13th witness statements of Anthony Lomas [2/3], [2/8] and [PTR/3];

   (4) the position papers [1/9] to [1/18];

   (5) the statement of agreed positions relating to the French law issues [1/19];

(6) Linklaters' letter of 30 September 2015 setting out the Administrators' proposed order of business at trial [PTR/4/13] and the Respondents' responses to it ([PTR/4/17] (on behalf of Wentworth), [PTR/4/25] (on behalf of the SCG), [PTR/4/45] (on behalf of GSI) (see also Linklaters' letter of 6 October [PTR/4/40]);

(7) the draft PTR Order [PTR/1] and;

(8) the Tranche A and B judgments [6/3] and [6/4].

BACKGROUND

8. This section of this skeleton argument, which borrows extensively from judgments which have been handed down on various applications made by the Administrators, is intended to assist the court in putting the Tranche C issues into their broader context.

LBIE

9. The Lehman Brothers Group was, in 2008, one of the four biggest investment banks in the United States, the core of its business being global investment banking, including the provision of financial services to corporations, governments and municipalities, institutional clients and high net worth individuals. It organised its business activities in three segments, namely capital markets, investment banking and investment management. Those segments included businesses in equity and fixed income sales, trading and research, investment banking, asset management, private investment management, principal investing and private equity.

10. LBIE was the Group's principal trading company in Europe. It provided a wide range of financial services to clients (including corporate customers, institutions, governments, hedge funds and private clients) on a global basis. LBIE had trading, research, structuring and distribution capabilities in equity and fixed income products.

It was a leading global market maker in numerous equity, fixed income and derivative products.

11. LBIE was incorporated on 10 September 1990 under the Companies Act 1985 as a company limited by shares. On 21 December 1992, it was re-registered as an unlimited company. It is understood that this step was taken for US tax reasons.

12. LBIE went into administration on 15 September 2008. Its entry into administration was caused by its ultimate parent company, Lehman Brothers Holdings Inc. ("LBHI"), which was incorporated in the United States and had provided a treasury function, including day to day liquidity management, throughout the Group, informing LBIE that it would not be putting LBIE in funds to settle its trades and other liabilities on 15 September 2008 and that it would imminently be filing for Chapter 11 bankruptcy protection under the US Bankruptcy Code.

13. LBIE has two members (for convenience referred to below as LBL and LBHI2 respectively), both other companies in the Group. Both have asserted ordinary unsecured claims against LBIE and one of them (LBHI2) had a very large claim as a subordinated loan creditor (which it has now sold to the Fourth Respondent ("Wentworth") although it retains an interest in that claim through its interest in Wentworth).

LBIE's administration

14. The Administrators have been seeking to achieve the purpose of administration by performing their functions with the objective of achieving a better result for LBIE's creditors as a whole than would have been likely if LBIE had been wound up (without first being in administration). The Administrators did not consider it reasonably practicable to rescue LBIE as a going concern.

15. When LBIE entered administration, it was not anticipated that there would be any surplus of assets once the general body of unsecured creditors had been paid. In early

2012, as a result of progress made by the Administrators in resolving the LBIE estate, the possibility of a surplus started to be discussed in the market.

16. On 26 November 2012, the Administrators gave notice of their intention to pay a first interim dividend of 25.2 pence in the pound[3]. In their ninth progress report for the six month period to 14 March 2013, published in April 2013, the Administrators provided for the first time illustrative outcome estimates indicating a potential surplus in an illustrative high case scenario. There were a number of reasons which contributed to the improvement in the outlook for creditors. Principally, there was a significant increase in anticipated asset realisations (from a range of £7.5 billion to £12.5 billion in September 2011 to a range of £15.88 billion to £18.84 billion by September 2013) and a marked reduction in the value of unsecured claims. A significant factor was the success of the Administrators in negotiating settlements with other companies in the Lehman Brothers Group, in particular, the principal US broker dealer, Lehman Brothers Inc.

17. With the permission of the court, the Administrators have declared and paid dividends of, in aggregate, 100p in the pound, totalling some £12.1 billion.

The Waterfall litigation

Waterfall I

18. The purpose of the first "Waterfall" application – Waterfall I – was to determine the types of claim which may be made against the surplus before any return to members and the order in which such claims rank for payment, and to resolve the existence and

[3] Paragraph 65 of Schedule B1 to the Insolvency Act 1986 permits the administrator of a company to make distributions to creditors of the company, with the permission of the court where the creditors are neither secured nor preferential. Once an administrator gives notice of an intention to make a distribution, the administration is commonly referred to as a distributing administration. Detailed provisions related to the making of distributions to creditors by administrators are contained in rules 2.68-2.105 of the Insolvency Rules 1986. The Administrators received the Court's permission to make such distributions by Order dated 2 December 2009.

extent of the potential liability of the members as contributories pursuant to section 74 of the Insolvency Act 1986.

19. Issues arose as to the potential liability of the members for the liabilities of LBIE and the relationship between their liability, if any, as members and their claims as creditors. Those issues have been determined in the Waterfall I litigation. The Waterfall I litigation also led to the existence of "currency conversion claims" being confirmed as a type of non-provable liability which can be claimed in the event of a surplus.

20. David Richards J. delivered his judgment on 14 March 2014. The Judge's conclusions are recorded in paragraph 250 of his judgment in the following terms:

> *"i) The claims of LBHI2 under its subordinated loan agreements with LBIE are subordinated not only to provable debts but also to statutory interest and un-provable liabilities.*
>
> *ii) Creditors of LBIE whose contractual or other claims are denominated in a foreign currency are entitled to claim against LBIE for any currency losses suffered by them as a result of a decline in the value of sterling as against the currency of the claim between the date of the commencement of the administration of LBIE and the date or dates of payment or payments of distributions to them in respect of their claims. Such currency conversion claims rank as un-provable liabilities, payable only after the payment in full of all proved debts and statutory interest on those debts.*
>
> *iii) If the administration of LBIE is immediately followed by a liquidation, any interest in respect of the period of the administration which has not been paid before the commencement of the liquidation will not be provable as a debt in the liquidation nor will it be payable as statutory interest under either rule 2.88 of the Insolvency Rules or section 189 of the IA 1986.*
>
> *iv) Those creditors of LBIE with debts which carry interest by reason of contract, judgment or other reasons unconnected with the administration or liquidation of LBIE will be entitled to claim in a liquidation of LBIE, which immediately follows the administration, for interest which accrued due during the period of the administration, as an un-provable claim against LBIE, payable after the payment in full of all proved debts and statutory interest on such debts.*

v) The obligation of members to contribute under section 74(1) of the IA 1986 extends not only to provide for proved debts but also for statutory interest on those debts and un-provable liabilities.

vi) The contributory rule (that is, the rule that a contributory of a company in liquidation cannot recover anything in respect of any claims he may have as a creditor until he has fully discharged his obligations as a contributory) applies only in a liquidation. It does not apply in an administration, including the administration of LBIE. The equitable rule in Cherry v Boultbee also does not apply.

vii) LBIE, acting by its administrators, will be entitled to lodge a proof in a distributing administration or a liquidation of either LBL or LBHI2 in respect of those companies' contingent liabilities under section 74(1) of the IA 1986 which may arise if LBIE were to go into liquidation. The valuation of such claims would be a matter of estimation under the provisions of the Insolvency Rules.

viii) In a distributing administration or liquidation of LBL or LBHI2, the claims of those companies respectively as creditors of LBIE would be the subject of mandatory set-off against the claims of LBIE in respect of those companies' contingent liabilities as contributories. I have reached the conclusion that the decision in In re Auriferous Properties Limited (No 1) [1898] 1 Ch 691 was wrong and should not be followed.

ix) In the administration of LBIE the contingent liabilities of LBL and LBHI2 as contributories will be the subject of mandatory set-off against the admitted proofs of debt of those companies as creditors of LBIE."

21. Each of the declarations made by the Judge, which in substance mirrored the conclusions set out above, was appealed to the Court of Appeal.

22. The Court of Appeal handed down its Waterfall I judgment on 14 May 2015. The Court of Appeal allowed the Administrators' appeal against the declarations recording

conclusion (iii)[4] above and otherwise dismissed the appeals including each of the appeals brought by LBL, LBHI2 and LBHI[5].

23. LBL, LBHI2 and LBHI have sought permission to appeal to the Supreme Court to reverse the position reached by the Court of Appeal on every issue raised in the Waterfall I Application, other than the sole issue on which they have thus far been successful, being the declarations reflecting the Judge's conclusion (vi)[6], the unavailability of the contributory rule in an administration, which conclusion the Court of Appeal agreed with.

24. The applications for permission to appeal to the Supreme Court have not yet been determined.

Waterfall II

25. The Administrators issued a further application for directions on 12 June 2014 ("Waterfall II"). The application, as amended, contains 42 paragraphs raising a wide variety of different issues. Although there were some issues on which the Administrators may have been content to proceed on the basis of legal advice without recourse to the Court, the application was formulated in consultation with the First to Fourth Respondents and, taken as a whole, answers are required by the Administrators in order to enable them to carry out their statutory functions.

26. In order to keep the Waterfall II Application within manageable bounds, David Richards J. directed on 21 November 2014 that the questions raised be divided into

[4] And, because it followed that the issue does not arise, (iv).

[5] A variation was made to the Judge's declaration recording conclusion (i) above but the Court of Appeal's Order makes clear that the subordinated debt is subordinated to provable debts, statutory interest and non-provable liabilities and is repayable only on contingencies including the payment of all such claims.

[6] As a result of the Court of Appeal splitting decision (ii) into two parts, this is reflected in declaration (vii) of the Court of Appeal judgment.

three groups, each of which would be considered at a separate hearing. The issues were divided into three tranches:

(1) Tranche A concerned the extent and quantification of the entitlement of creditors to interest on their debts for periods after the commencement of the administration.

(2) Tranche B concerned the effect of certain post-administration contracts made with creditors on their claims for post-administration interest and currency conversion losses. The post-administration contracts which were in issue were the Claims Resolution Agreement (a multi-lateral, contractual solution which the Administrators introduced as a more expeditious means by which trust assets could be returned to LBIE's clients and those clients' claims against LBIE could be established) and Claims Determination Deeds (bilateral contracts by which creditors' claims against (and liabilities owed to) LBIE were agreed and compromised).

(3) Tranche C concerns generic issues arising out of the construction and effect of ISDA Master Agreements and other market standard agreements.

27. On 31 July 2015, David Richards J. handed down his judgments on both Tranches A and B (which were heard separately in February and May 2015, respectively).

28. His conclusions on Tranche A are summarised in paragraph 243 of the Tranche A judgment ([2015] EWHC 2269 (Ch)) as follows:

> *"i) Bower v Marris does not apply to the calculation of post-administration interest under rule 2.88(7)-(9);*
>
> *ii) rule 2.88 represents a complete code for the payment of post-administration interest on proved debts, leaving no room for any non-provable claim for further interest;*

iii) interest is not payable on statutory interest in respect of the period between the payment in full of the debts proved and the date or dates on which statutory interest is paid;

iv) "the rate applicable to the debt apart from the administration" in rule 2.88(9) does not include judgment rate on a judgment obtained after the commencement of the administration or the judgment rate which would apply to a debt if the creditor had obtained judgment for it but did not in fact do so;

v) statutory interest is payable on future debts and on the amount admitted to proof in respect of contingent debts from the date of the commencement of the administration; and,

vi) the calculation of currency conversion claims should not take into account the statutory interest paid to the relevant creditor."

29. His conclusions on Tranche B are summarised in paragraph 190 of the Tranche B judgment ([2015] EWHC 2270 (Ch)) as follows:

"i) Neither the CRA nor any of the CDDs, as a matter of construction, have the effect of releasing currency conversion claims.

ii) Neither the CRA nor any CDD has, as a matter of construction, the effect of releasing in whole or in part claims to statutory interest under rule 2.88. In all cases, creditors are entitled to the payment of statutory interest at the higher of judgment rate or the rate otherwise applicable apart from the administration.

iii) The CRA does not, as a matter of construction, itself create or give rise to any currency conversion claim.

iv) If, as a matter of construction, the CRA or any of the CDDs had the effect of releasing currency conversion claims, the administrators would have been directed, under the principle in Ex parte James and under paragraph 74 of schedule B1 to the Insolvency Act, not to enforce such releases."

30. On 9 October 2015, David Richards J. will deal with applications for permission to appeal and other matters consequential upon his judgments in Tranches A and B.

The Waterfall II Respondents

31. The most active Respondents in the Waterfall II litigation are the Senior Creditor Group (comprising the First to Third Respondents) (the "SCG") and Wentworth – the holder (amongst other things) of the subordinated debt claims against LBIE.

32. In general terms:

    (1) The SCG's objective is to maximise the First to Third Respondents' claims to statutory interest and non-provable liabilities.

    (2) Wentworth's objective (vis à vis its interests in the subordinated debt) is to minimise the claims of the non-subordinated creditors to statutory interest and in respect of non-provable liabilities with a view to maximising any surplus available after payment in full of those two categories of claim – so as to make a recovery in respect of the subordinated debt.

33. However, neither the SCG nor Wentworth has been appointed as a representative of a class of creditors under CPR 19.6 or CPR 19.7. Rather, they were joined to the Waterfall II Application in the expectation that they would advance submissions that would take account of the interests of most if not all types of creditor in the estate.

34. There are some limitations on the ability of Wentworth and the SCG to advance submissions on behalf of the non-subordinated creditors and the holder of the subordinated debt respectively, without regard to other considerations.

    (1) The SCG is not able to represent the interests of <u>all</u> non-subordinated creditors of LBIE on <u>all</u> Waterfall II issues because the non-subordinated creditors have conflicting interests in many of the issues raised, particularly in Tranche C, e.g. depending on whether they have a contractual right to interest at a rate which might exceed the Judgments Act rate or non-provable claim.

(2) Further, whilst Wentworth is the holder of the subordinated debt and would benefit in that capacity from the reduction of claims to default interest on provable debts, Wentworth also has substantial claims against LBIE under Master Agreements and would benefit in that capacity from a decision in favour of the SCG on Issues 10-16 and 18 (i.e. those matters of construction of the Master Agreements governed by English law)[7], particularly should it become clear that a recovery in relation to the subordinated debt appears unlikely. Precisely what is in Wentworth's financial interests is outside of the Administrators' knowledge and Wentworth has never held itself out as being a representative or being under any obligation to advance arguments other than in its own, rather complex, interests.

35. The Fifth Respondent ("York") is one of four co-participants in unsecured claims against LBIE with an agreed total value of US $676.25 million. York is authorised by the other co-participants to act on their behalf. Although largely aligned with the SCG, York advanced its own submissions on certain of the Tranche A issues. York has not advanced any arguments on Tranches B or C and (as matters stand) will not be represented at the trial of the Tranche C issues.

36. The Sixth Respondent ("GSI") played no role in Tranches A and B but was joined to the Waterfall II Application on 23 June 2015 for the purpose of advancing arguments in respect of Tranche C Issues 11 to 14 and 27 as per the order of David Richards J. of the same date. GSI's joinder was expressly limited to "*the submission of evidence and the making of arguments* ***which do not duplicate those made by the [SCG]***" (emphasis

[7] It also holds substantial claims under the French master agreements which are the subject matter of others of the Tranche C issues.

added) [1/7/57]. GSI has claims against LBIE under ISDA Master Agreements governed by English law[8].

37. Based on claims and assignments notified to the Administrators, the SCG, Wentworth and GSI hold, in aggregate, approximately 65% of the claims against LBIE which arise under ISDA Master Agreements (with approximately £1.1 billion being held by the SCG, approximately £1.6 billion being held by Wentworth and approximately £100 million being held by GSI).

The Administrators' role

38. The Waterfall II Application was issued by the Administrators so that issues which are holding up the distribution of the surplus can be determined by the Court.

39. At each stage the Administrators have reviewed the arguments being deployed by the Respondents for the following purposes:

(1) where the Administrators considered there to be matters of material significance which had not been raised by any of the Respondents or which give rise to an arguable alternative to a common position taken by the Respondents, the Administrators have sought to advance submissions to that effect, in order to ensure that the Court has the benefit of fully developed adversarial argument on these points;

(2) on those issues where the Respondents are (or were) divided, the Administrators have made submissions where they have considered it necessary to do so in order

[8] At the hearing of GSI's application to be added as a respondent to the Waterfall II Application, David Richards J. asked Leading Counsel for the Administrators to let him know what GSI's claim was worth. On instructions, Leading Counsel informed the Judge that the claim was worth approximately £80 million. In fact, the value of GSI's admitted proprietary claim is £54.75 million, £29.2 million of that admitted claim being payable under ISDA Master Agreements. Entities in the Goldman Sachs group hold additional non-proprietary claims in the LBIE estate.

to ensure that all available arguments, to the extent that such arguments are tenable and material, are before the Court; and/or

(3) the Administrators have provided relevant further background information or evidence necessary to inform the Court.

40. On some issues in the Waterfall II Application, all the active Respondents have taken the same position and the Administrators have been content not to advance any other position because they do not consider there to be a tenable and material position to the contrary.

41. The Administrators have been, and remain, content to act on directions given by the Court without the appointment of true representative creditors. The Administrators have uploaded all the position papers and witness evidence served by the Administrators and the Respondents onto the LBIE administration website[9]. Where issues have been agreed between the parties, the Administrators have given notice of the agreed position on the website and invited creditors to contact their team should they have any queries.

THE TRANCHE C ISSUES

42. The Tranche C issues are Issues 10 to 27 (other than Issue 17 which was removed from the Application) and they raise questions of:

(1) English law, in the context of the 1992 and 2002 versions of the ISDA Master Agreement (which agreements enable the parties to select either English or New York law as the governing law of the contract) (Issues 10-16, 18 and 27);

[9] It should be noted that many of LBIE's creditors are highly sophisticated entities, have been following the Waterfall applications with close attention and are well-equipped to identify whether all arguments which might affect their interests are being advanced.

(2) New York law, also in the context of the 1992 and 2002 versions of the ISDA Master Agreement (Issues 19 and 27);

(3) German law, in the context of the German Master Agreement (Issues 20-21 and 27); and

(4) French law, in the context of four types of Master Agreement governed by French law (Issues 22-27).

43. The main Respondents on all of the issues, including the English law issues, are the SCG and Wentworth. However:

(1) GSI will be making arguments on a number of the English law issues, broadly consistent with, but not duplicative of, those adopted by the SCG; and

(2) the Administrators will be making submissions on a number of the English law issues, so as to fulfil the role they have as outlined above.

44. GSI will play no role as regards the foreign law issues and the Administrators' role on the foreign law issues has been and, as matters stand, remains to seek to ensure that the necessary evidence and arguments are being made by the SCG and Wentworth.

English law issues

45. Issues 10 to 16 and 18 relate to ISDA Master Agreements governed by English law. They ask a number of questions relating to the application and calculation of the "*Default Rate*" of interest as defined in Section 14 of the ISDA Master Agreement. This is the rate which applies, *inter alia*, in circumstances in which one of the parties (in this case LBIE) suffers an Event of Default (in this case, LBIE going into administration) and: (a) is responsible for making a payment to the Non-defaulting Party on the closing out of the transactions governed by the Master Agreement; and (b) fails to make that payment on time.

46. The Default Rate means:

> "*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*".

47. Two of the central issues which the Court is invited to determine are:

(1) Whether the "*cost… to fund or of funding*", the relevant amount can include costs incurred by funding the relevant amount other than through borrowing; and

(2) Whether, where the original Non-defaulting Party has transferred all or any part of its interest in the close-out amount to an assignee, the "relevant payee" is the assignor or the assignee of that interest.

48. Issues 10 to 16 and 18 are all issues of construction of the ISDA Master Agreements.

49. A significant proportion of LBIE's debts arise under ISDA Master Agreements and the outcome of the Tranche C issues (in particular, Issues 10 to 19) will have a significant impact on the amount of the surplus the Administrators will be required to distribute in respect of statutory interest.

50. As Mr Lomas explains in his 12th witness statement, 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. Their claims represent approximately £4.4 billion of £12.2 billion of LBIE's total admitted claims.

51. The Respondents 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 Rate interest in respect of ISDA claims remains unclear. Some of LBIE's ISDA creditors contend that they can establish claims to interest at the Default Rate at rates significantly in excess of the Judgments Act rate.

52. As Mr Lomas explains in his 12th witness statement at paragraph 11 [2/8/321]:

> *"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."*

53. It is, of course, possible that a compound rate of below 8% will produce a greater amount of interest being payable than the Judgments Act rate. In circumstances where a creditor has a contractual entitlement to compound interest at such a rate, it is common ground that the rate which will apply to the creditor's claim to statutory interest will be the rate applicable to the debt apart from the administration.

54. It follows that the Court's determination of the ISDA related Tranche C issues will significantly impact upon the extent of statutory interest payable by LBIE and, in consequence, the amounts (if any) that will ultimately be available to meet non-provable claims, including currency conversion claims, and the subordinated debt claims.[10]

[10] In order to assist the Court, the Administrators' team has conducted an analysis of some of the possible approaches to performing a Default Rate interest calculation by using some of the methodologies which are in issue in these proceedings. This analysis is described in the Annex to Mr Lomas' 12th witness statement at pages

55. Even putting to one side the aggregate amount of the claims to statutory interest, it is of significant practical importance for the efficient distribution of the surplus that the Administrators receive clear guidance as to how they should evaluate the cost of funding self-certified by ISDA creditors for the purposes of calculating their respective Default Rates.

New York law issues

56. Issue 19 asks:

> "*Whether the answer to questions 10 to 18… is different if the underlying Master Agreement is governed by New York rather than English law*".

57. Accordingly, the Court will be required to consider all of the issues it has considered as a matter of English law a second time around but, this time, dealing with them as issues of construction applying the principles of construction which apply under New York law. The SCG and Wentworth have both filed expert evidence going to those principles and a joint statement of agreed and non-agreed issues on matters of New York law was served on 30 September 2015 [4/4].

58. It appears to the Administrators that there is little in dispute between the New York law experts and the SCG has confirmed that it considers that there is no need for the New York law experts to attend trial to be cross-examined [PTR/4/25]. Wentworth has not yet stated whether or not it agrees. The trial timetable will not be capable of being agreed until it is clear whether time needs to be allocated to the cross-examination of the New York law experts.

1 to 20 of AVL12. The Annex is intended to assist in the illustration of some of the more significant practical implications of hypothetical counterparties adopting particular methodologies when certifying their respective costs of borrowing, including the associated impact this might have on the LBIE estate's liability for statutory interest and the Administrators' distribution of the surplus.

German law issues

59. Issues 20 and 21 relate to the proper interpretation of the German Master Agreement, as a matter of German law. The SCG and Wentworth have both filed expert evidence going to matters of German law and will cross-examine each other's expert witness at trial.

60. The German law issues can be summarised as follows:

    (1) Issue 20 concerns: (i) whether, and in what circumstances, following LBIE's administration, a creditor with a claim under the German Master Agreement would be entitled to make a "damages interest claim" within the meaning of section 288(4) of the German Civil Code on any sum which is payable pursuant to the close-out provisions (clauses 7 to 9) of the German Master Agreement; and, if it can, (ii) whether (and if so, in what circumstances) all or part of such "damages interest claim" can constitute part of "*the rate applicable to the debt apart from the administration*" for the purpose of rule 2.88(9) of the Insolvency Rules 1986.

    (2) Issue 21 poses the questions relating to: (i) how, if both of the questions raised in Issue 20 are answered in the affirmative, the "damages interest claim" is to be quantified in circumstances in which the relevant claim under the German Master Agreement has been transferred (by assignment or otherwise) to a third party; and (ii) the burden of proof in establishing a "damages interest claim".

61. At paragraph 23 of his 13th witness statement [PTR/3], Mr Lomas states that, as at 7 October 2015, 15 claims under the German Master Agreement have been admitted in an aggregate amount of approximately £311 million.

French law issues

62. The French law issues concern four different master agreements governed by French law. Largely mirroring the German law issues, the French law issues include:

(1) Whether particular contractual rights contained in the agreements which relate to interest payments following a default are capable of being "*the rate applicable to the debt apart from the administration*" for the purpose of rule 2.88(9) of the Insolvency Rules 1986; and

(2) Whether the "party" entitled to receive such interest payments is to be construed as referring to the original contracting party or to a third party in circumstances in which the relevant right has been transferred (by assignment or otherwise) to a third party.

63. Mr Lomas' evidence (at paragraph 6 [PTR/3]) is that, as at 23 September 2015, 50 claims under French law governed master agreements had been admitted and the Administrators are not aware of any further claims under those agreements. The claims have been admitted in an aggregate amount of approximately £234.1 million. In value terms, the vast majority of the claims under the French law governed master agreements are under the AFB Master Agreement for Foreign Exchange and Derivatives Transactions (1994) and the FBF Master Agreement Relating to Transactions on Forward Financial Instruments (2001).

64. The Administrators (and the Respondents) no longer wish the Court to determine the French law issues, Issues 22 to 26. The SCG and Wentworth have reached an agreed position as to the French law position [1/19] under the AFB Master Agreement and the FBF Master Agreement (which agreements govern approximately 99.5% (by value) of the claims under the four French law governed master agreements) and for the reasons of expediency and proportionality set out in the 13th witness statement of Mr Lomas [PTR/3] and summarised below, the Administrators consider that it would be preferable

to remove the French law issues from Tranche C and proceed on the basis set out in that witness statement.

Issue 27

65. Issue 27 asks whether the answers to Issues 10 to 26 would be impacted where the relevant payee falls into one of three categories of counterparty (a Credit Institution or Financial Institution; a Fund Entity; or a corporate or other type of counterparty). None of the parties considers that Issue 27 should be answered in the affirmative and so, in due course, the Court will be invited to make a declaration which reflects that agreed position.

PTR ISSUES

The 9 March 2015 Order

66. In his order of 9 March 2015 (the "CMC Order"), David Richards J. not only divided up the Waterfall II issues into three tranches, he also gave extensive case management directions for the case management of each of the three tranches.

67. The directions given for Tranche C are at paragraphs 11 to 37 of the CMC Order. This PTR has been listed pursuant to paragraph 35. The Court will note that:

    (1) Paragraphs 11 to 32 contain a timetable for the production of expert evidence of foreign law.

    (2) Paragraph 36 required the trial bundles to be produced prior to the PTR, so as to be available for use at the PTR. That direction has been complied with and the Court has a set of the trial bundles.

    (3) Sub-paragraphs 37(1) to (3) set out a timetable for the production of skeleton arguments for trial.

(4) Sub-paragraph 37(4) requires the parties to use their best endeavours to agree and file, by 4pm on 4 November 2015, an agreed bundle of authorities and a reading list.

English and New York law issues

68. A number of the English law issues (Issues 14-16, 18 and 27) had been agreed between the Administrators, the SCG and Wentworth. This was notified to the Court at the CMC in March 2015. The parties have been corresponding regarding the preparation of a Statement of Agreed Positions which will be provided to the Court once it is clear what is and what is not agreed. In correspondence, GSI has stated (currently without explanation) that it disagrees with the formulation of the draft agreed positions on Issues 14 and 15 which are otherwise largely agreed by the Administrators, SCG and Wentworth. Following the PTR, the Administrators will continue to seek to reach agreed positions and to identify what is in issue as regards Issues 14-16, 18 and 27.

69. To the extent that agreement can be reached, the Court will be invited, once: (i) notice of these agreed positions has been notified to LBIE's creditors in the usual way; and (ii) the Court has handed down its judgment, to satisfy itself that the agreed positions are correct and to make appropriate declarations. If agreement cannot be reached, the limited disagreement which remains will have to be resolved at trial.

70. With one exception, so far as the Administrators are concerned, no further directions are required as regards the English law issues or the New York law issues at the PTR, and none has been identified by the Respondents[11]. The one exception is that it has been suggested by the SCG that the Administrators' Tranche C skeleton argument should be filed at the same time as, and exchanged with, the Respondents' skeleton arguments. This would require David Richards J's 9 March 2015 Order (paragraph 37)

[11] Save that GSI has raised a query as to whether Issues 11 and 12 need to be amended to ensure that the positions they have adopted are adequately provided for. The Administrators do not consider that any amendments are required and have explained in correspondence why that is the case. The SCG's and Wentworth's positions in this regard have not yet been shared with the Administrators.

to be varied [1/4/38] and would represent a departure from the approach taken in Waterfall II generally, the Administrators having been directed to file and serve their skeleton arguments for trial one week after the Respondents (with the Respondents having a right of reply) in both Parts A and B. The Administrators' role has not changed since the CMC Order was made.

71. The direction given by David Richards J. was given to reflect the role the Administrators are playing in this litigation, as set out above. Their role is to ensure that all tenable positions are adopted, and arguments made, so that the Court is able properly to determine the issues. The Administrators would be unable to fulfil that function without reviewing the Respondents' skeleton arguments before finalising their own.

72. This is important in circumstances in which the Respondents are not true representative creditors and particularly so where, as in Tranche C, Wentworth has a substantial portfolio of admitted claims under ISDA Master Agreements such that its financial interests are not limited to its interest as the holder of LBIE's subordinated debt.

73. It is, of course, true that the Administrators are, as matters stand and in light of the arguments which they understand from the Respondents' position papers and correspondence will be advanced by the Respondents, intending to make submissions on certain material and tenable positions. Given the role that the Administrators are playing, that does not justify the variation to the David Richards J's Order proposed by the SCG, not least, because the Administrators advanced a positive case on certain of the issues in Tranches A and B.

74. The Administrators' team has been working to the deadline of 23 October 2015 and, to bring that deadline forwards at the PTR on 9 October 2015, is potentially unmanageable, would be unfair and is unjustifiable.

German law issues

75. The production of the expert's reports on German law, and revisions made by the SCG to its case on the German law issues, led to it being identified that:

(1) Issue 20 did not, in fact, properly reflect what is in issue between the SCG and Wentworth and should be amended;

(2) as a result, the questions posed to the German law experts also required to be amended; and

(3) the existing German law expert evidence does not adequately deal with what is now in issue between those Respondents.

76. Following correspondence on these issues, the Administrators have agreed with the SCG and Wentworth:

(1) a revised formulation of Issue 20 (as to which, see [PTR/2/15]); and

(2) a revised list of questions for the German law experts (as to which see [PTR/1/6]).

77. A summary of the administration regime, including the proving process, has largely been agreed as between the Administrators, the SCG and Wentworth for use by the German law experts. It is not yet in final form and, whilst any agreement as to the final wording of the summary will post-date the production of the experts' reports, they have been provided with drafts which will doubtless have assisted them in the preparation of that evidence.

78. The SCG and Wentworth have, thus far, been unable to reach agreement as to a new date for the holding of the experts' meeting notwithstanding that they have agreed a date (22 October 2015) for the production by their experts of a joint statement setting

out the issues on which they agree and disagree following the postponed meeting of the experts. The Court will be asked to resolve this remaining dispute at the PTR.

79. In consequence of the delays in the production of their expert evidence, there is insufficient time for the German law experts to produce supplemental reports but they have served revised or replacement reports which focus on the issues now identified as being the issues which require determination by the Court ([4/11] and [4/12]).

80. Paragraphs 3 to 7 and 9 of the draft PTR Order make provision for the necessary amendments to Issue 20 and the questions for the German law experts and for the necessary variations to the timetable for the German law evidence. It has also been agreed, as is reflected in the draft Order, that the directions given by David Richards J. in respect of skeleton arguments be varied such that the German law issues will be the subject of a second skeleton argument served by each of the SCG and Wentworth, with the Administrators having permission to serve a skeleton argument on the German law issues if so advised. The details are contained in the draft Order [PTR/1].

The French law issues

81. As referred to above, and explained in detail in Mr Lomas' 13th witness statement [PTR/3], the parties wish to remove the French law issues from the Application.

82. The Application is an application for directions made by the Administrators under paragraph 63 of Schedule B1 to the Insolvency Act 1986. The Administrators have, and the Court has afforded the Administrators in the conduct of this administration, a wide margin of appreciation in selecting those issues on which they require directions from the Court.

83. At paragraph 19 of his 13th witness statement [PTR/3], Mr Lomas says:

> *"In light of the fact that only five of the French Law Claims arise under the AFTB Master Agreement or the AFTI Master Agreement, with a collective value of approximately £1.2m… the Senior Creditor Group, Wentworth and the Joint*

> *Administrators are… in agreement that it would be disproportionate to deal with issues concerning the construction and effect of the contractual right to interest under these agreements at the Tranche C trial, and consider instead that it would be preferable for the Joint Administrators to deal with these claims on a case by case basis with the creditors in respect of each of those claims. In fact, it may be the case that no creditor with admitted claims under the AFTB Master Agreement or the AFTI Master Agreement will seek to claim statutory interest on those claims at anything other than the Judgments Act rate."*

84. It is submitted that it would be disproportionate in terms of costs and the use of Court time for the issues relating to those two master agreements to be determined at the November trial of the Tranche C issues.

85. Further, in circumstances in which: (i) the SCG and Wentworth have reached an agreed position as regards the two French master agreements under which substantial claims have been admitted in the administration [1/19]; (ii) the SCG and Wentworth hold (or have an economic interest in) approximately 26% by value of the claims under those two French master agreements; and (iii) creditors have been given an opportunity to let the Administrators know if they disagree with the agreed position and none has come forward to do so[12], it is not appropriate, necessary or practical to have the French law issues relating to the AFB Master Agreement and the FBF Master Agreement determined at that trial.

86. Whilst it is possible that creditors with claims under the AFB Master Agreement and/or the FBF Master Agreement might later contend that the agreed position is, in one or more respects, wrong and not binding upon them, the SCG and Wentworth have both confirmed that they will be bound by the agreed position in respect of their admitted Euro-denominated claims under the AFB Master Agreement or FBF Master Agreement.

87. Accordingly, the Court is respectfully invited to amend the Application so as to remove the French law issues.

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[12] See paragraphs 12 to 16 of Mr Lomas's 13th witness statement at [PTR/3].

Trial timetable

88. The Administrators are seeking to agree a trial timetable with the Respondents and the draft PTR Order produced by them includes a provision that they do so by 4pm on 26 October 2015 [PTR/1].

89. As a starting point, on 30 September 2015, Linklaters wrote to the Respondents' solicitors proposing that the trial be divided up into three parts:

    (1) the English law issues;

    (2) the New York law issues; and

    (3) the German law issues.

90. In that letter, Linklaters also proposed the order in which:

    (1) each of the parties will make submissions; and

    (2) the experts will be cross-examined.

91. Linklaters explained that once the running order had been agreed, they would propose a timetable.

92. The "trial sequencing", as it has been referred to in the correspondence, has largely been agreed and it is hope that, by the time of the PTR, an agreed position will have been reached and can be shared with the Court.

CONCLUSION

93. For the reasons set out above, the Administrators invite the Court to make an Order in the terms of the draft at [PTR/1].

94. Further, should the Court consider that there are any steps the Administrators or their legal team might take to assist the Court further with its reading into the case, the Court should not hesitate to ask them to do so.

William Trower QC

Daniel Bayfield

Stephen Robins

South Square

8 October 2015

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

B E T W E E N :

(1) ANTHONY 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)

Applicants

-and-

(1) BURLINGTON LOAN MANAGEMENT LIMITED
(2) CVI GVF (LUX) MASTER S.A.R.L.

Respondents

ADMINISTRATORS' SKELETON ARGUMENT FOR 9 OCTOBER 2015 PTR

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