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

BETWEEN:

(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.À.R.L
(3) HUTCHINSON INVESTORS, LLC
(4) WENTWORTH SONS SUB-DEBT S.À.R.L
(5) YORK GLOBAL FINANCE BDH, LLC

Respondents

SENIOR CREDITOR GROUP'S

REPLY POSITION PAPER

STATUTORY INTEREST

Construction of Rule 2.88

Question 1: Whether on the true construction of Rule 2.88(7) of the Rules, Statutory Interest is payable on a simple or compound basis where the rate applicable is specified in section 17 of the Judgments Act 1838? If payable on a compound basis, with what frequency is it to be compounded?

1. **Senior Creditor Group's position:**

(1) The Senior Creditor Group's position is as set out in its Position Paper.

Question 2: Whether on the true construction of Rule 2.88(7) of the Rules, Statutory Interest is calculated on the basis of allocating dividends:

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

(ii) first to the reduction of the principal and then to the payment of accrued Statutory Interest; or

(iii) on the basis of some other sequencing.

2. **Senior Creditor Group's position:**

(1) The rule in *Bower v Marris* exists for reasons of justice and convenience: *MacKenzie v Rees* (1941) 65 CLR 1. The rule accords with the policy of insolvency legislation. As set out in paragraph 2(7) of the Senior Creditor Group's Position Paper, it (amongst other things):

(a) Puts the creditor in the position it would have been apart from the insolvency proceedings;

(b) Protects the creditor against the erosion of its right to receive the interest rate to which it is entitled by r.2.88 which it would suffer

if the amount of such interest was calculated on the basis that distributions were deemed applied first to principal; and

(c) Ensures creditors are not treated unequally with respect to Statutory Interest depending on whether and when they submitted proofs of debt, had those proofs admitted, or received dividends.

(2) Wentworth and the Administrators contend that the rule in *Bower v Marris* is based on old law which was repealed by the enactment of section 189 of the 1986 Act from which r.2.88(7) was derived and that, as a result, Statutory Interest now has to be calculated on the basis of allocating dividends solely to the reduction of proved debts.

(3) The first argument that Wentworth and the Administrators make is based on the wording of r.2.88(7) which states that interest is to be paid from "*any surplus remaining after payment of the debts proved*". They say that, given that principal constituted by the proved debts must already have been paid in full, the surplus cannot be applied in paying interest before principal. They say that r.2.88(7) is therefore inconsistent with the rule in *Bower v Marris*.

(4) This argument is based on a simple misunderstanding of the old law and of the requirement that interest is to be paid from any surplus remaining only after all proved debts have been paid in full.

(a) All insolvency legislation since 1824 has expressly provided, to the same effect as r.2.88(7), that interest was not to be paid out of any surplus unless and until all proved debts had been paid in full; see, in particular, section 129 of the Bankruptcy (England) Act 1824 (5 Geo IV c 98), section 139 of the Bankruptcy (England) Act 1825 (6 Geo IV c 16), section 197 of the Bankruptcy Consolidation Act 1849 (12 & 13 Vict c 106) section 40 of the Bankruptcy Act 1883 and section 33 of the Bankruptcy Act 1914.

Thus, for example, section 33(7) and (8) of the 1914 Act provided that "*Subject to the provisions of this Act, all debts proved in the bankruptcy shall be paid pari passu"* and that *"If there is any surplus after payment of the foregoing debts, it shall be applied in payment of interest …"* (emphasis added). Indeed, the 1825 Act (and the 1824 Act before it) merely "*recognised and extended*" the rule which had previously "*prevailed in bankruptcy with regard to the surplus*", by granting a right to post-bankruptcy interest on debts which did not otherwise carry interest; *Re Langstaffe* [1851] O.J. No.238 at [10] and *Bromley v Goodere* (1743) 1 Atkyns 75; 26 ER 49.

(b) Such provisions, in providing that post-insolvency interest is not to be paid unless and until all proved debts have been paid in full, reflect the basic priority regime in insolvency, namely that proved debts rank in priority to claims to post-insolvency interest.

(c) An identical argument of construction to that now made by Wentworth and the Administrators was made in *Bower v Marris* itself; see the Lord Chancellor at p.526-7 ("*it is said … that the payments by way of dividends … were appropriated and were paid to and received by the [creditor] on account of so much principal money, and therefore that interest from that time ceased upon the amount of such principal money*"). The argument was rejected by the Lord Chancellor who held that this was not the effect of the legislation.

(d) Provisions dealing with the application of any surplus were re-enacted by the legislature, in materially similar terms, over the next hundred and fifty years in parallel with the continued application of the rule of *Bower v Marris*.

(e) In *Re Humber Ironworks* (1869) LR 4 Ch 643 Selwyn JL at p.645 confirmed that the rule in *Bower v Marris* applied in corporate insolvency, explaining that "*in as much as they have all been paid in process of law, and without any contract or agreement between the parties, the*

account must, in the event of there being an ultimate surplus, be taken, as between the company and the creditors in the ordinary way". In other words, in the event of a surplus, calculating the amount of interest payable would be done in the ordinary way by notionally treating any dividends which had been paid as having been paid first in respect of interest and then principal.

(f) The rule in *Bower v Marris* reflects a general equitable rule that in the ordinary way the law will apply a payment made by a debtor to discharge interest before applying it to principal.

(g) The rule in *Bower v Marris* was confirmed as still good law in the context of corporate insolvency and applied, prior to the introduction of the 1986 Act, as recently as 1984: see *Re Lines Bros* [1983] 1 Ch 1 and *Lines Bros (No.2)* [1984] 1 Ch 438.

(5) The second argument that Wentworth and the Administrators make is that the 1986 Act and Rules changed the law, in particular because they provided, for the first time in relation to corporate insolvency, that post-insolvency interest would be paid on debts which did not carry interest apart from the insolvency.

(6) It is correct that r.2.88(9), which provides that post-insolvency interest is payable on all proved debts at "*whichever is the greater of the rate specified under paragraph (6) and the rate applicable to the debt apart from the administration*", provides for post-insolvency interest to be paid out of any surplus even on debts to which interest is not otherwise applicable. It is incorrect to suggest, however, that this is inconsistent with *Bower v Marris*, let alone indicates an intention to repeal it.

(a) Prior to 1986 the position in personal bankruptcy was that post-insolvency interest was payable out of any surplus even on debts which did not otherwise accrue interest. Indeed, this had been the position since section 129 of the Bankruptcy (England) Act

1824. In bankruptcy, therefore, the regime already involved both the payment of interest out of any surplus on debts which did not otherwise accrue interest and also the application of the rule in *Bower v Marris* without this being regarded as inconsistent.

(b) The extension, to corporate insolvency, of the right to post-insolvency interest on any debts which did not otherwise accrue interest out of any surplus, as provided for by the 1986 Act, merely remedied an anomaly with bankruptcy and an injustice which had been identified since at least 1869: see *Re Humber Ironworks* per Giffard LJ at p.648 ("*I do not see with what justice interest can be computed in favour of creditors whose debts carry interest, while creditors whose debts do not carry interest are stayed from recovering judgment, and so obtaining a right to interest*"). See also *Re Fine Industrial Commodities Ltd* [1956] 1 Ch 256 per Vaisey J at p.263 and *Re Rolls-Royce Ltd* [1974] 3 All ER 646 per Pennycuick V-C at p.653b.

(7) The 1986 Act and Rules did not repeal the rule in *Bower v Marris* and there is no suggestion in any subsequent case that it did; see for example, *Wight v Eckhardt* [2004] 1 AC 561 per Lord Hoffmann at [21] to [31] approving both *Re Humber Ironworks* and *Re Lines Bros*.

(8) Wentworth's and the Administrators' contentions are inconsistent with fundamental principles of company and insolvency law.

(a) As the Administrators accept in the context of Question 3, "*the overarching purpose of the Statutory Interest provisions is to compensate creditors for being kept out of their money and deprived of their contractual (or other) rights as a result of the administration*" and that "*There is no policy justification for seeking to deprive parties of their full contractual and other rights to interest once all proved debts have been paid*"; see their Position Paper at [21] and [22].

(b) *Bower v Marris* is consistent with that purpose. Thus, for example, the effect of the rule is that a creditor with a contractual right to interest will receive, out of any surplus, the full amount of interest which he is entitled to receive calculated in the ordinary way and in accordance with the underlying equitable rule, before any distributions are made to shareholders.

(c) Wentworth's and the Administrators' contention is inconsistent with that purpose. According to them, for example, the effect of the introduction of the 1986 Act was that a creditor with a contractual right to interest will no longer receive, out of any surplus, the full amount of interest which he is entitled to receive under his contract.

(d) According to Wentworth and the Administrators, the legislature, by enacting r.2.88(7), therefore decided to override the right of a creditor to interest calculated on the basis that any payments are treated as having been appropriated first to interest and then to principal, in the ordinary way and in accordance with the underlying equitable rule, regardless of the fact that this involved reversing over 150 years of practice and procedure in bankruptcy and corporate insolvency and regardless of the fact that, as the Administrators accept, "*there is no policy justification*" for the legislature having taken such a course.

(e) The consequence, according to Wentworth and to the Administrators, is that part of the surplus is now required to be distributed to shareholders despite, for example, the continuing existence of claims by creditors with a contractual right to interest which have not been satisfied in full.

(9) Wentworth's and the Administrators' contentions are inconsistent with the analysis in the authorities of the effect of the insolvency process, including, for example, that:

(a) So far as contractual rights are concerned: "… *as soon as it is ascertained that there is a surplus, the creditor whose debt carries interest is remitted to his rights under his contract*"; per Giffard LJ in *Re Humber Ironworks* at p.647.

(b) More generally: "… *when the time comes for dealing with the surplus it must no longer be deemed to be an insolvent company, but has to be treated as a company which is, and was, and always has been, solvent*"; per Vaisey J in *Re Fine Industrial Commodities Ltd* at p.262.

See also the Cork Report which, consistently with this, stated at [1384] that "*the creditor who is entitled to interest on the debt for which he has proved may recover the interest accruing after the presentation of the winding up petition as if there had been no winding up at all*".

(10) Wentworth's and the Administrators' contentions as to the effect of the 1986 Act produce a combination of results which are incoherent as a matter of principle and policy. For example:

(a) The effect of Wentworth's and the Administrators' contentions in relation to corporate insolvency is that, at the same time as prejudicing creditors who had a right to interest apart from the insolvency by overriding part of their rights, the legislature decided to improve the position of creditors who were not otherwise entitled to interest. There is no sensible policy reason why the legislature would have wanted to prejudice the interests of the former whilst benefiting the latter in this way and none was ever suggested in the Cork Report or elsewhere.

(b) The position is even more extreme on Wentworth's case. Its position in relation to Question 3 is that when r.2.88(9) refers to "*the greater of the rate specified under paragraph (6) and the rate applicable to the debt apart from the administration*", the reference to the rate applicable to the debt apart from the administration is merely to

the percentage rate and does not take account of any other provision of the contract which may affect the rate at which such interest accrues, such as compounding. On Wentworth's case therefore, at the same time as the legislature removed the anomaly and injustice identified by Giffard LJ in *Re Humber Ironworks* and gave creditors whose debts do not otherwise carry interest a right to post-insolvency interest, they further prejudiced the contractual rights of creditors whose debts did carry interest. On its case, the 1986 Act not merely overrode the effect of *Bower v Marris* thereby reversing over 150 years of insolvency practice, but at the same time also overrode the right which creditors previously had in the event of a surplus to post-insolvency interest calculated in accordance with the terms of their contracts, including, for example, a right to compound interest.

(11) The Administrators contend that, given that it is a matter of statutory interpretation, "*it is nothing to the point that so-called 'Bower v Marris calculation' may be applied in other common law jurisdictions".* This dismissive treatment of the position in such other jurisdictions is unjustified:

(a) Although all such jurisdictions have a similar rule of priority that proved debts rank in priority to claims to post-insolvency interest, there is no Commonwealth jurisdiction which has rejected the approach in *Bower v Marris* and all that have considered it have adopted it.

(b) In *Re Hibernian Transport Companies Ltd (No.2)* [1991] 1 IR 271 at p.272 Carroll J expressly referred to section 33(8) of the Bankruptcy Act 1914 and section 40 of the Bankruptcy Act 1883 when determining the correct approach in Ireland.

(12) The Senior Creditor Group's position is that:

(a) The rule in *Bower v Marris* continues to reflect good law such that, in the event of a surplus, the amount of interest to be paid out of any surplus is to be calculated in the ordinary way by notionally treating any dividends which have been made as having been paid first in respect of interest and then principal.

(b) This approach is consistent with the basic principles of insolvency law that the process of collective execution leaves the legal rights of creditors unaffected save to the extent of actual payment, that proved debts rank in priority to claims in respect of post-insolvency interest, that creditors are not unfairly prejudiced by delay in the distribution of the assets and that the company's assets must be applied in discharge of its liabilities before any distributions are made to shareholders.

(c) If the rule in *Bower v Marris* is not applied, the effect in this Administration is that creditors will, in the absence of other compensation for delay, be deprived of at least £500 million of interest to date (on the Senior Creditor Group's estimation). They will also be deprived of a further around £40 million of interest for every month between today and the date on which interest is actually paid by the Administrators.

Question 3: Whether the words "the rate applicable to the debt apart from the administration" in Rule 2.88(9) of the Rules refer:

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

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

3. **Senior Creditor Group's position**:

(1) The Senior Creditor Group's position is that, if there is a surplus, a creditor with a contractual right to interest is entitled to interest calculated in accordance with such rights and that this is reflected consistently in the Rules, such that, for example, the phrase "*the rate applicable to the debt apart from the administration"* in r.2.88(9) encompasses all factors relevant to the rate at which interest accrues.

(2) The Administrators take the same position, emphasising, at least in the context of Question 3 although not also Question 2, that such a construction is consistent with the fact that "*there is no policy justification for seeking to deprive parties of their full contractual or other rights to interest once proved debts have been paid in full*"; see at [22] to [23].

(3) Wentworth's position, consistent with their approach to Question 2, is, in contrast, that "*the regime imposed by r.2.88 is a self-contained statutory regime which operates (in contradistinction to the pre-1986 law) otherwise than by remitting creditors to their contractual rights upon a surplus arising*" [20].

(4) Wentworth's position is that, when the legislature enacted r.2.88(7) and (9), it was intending to reverse the effect of over 150 years of statute and authority in bankruptcy and corporate insolvency.

    (a) It accepts that, prior to 1986, a creditor with a contractual right to interest was entitled, in the event of a surplus, to interest calculated in accordance with his contractual rights, including, amongst other things, the right of appropriation and the right to compound interest if applicable.

    (b) It contends, however, that the effect of the 1986 Act and Rules was, save in one respect only, to remove all such rights. The "*sole exception*" is that r.2.88(9) permits a creditor who has a contractual right to interest at a percentage rate higher than the Judgments Act Rate to claim interest at that higher percentage rate [21].

(5) Wentworth makes three points in support of its position. There is nothing in any of these points:

(a) First it is said that "*the use of the word 'rate' is important*" because r.2.88(9) requires a comparison to be made between two rates and "*in order to make that comparison, it is necessary that the two rates are comparable*" [22]. The argument is that it is impossible to tell whether a compound rate is greater or less than the Judgments Act Rate. This argument is self-evidently wrong. Provided that the relevant period of calculation is known, it is a simple question of maths to calculate which rate of interest is the greater. Indeed, this method of calculating the rate applicable is the one adopted by Wentworth in the context of Question 13; see at [82] to [83].

(b) Secondly it is said that "*when construing a statute requiring interest to be paid, it is the norm that it is intended to refer to simple interest*" [23]. But r.2.88(9) provides for interest to be paid at "*the rate applicable to the debt apart from the administration*" and the effect of that is effectively to incorporate the contractual provisions for the determination of that rate.

(c) Thirdly it is said that r.2.88(7) requires Statutory Interest to be paid on 'those debts' i.e. the debts which have been proved and "*payment of interest on a compound basis would be inherently inconsistent with that requirement, since on a proper analysis, compound interest on a debt involves the payment of interest on a sum other than a debt*" [24]. There is nothing in this point. The logic of the argument is that if a contract provides for the payment of compound interest on a principal debt, the creditor is nevertheless not entitled to compound interest as that would involve the payment of interest not merely on the original principal debt but also on interest accrued.

(6) There is no sensible policy reason why the legislature would have wanted to prejudice the interests of creditors with a contractual right to interest in this way. None was ever suggested in the Cork Report and Wentworth does not seek to identify one now.

(7) The suggestion that the legislature intended to prevent a creditor from relying on all aspects of its contractual right to interest, with the sole exception of the right to a specified percentage rate, is incoherent as a matter of policy and principle.

(a) R.2.88(9) provides that "*the rate of interest payable under paragraph (7) is whichever is the greater of the rate specified under paragraph (6) and the rate applicable to the debt apart from the administration*".

(b) The effect of Wentworth's construction is that, under r.2.88(9), a creditor with a high contractual right to simple interest at, say, 20% is entitled to recover interest at 20% (given that this is greater than the Judgments Act Rate of 8%), whilst a creditor with a more modest contractual right to compound interest at, say, 8.5% is only entitled to simple interest at 8.5%. Similarly, the effect of Wentworth's construction is that a creditor with a right to compound interest at, say, 7.5% is only entitled to interest at the Judgments Act Rate despite the fact that, over time, its contractual claim could yield a greater amount than a claim at that rate.

(c) The suggestion that the policy underlying r.2.88(9) was, in effect, to penalise creditors with a contractual right to compound interest and to do so regardless of the underlying percentage rate of interest to which that right attached is nonsensical. There is nothing objectionable in a contractual right to compound interest, particularly given that simple interest "*is an artificial construct which has no relation to the way money is obtained or turned to account in the real world*" and "*never provides a full indemnity for the loss to the litigant*":

Sempra Metals Ltd v IRC [2007] UKHL 34 per Lord Hope at [33] and [41].

(8) The Senior Creditor Group's position is that the phrase "the rate applicable to the debt apart from the administration" in r.2.88(9) can and naturally does encompass all factors relevant to the rate at which interest accrues.

(9) The Administrators in [31] and [32] say that they have identified a sub-issue on which they invite the Respondents to explain their position, namely whether, where a creditor has a contractual or other entitlement to receive compound interest:

(a) under r.2.88(9) interest continues to compound in full following the payment in full of the principal debt [31.1]; or

(b) if not, the creditor has a non-provable claim in respect of the interest that would have continued to compound on a contractual basis following the payment in full of the principal amount [31.2].

(10) The Senior Creditor Group's position, as set out in their original Position Paper, is that the sub-issue does not arise because it is premised on the Administrators' incorrect approach in relation to Question 2, namely that r.2.88(7) requires that, regardless of the contractual position, any calculation of the amount of interest payable out of the surplus must be done on the premise that principal was paid in full.

(11) Without prejudice to this:

(a) If the Senior Creditor Group is wrong in its approach to Question 2, then Statutory Interest continues to compound in full following the payment in full of the principal debt. Any other position fails to give effect to the creditor's right to be paid compound interest.

(b) If the Senior Creditor Group is wrong in its approach to Question 3 and '*the rate applicable to the debt apart from the administration*' does not require one to take account of all of the components which determine the rate at which interest accrues on the debt apart from administration, then, as set out in their original Position Paper at [3], the excess (if any) of the amount payable taking all such components into account over the amount actually paid under r.2.88(7) ranks as a non-provable claim.

(12) Any other conclusion would have the effect that, contrary to fundamental principle and policy in company and insolvency law, the surplus would be required to be distributed to shareholders despite the fact that a creditor would not have received the full amount of interest to which he was entitled in accordance with the terms of his contract.

Question 4: Whether the words "the rate applicable to the debt apart from the administration" in Rule 2.88(9) of the Rules are apt to include (and, if so, in what circumstances) a foreign judgment rate of interest or other statutory interest rate.

4. **Senior Creditor Group's position:**

(1) Wentworth contends that the words "*the rate applicable to the debt apart from the administration*" in r.2.88(9) are capable of including a foreign judgment rate of interest if, but only if, the creditor already had the benefit of a foreign judgment as at the date of the administration.

(2) The Senior Creditor Group, together with York and the Administrators, contend that this is incorrect.

(3) The purpose of the rules governing Statutory Interest is to entitle a creditor to interest which the insolvency regime has prevented it from establishing either by proving or by commencing his own proceedings: *Re Lehman Brothers International (Europe)* [2014] EWHC 704 at [163]. So far as

the latter situation is concerned, as Giffard LJ stated in *Re Humber Ironworks* (1869) LR 4 Ch App 643 "*I do not see with what justice interest can be computed in favour of creditors whose debts carry interest, while creditors whose debts do not carry interest are stayed from recovering judgment, and so obtaining a right to interest*".

(4) The first argument that Wentworth makes is based on the wording of r.2.88(9). They say that r.2.88(9) is to be construed as referring to the rate applicable to the debt "*pursuant to such rights as existed as at the date of administration*". It is said that this follows from the fact that the commencement of the administration is the notional date of proof and distribution such that the obligation to distribute the surplus notionally arises at the same date.

(5) This argument is misconceived:

(a) The fact that the assets of the company are treated as if they had been notionally collected and distributed on the date of the commencement of the liquidation or, in this case, administration, is irrelevant.

(b) That fiction is employed as a way of explaining why, for the purposes of the process of collective enforcement, the value of provable debts is ascertained as at the date of the commencement of the insolvency proceedings: *Re Humber Ironworks and Shipbuilding Co.* (1869) LR 4 Ch App 643; *Re Dynamics Corporation of America* [1976] 1 WLR 757; *Wight v Eckhardt* [2004] 1 AC 147.

(c) That description of the collection and distribution of assets has no explanatory force once all provable debts have been paid in full. It is not relevant when determining how any surplus that remains should be applied to pay interest for the period for which those debts have been outstanding. This is because the need to pay interest from the surplus assumes that there has been a delay

in the distribution of the estate. One cannot assume, as Wentworth does, that it must be distributed on the premise that no delay has occurred. If that were the case, no interest would ever be payable on debts proved.

(d) Nor is it correct that interest from the surplus can only be paid in respect of an accrued right to interest which existed as at the commencement of the administration, at least in the sense contended for by Wentworth. This ignores the fact that a creditor may have a right to interest, even if an order for the payment of interest has not yet been made. It also ignores the fact that "*the justification for statutory interest, even in those cases where debts do not already carry interest, is that creditors are prevented by the liquidation regime from obtaining judgment against the company which would then carry interest at judgment rate*": *Re Lehman Brothers International (Europe)* [2014] EWHC 704 at [163]. This statutory purpose, which is reflected in the entitlement to interest at the rate specified in section 17 of the Judgments Act 1838, is also capable of applying in respect of foreign proceedings.

(6) The second argument that Wentworth makes is that it would be inconsistent with the fundamental principles of insolvency law and inconsistent with the statutory moratorium if the "*rate applicable to the debt apart from the administration*" could include a foreign judgment rate of interest in circumstances where, absent action in breach of the stay or pursuant to an exception granted by the Court in the exercise of its discretion to lift the stay, the creditor would not have been able to sue in that foreign jurisdiction and obtain the foreign judgment rate.

(7) This is incorrect:

(a) The fundamental principle of insolvency law referred to by Wentworth is that creditors' rights of individual enforcement are exchanged for a collective enforcement process. However, that

principle does not dictate the way in which creditors' rights should be determined in the context of that collective enforcement process.

(b) The moratorium is designed to protect the collective enforcement process. There is no inconsistency in a regime which, on the one hand, determines a creditors' *right* to interest by reference to the rate which it could have obtained but for the moratorium and, on the other hand, requires that right to be enforced collectively with other creditors.

(c) The fact that a creditor might not have been able to obtain an order for payment of interest, absent action in breach of the stay or pursuant to an exception granted by the Court in the exercise of its discretion to lift the stay, is not a reason for denying him interest. To the contrary, the existence of the moratorium is the reason why creditors are entitled to receive interest calculated at the Judgments Act Rate: *Re Lehman Brothers International (Europe)* [2014] EWHC 704 at [163].

(8) The third argument that Wentworth makes is that there is no basis for any factual assumption that LBIE would not have paid or defended the claim. As to this:

(a) R.2.88(9) requires the assumption of a counter-factual hypothetical; i.e. consideration of the position but for the administration.

(b) It is entirely appropriate to assume that the relevant rate is that which would have been obtained had that entity failed to pay or successfully defend the claim. Had LBIE paid or had a valid defence to the claim, no proof of debt would have been lodged or admitted and the present issue would not have arisen.

(c) This is also consistent with the alternative of Judgments Act Rate interest, which a creditor is entitled to without having to show that, if proceedings had been issued, the debtor would not have paid or defended the claim.

(9) The Senior Creditor Group contends that the words "*the rate applicable to the debt apart from the administration*" in r.2.88(9) are also capable of including a foreign judgment rate of interest in the following circumstances:

(a) Where, under foreign law, the creditor has a right to interest on his claim pursuant to statute.

(b) Where foreign proceedings were commenced after the commencement of the insolvency and judgment was subsequently obtained and, under foreign law, the court can award interest.

(c) Where foreign proceedings were commenced after the commencement of the insolvency and, under foreign law, the court can award interest.

(d) Where a creditor is entitled to commence foreign proceedings and, under foreign law, the court can award interest.

(e) Where a creditor was entitled to commence foreign proceedings and, under foreign law, the court could have awarded interest.

Provided that, in each case, the foreign proceedings are proceedings that the creditor was or is entitled to commence and the foreign law was or is a law applicable to the claim, whether as result of the foreign law being the governing law of the claim or the jurisdiction being one in which the creditor was required or entitled to commence proceedings.

(10) In their Position Paper the Administrators ask the Respondents to clarify from what date interest based on a foreign judgment rate will begin to accrue, in circumstances where a creditor could have sued in the foreign jurisdiction as at the Date of Administration but has not done so. The Senior Creditor Group's position in this respect is that interest will be treated as beginning to accrue from the Date of the Administration.

Question 5: Whether, for the purposes of establishing, as required under Rule 2.88(9) of the Rules, "whichever is the greater of the rate specified under paragraph (6) and the rate applicable to the debt apart from the administration", the comparison required is of:

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

(ii) only the numerical rates themselves,

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

5. Senior Creditor Group's position:

(1) The parties' positions in relation to Question 5 reflect the positions that they have taken in relation to Question 3.

(2) The Senior Creditor Group and the Administrators agree that, for the purposes of establishing whichever is the greater of the Judgments Act Rate and the rate applicable to the debt apart from the administration, the comparison required is of the total amounts of interest that would be payable under r.2.88(7) based on each method of calculation.

(3) The Senior Creditor Group and the Administrators also agree that, where the "*rate applicable to the debt apart from the administration"* varies from time to time, it is necessary to calculate the total amount of interest the creditor would be entitled to under the rate applicable to the debt apart from the

administration as it varies from time to time with the total amount of interest the creditor would be entitled to under the Judgments Act Rate, and to pay the greater of the two amounts.

(4) The Administrators contend in the alternative that, where the rate applicable to the debt apart from the administration varies from time to time so as to be less than the Judgments Act Rate at certain times, interest is payable at the Judgments Act Rate for those parts of the period during which it was greater than the rate applicable to a creditor's debt apart from the administration.

(5) Wentworth accepts that if (as the Senior Creditor Group and the Administrators contend) the "*rate applicable to the debt apart from the administration"* can include a compound rate then the comparison of the Judgments Act Rate and the rate applicable to the debt apart from the Administration is not conducted simply by comparing the headline rates.

(6) However, Wentworth is wrong to say that in those circumstances it is necessary to identify a weighted average simple rate which equates to the compound rate in order to allow a proper comparison with the Judgments Act Rate. All that is required is to compare the total amount of interest the creditor would be entitled to under the rate applicable to the debt apart from the administration with the total amount of interest the creditor would be entitled to under the Judgments Act Rate, and to pay the greater of the two amounts.

(7) The Administrators in [40] say that they have identified a related issue on which they invite the Respondents to explain their position. That issue concerns the way in which the greater of the Judgments Act Rate and the rate applicable to the debt apart from the administration should be determined in circumstances where a creditor has several proved debts, but only one or more of these arises from a contract (or contracts) conferring a right to interest (or which gives rise to a rate of interest in excess of the Judgments Act Rate).

(8) The Senior Creditor Group's position (consistent with its position on Question 37) is that:

(a) R.2.88(7) in combination with r.2.88(9) requires any surplus remaining after payment of the "*debts proved*" to be applied in paying interest on "*those debts*" at the greater of the Judgments Act Rate and the rate applicable to the debt apart from administration.

(b) Where a creditor has submitted a single aggregated proof in respect of a number of debts, it is necessary in the case of each debt making up the single aggregated proof to compare the total amount of interest payable under the rate applicable apart from the administration with the total amount of interest the creditor would be entitled to under the Judgments Act Rate.

(c) This follows from the fact that neither the process of proving nor the submission of a proof of debt creates new substantive rights in creditors or destroys the old ones (see *Wight v Eckhardt Marine* [2003] UKPC 37 [27]). The "*debts proved*" within r.2.88(7) are the underlying debts to which a proof of debt relates.

(d) Any other conclusion would give rise to anomalous results. For example, it would mean that two creditors who are each owed a number of identical debts would be treated differently depending on whether they submitted single or multiple proofs of debt.

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

(i) the Date of Administration;

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

(iii) another date.

6. **Senior Creditor Group's position**:

(1) The Senior Creditor Group's position in relation to Question 6 is set out in their Position Paper. That position is subject to the answers to Questions 7 and 8 which deal with the effect of the rules governing contingent and future claims.

(2) The purpose of r.2.88(9) is to entitle a creditor to interest which the insolvency regime has prevented it from recovering either by proving or commencing its own proceedings.

(3) The basic position (which is subject to the Senior Creditor Group's answers to Questions 7 and 8) is that to the extent a creditor has a right to claim interest on a debt which, absent the insolvency, it would be entitled to recover from the company but which the insolvency regime prevented it from proving:

(a) The words "*the rate applicable to the debt apart from the administration*" require the amount of interest to be calculated, in accordance with such rights.

(b) The reference to "*the rate applicable to the debt apart from the administration*" is, in such a case, designed to respect, so far as possible, a creditor's rights in respect of interest on amounts owed apart from administration.

(4) To the extent that the creditor is entitled to interest because the insolvency regime has prevented it from commencing proceedings then such interest runs from the date of administration whether such interest is at the Judgments Act Rate pursuant to r.2.88(6) or at a foreign judgment rate as referred to in relation to Question 4.

Period during which the debts "have been outstanding since LBIE entered administration" for the purposes of Rule 2.88(7)

Question 7: Whether Statutory Interest is payable in respect of an admitted provable debt which was a contingent debt as at the Date of Administration from:

(i) the Date of Administration;

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

(iii) another date,

having regard to whether:

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

a. the final dividend; or

b. Statutory Interest; and / or

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

7. **Senior Creditor Group's position**:

(1) The Senior Creditor Group and York contend that contingent claims are "*outstanding*" for the purposes of r.2.88(7) from the date of Administration and for so long as all or part of such claims remain unpaid.

(2) Given the nature and effect of the rules governing the estimation of contingent claims (described below) creditors with contingent claims are entitled to interest at the higher of the Judgments Act Rate and "*the rate applicable to the debt apart from the administration*" from the Date of the Administration.

(3) Wentworth and the Administrators contend that Statutory Interest is payable on a contingent debt only from the date on which the contingent debt ceased to be a contingent debt.

(4) Their contentions ignore the nature and effect of the rules governing the estimation of contingent claims and are, for that reason, based on a false premise:

(a) The Rules provide that debts are proved by reference to the amount of the claim as at the date of the Administration (see, in particular, r.2.72(3)(b)(ii)).

(b) The purpose of this rule and all the other rules concerned with fixing the amount of the debt as at the date of the Administration (such as r.2.86(1), which provides that all debts in a foreign currency must for the purposes of proof be converted into Sterling as at the date of the Administration) is to ensure that the assets are distributed *pari passu* amongst proved debts; *Re Dynamics Corporation* [1976] 1 WLR 757.

(c) Where the debt is contingent as at the date of the Administration, the amount of the provable claim as at that date is its estimated value in accordance with r.2.81.

(d) To the extent that the contingent debt is one which, assuming the contingency occurs, will only be payable in the future, the process of estimating its value as at the date of the Administration as required by the Rules takes account of: (a) the likelihood of the contingency occurring; and (b) the fact that, if it occurs, it will occur and the debt will only be payable in the future: see *Re MF Global UK* [2013] EWHC 92 at [54] where David Richards J described the valuation of a contingent debt as "*essentially a process of putting a present value on possible future events or outcomes*".

(5) Despite the Rules requiring a contingent claim to be admitted for proof in an amount reflecting its value as at the date of the Administration, Wentworth and the Administrators contend that Statutory Interest does

not start accruing and is not payable unless and until the contingency occurs.

(6) If this were correct, the consequence would be that:

(a) The creditor would receive no compensation in respect of the period between the date of Administration and the date that the contingency occurs. He would receive dividends on his proof on the estimated value of his claim as at the date of Administration, like all other creditors, but, unlike other creditors, would be entitled to interest not from the date of the Administration but only from the date when the contingency occurs.

(b) Contingent creditors, unlike other creditors, will never be entitled to receive the full value of their debts and, depending on the date on which the contingency occurs, may never receive any compensation for delayed payment of their claim.

(7) The first argument that Wentworth and the Administrators make is based on the wording of r.2.88(7) which states that interest is payable on debts proved "*in respect of the periods during which they have been outstanding since the relevant date"*. They both contend that a contingent debt cannot be said to be "*outstanding"* until such time as the contingency occurs and the Administrators also contend that to be "*outstanding*" a debt must be "*due and payable*".

(8) As to this:

(a) The ordinary meaning of the word "*outstanding*" is wide enough to include contingent debts which have not yet become due or payable: see, for example, *Crystal Palace FC (2000) Ltd v Paterson* [2005] EWCA Civ 180 per Clarke LJ referring to the definition of "*outstanding*" in the fifth edition of the Shorter Oxford Dictionary as including "*unresolved, pending; esp (of a debt etc) unsettled*".

(b) As a matter of statutory interpretation, contingent debts admitted to proof are "*outstanding*" since the Date of Administration for the purposes of r.2.88(7).

(c) R.2.88(7) entitles creditors to receive interest on the amount outstanding *in respect of their admitted proofs* from the date of administration. The admitted proof in respect of a contingent debt will be for an amount reflecting its estimated value as at the Date of Administration: see above. It is immaterial whether the debt proved is present or future, certain or contingent (r.13.12(3)). The reference to "*outstanding*" is to the period for which proved debts which are ascertained as at the Date of Administration are "*unresolved*" i.e. remain in whole or in part unpaid.

(d) R.2.105 deals with future debts. It provides that "*for the purpose of dividend (and no other purpose) the amount of a creditor's admitted proof (or, if a distribution has previously been made to him, the amount remaining outstanding in respect of his admitted proof) shall be reduced by applying [the formula]*" (emphasis added). Although r.2.105 is dealing with future debts (and not contingent debts admitted to proof for an amount that reflects their estimated current value), the word "*outstanding*" in r.2.105 is used to refer to future debts i.e. it cannot refer solely to debts which are due and payable.

(9) The logic of the Senior Creditor Group's position is accepted by Wentworth in its treatment of future debts. In particular:

(a) Wentworth (but not the Administrators) accepts at [54] that "*a debt which is certain to become payable in the future can properly be described as 'outstanding' from time of its creation*", despite not being due and payable.

(b) In that context Wentworth accepts that, as dividends received in respect future debts represent the value of those debts as at the date of the administration, "*Statutory Interest should be payable to the future creditor from the Date of Administration*" (at [55]).

The same logic and reasoning applies in the context of contingent debts admitted to proof.

(10) Wentworth contends that future debts are treated differently from contingent debts on the basis that (a) a future debt is certain to fall due for payment at some point (whereas a contingent debt may not) and (b) the Insolvency Rules make specific provision for discounting the value of future debts for the purpose of dividend. However, given that the amount of both future and contingent debts is assessed as at the date of administration, and that the word "*outstanding*" is sufficiently broad to cover contingent claims as well as future claims which have been proved, there is no justification for saying that the Rules provide for interest to be payable on the former only when the contingency occurs but on the latter from the date of the Administration.

(11) Wentworth refers to the general rule, in liquidation and in administration, that the proof and distribution process notionally occurs on the date of commencement of the liquidation or administration, but says at [44] that "*this principle is, however, subject to exception where rigid adherence to it would not properly give effect to the pari passu nature of the distribution required*" and that such an exception is required here to ensure *pari passu* treatment in respect of interest.

(12) However, Wentworth's and the Administrators' approach would result in Statutory Interest being paid on a basis that was not *pari passu*:

(a) Although all claims would have been ascertained on a common basis by reference to the amount of the debt as at the date of the

Administration, whether they would be paid interest and if so for what period would depend on whether they were contingent.

(b) Unless interest also accrues in respect of contingent debts since the date of administration, contingent creditors, unlike other creditors, will never be entitled to receive the full value of their debts as at the date of administration.

(13) Wentworth and the Administrators contend that it would be unfair to other creditors, and result in a windfall to contingent creditors, if the debts proved by contingent creditors accrued interest from the Date of Administration.

(14) This argument is based on the same misunderstanding of the process of estimating contingent debts and proving for contingent claims. In particular, it ignores the fact that, under the Rules, the value of a contingent debt admitted to proof represents the estimated value of the claim as at the date of administration.

(15) Given the nature and effect of the rules governing the estimation of contingent claims as at the date of the administration, as described above, Statutory Interest accrues on the amount outstanding in respect of their admitted proofs from the date of administration at the greater of the rate applicable apart from the Administration and the Judgments Act Rate.

(16) For the avoidance of doubt, the issue raised by Question 7 is not concerned with a debt which is a present debt or liability but which requires estimation under r.2.81 because it does not bear a certain value.

(17) Whether or not any particular claim is contingent and, if contingent, in what sense (including whether and if so how its value requires to be estimated under r.2.81 as at Date of Administration), is an issue that depends on the facts of each claim and is not addressed by the Senior Creditor Group in its Position Paper.

Question 8: Whether Statutory Interest is payable in respect of an admitted provable debt which was a future debt as at the Date of Administration from:

(i) the Date of Administration;

(ii) the date on which the future debt ceased to be a future debt; or

(iii) another date,

having regard to whether the future debt remained a future debt at the time of the payment of:

(i) the final dividend; or

(ii) Statutory Interest.

8. Senior Creditor Group's position:

(1) The Senior Creditor Group, York and Wentworth all agree that Statutory Interest is payable in respect of an admitted provable debt which was a future debt as at the Date of Administration from the Date of Administration.

(2) Given the nature and effect of the rules governing the payment of dividends on future debts (described below) creditors with future claims are entitled to interest at the higher of the Judgments Act Rate and "*the rate applicable to the debt apart from the administration*" from the Date of the Administration.

(3) The Administrators have however invited the Court to consider certain arguments in favour of the contention that Statutory Interest is only payable in respect of future debts admitted to proof from the date on which the future debt ceased to be a future debt.

(4) The first argument that the Administrators make is based on the wording of r.2.88(7) which states that interest is payable on debts proved "*in respect of the periods during which they have been outstanding since the relevant date*". They suggest that "*outstanding*" means "*due and payable*" and that a future debt

cannot be said to be "*outstanding"* until such time as future debt ceased to be a future debt.

(5) This argument is misconceived for the same reasons it is misconceived in the context of contingent debts admitted to proof, and the Senior Creditor Group's reply to Question 7 applies *mutatis mutandis* in the context of future debts admitted to proof.

(6) The position is even starker in the context of future debts admitted to proof as r.2.105, which deals with the valuation of such debts for the purposes of dividend payments, provides that "*for the purpose of dividend (and no other purpose) the amount of a creditor's admitted proof (or, if a distribution has previously been made to him, the amount remaining outstanding in respect of his admitted proof) shall be reduced by applying [the formula]*" (emphasis added).

(7) The second argument that the Administrators make is that creditors with future debts admitted to proof would receive a windfall if Statutory Interest is payable on future debts admitted to proof for the period they have been outstanding from the Date of Administration.

(8) However, the effect of the Administrators' approach is that in many cases, rather than receive a windfall, the creditor would receive a loss. For example:

(a) Creditors with future debts admitted to proof receive dividends based on the net present value of those debts as at the date of the administration (r.2.105).

(b) It would, accordingly and as Wentworth accepts, be unfair to creditors with future debts admitted to proof if Statutory Interest did not accrue on the amount outstanding in respect of their admitted proofs from the Date of Administration.

(c) For example, if a company owes a debt of £1000 payable five years after the administration date and the administrator pays a first and final dividend one day short of five years after the administration date, the effect of r.2.105 is that, five years after the administration date, the creditor will receive, in full and final payment of its claim, £783 (that being the value of his debt discounted back five years to the administration date in accordance with r.2.105).

(d) Notwithstanding this, the Administrators contend that such a creditor would have no entitlement to interest under the Insolvency Rules.

Question 9: Whether a creditor's accession to the CRA (and, in particular, the effect of clauses 20.4.3, 24.1, 25.1, 25.2 and 62.4 of the CRA) would impact upon the answers to questions 7 and 8 above, and if so, how.

9. **Senior Creditor Group's position:**

(1) The Senior Creditor Group's position is that a creditor's accession to the CRA does not affect the answers to Question 7 and 8. Questions 7 and 8 are concerned with the construction of r.2.88(7) and not of the CRA.

(2) Contrary to the Administrators' contention at [55.4], and for the reasons set out in the Senior Creditor Group's Position Paper and reply to Question 35, entry into the CRA does not release a creditor's right to interest under r.2.88(9) at a "*rate applicable apart from the administration*".

(3) Insofar as the "sub-issue" identified by the Administrators at [56] of their Position Paper is concerned, and for the avoidance of doubt, the Senior Creditor Group's position is that where a claim has been agreed under the CRA, interest under r.2.88(7) is payable from the Date of

Administration. Whether claims under the CRA are contingent is a question of fact to be determined on a case-by-case basis.

MASTER AGREEMENTS

ISDA

Question 10: Whether, on the true construction of the term "Default Rate" as it appears in the ISDA Master Agreement, the "relevant payee" refers to LBIE's contractual counterparty or to a third party to whom LBIE's contractual counterparty has transferred (by assignment or otherwise) its rights under the ISDA Master Agreement.

10. **Senior Creditor Group's position:**

(1) The Senior Creditor Group's position is that on the true construction of the term "*Default Rate*" as it appears in the ISDA Master Agreement, the "*relevant payee"* refers to whichever entity or person is entitled to receive payment of the Early Termination Amount from LBIE.

(2) Wentworth contends that the "*relevant payee*" refers to LBIE's original contractual counterparty.

(3) Wentworth's first argument is based on the assertion that the purpose of a right to interest is to "*compensate the person entitled to payment for having been kept out of its money*" [59]. Wentworth argues that the calculation of interest by reference to the cost of funding of the particular counterparty entitled to payment "*reflects the fact that it is that counterparty which has been kept out of its money"* [59]. However:

(a) Wentworth's argument ignores the fact that, following an assignment, the person entitled to payment is the assignee, not the original counterparty.

(b) Wentworth's argument also has the commercial consequence of treating an original counterparty which has assigned its claim – and therefore has no economic stake in the determination of the Default Rate – as the "*relevant payee"* whose certification matters.

(4) Wentworth's second argument is based on the express prohibition on assignment of rights under the 1992 and 2002 ISDA Master Agreements without the counterparty's consent [62]. Wentworth argues that the "*prohibition on assignment of rights without consent protects each party from exposure to the credit risk of third parties other than their specifically chosen counterparty"* [62] and that "*the protection afforded by Section 7 would be greatly reduced if "relevant payee" meant any third party to whom the right to payment under Section 6 was assigned"* [64]. However:

(a) Wentworth's argument ignores the fact that, by expressly providing that a right to payment from a Defaulting Party can be assigned without transfer of the entire agreement and without the Defaulting Party's consent, section 7 of the ISDA Master Agreement is intended to provide less protection to a party in default.

(b) This is further reflected in the use of the phrase "*relevant payee*" (as opposed to the more commonly used term "*party*" or the specially defined term "*Payee*") in the definition of Default Rate, which corresponds to the fact that a right to payment from a Defaulting Party can be assigned without transfer of the entire agreement and without the Defaulting Party's consent.

(5) Wentworth's third argument (at 68) is based on the terms of section 7(b) of the ISDA Master Agreements. As to this:

(a) Under the 1992 ISDA Master Agreement, an assignment is permitted by a party of "*any amount payable <u>to it</u> from a Defaulting Party"* (Wentworth's emphasis). Wentworth contends that the use of the phrase "*payable to it"* indicates that an assignee can only require such amounts as the original counterparty would have been entitled to. Wentworth's reliance on the "*to it*" language of

section 7(b) in the 1992 Master Agreement is misplaced. Neither section 6(e) (the only section cited in section 7(b)), nor section 7(b) itself expressly addresses the issue of interest. Rather, where the amount payable under section 6(e) upon early termination is assigned under section 7(b), the assignee's right to interest on that amount results from section 6(d)(ii), which provides, in substance, that interest on the Early Termination Amount calculated under section 6(e) will be paid "*together with*" that amount – without any limitation on the person or entity to whom this combined payment will be made.

(b) The position is even clearer under the 2002 ISDA Master Agreement, which provides that a party is entitled to transfer its interest in any Early Termination Amount "*payable to it by a Defaulting Party, together with any amounts payable on or with respect to that interest…"* (Wentworth's emphasis). Although the phrase "*to it*" follows and qualifies the phrase "*Early Termination Amount payable*", the phrase does *not* appear after the word "*payable*" in the subsequent phrase "*all amounts payable on or with respect to that interest and any other amounts associated with that interest*…". An assignment under section 7(b) of the 2002 Agreement clearly refers to *any* right to interest associated with the assigned right to the Early Termination amount, and not simply a right to interest "payable to it" (i.e. the original counterparty).

(6) Both Wentworth (at [67]) and the Administrators (at [68.6]) contend that if the "*relevant payee*" includes an assignee then there is potential for abuse. For example, the Administrators suggest that there would be potential for abuse where an existing counterparty effected an assignment to a special purpose vehicle with a high cost of funding. However:

(a) If Question 11 is determined on the basis described in [11(1)(b)] of the Senior Creditor Group's Position Paper and [75] of the

Administrators' Position Paper, no issue of relative benefit, and therefore no potential for abuse, arises.

(b) Even if this is not the case, where an assignee can certify a high cost of funding for Default Rate purposes, it will necessarily require a higher return on its investment to compensate it for its higher cost of funding, which will in turn reduce the price it is willing to pay to the assignor.

(c) Accordingly, there should be no benefit for an assignor in effecting an assignment to an entity with a high cost of funding relative to any other entity, and no or no realistic potential for abuse arises.

(7) Although stating that they are not taking a "*formal position*" with regards to Question 10, the Administrators have nevertheless raised a further possible argument in favour of the "*relevant payee*" being the original counterparty [68].

(8) The Administrators correctly highlight that under the ISDA Master Agreements there are circumstances in which interest is payable at the Default Rate by one *party* to the agreement to the other *party* to the agreement. However, contrary to the Administrators' suggestion, these provisions support the Senior Creditor Group's position and indicate that "*relevant payee*" is meant to carry its ordinary meaning of a person to whom payment is to be made:

(a) The 1992 and 2002 Master Agreements contain separate provisions governing interest payable before and after the designation of an Early Termination Date.

(b) The provisions requiring payment of interest at the Default Rate prior to the designation of an Early Termination Date uniformly specify, in terms, that such interest will be paid "*to the other party*"

(see section 2(e) of the 1992 Master Agreement; section 9(h)(i) of the 2002 Master Agreement).

(c) By contrast, the provisions requiring the payment of the Default Rate *after* the designation of an Early Termination Date – the situation here – uniformly *omit* any such limitation (see section 6(d)(ii) of the 1992 Master Agreement; section 9(h)(ii) of the 2002 Master Agreement).

(d) This distinction corresponds to the fact that the Default Rate on amounts due after designation of an Early Termination Date may be payable to a "*payee*" who is not a "*party*" by virtue of the freedom to assign without counterparty consent under section 7(b) of the Master Agreements.

Question 11: On the true construction of the term "Default Rate" as it appears in the ISDA Master Agreement, what meaning should be given to the expression "cost (without proof or evidence of any actual cost) to the relevant payee (as certified by it) if it were to fund or of funding the relevant amount"? In particular:

(i) can this cost:

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

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

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

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

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

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

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

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

11. **Senior Creditor Group's position:**

(1) The Senior Creditor Group's position in respect of Question 11 is as set out in its Position Paper.

(2) Wentworth makes a series of contentions to try to confine the Default Rate to a borrowing rate (plus 1%), which distort both the language and intention of the definition of Default Rate.

(3) Wentworth contends at [70] that the Default Rate has a different meaning depending on whether the relevant payee is, on the one hand, a Credit Institution or a Financial Institution or, on the other hand, another type of entity such as a fund or a corporate entity.

(4) This is incorrect. "*The cost . . . if it were to fund or of funding*" is a question of fact. The meaning of the definition of Default Rate does not change depending on the type of entity in respect of which the question is asked.

(5) In relation to Credit Institutions and Financial Institutions, Wentworth contends that the expression "*cost … if it were to fund … the relevant amount*" means such institutions' own '*cost of funds*' which, on Wentworth's case, in turn means "*the weighted average of interest payable on all borrowings divided by their total notional amount*".

(6) This is incorrect:

(a) The "*cost*" that may be certified for Default Rate purposes is not limited, either generally or in relation to any particular type of institution, to a cost of borrowing (average or otherwise).

(b) To the contrary, such cost may reflect, to the extent applicable in a given case, the costs identified at [11(4) and (5)] of the Senior Creditor Group's Position Paper.

(c) Contrary to Wentworth's assumptions, banks do not fund exclusively by borrowing, and fund different assets with different funding sources.

(7) Wentworth otherwise contends that the use of the word "*cost*" in the definition of "*Default Rate*" refers to "*the lowest amount which the relevant payee would be required to pay over the relevant period*". According to Wentworth, this is because any amount over and above such lowest amount would not represent a "*cost*" but "*an amount paid voluntarily*".

(8) This is incorrect:

(a) With respect to the costs identified at [11(3)(a) and 11(4)] of the Senior Creditor Group's Position Paper, the Default Rate definition does not compel the relevant payee to certify its cost on the basis of raising a sum equivalent to the relevant amount (actually or hypothetically) by way of incremental borrowing. Even where a relevant payee elected to do so, the amount it would have to "*pay*" (i.e. coupon and fees) in funding through incremental borrowing would not constitute its sole "*cost*", as additional costs would result from its increased leverage, and its "*cost*" should take account of such additional costs.

(b) With respect to the costs identified at [11(3)(b) and 11(5)] of the Senior Creditor Group's Position Paper, the meaning of "*cost*" contended for by Wentworth is inapposite, as such costs derive from the relevant payee being forced to fund the Defaulting Party in the sum of the relevant amount rather than from any choice on the part of the relevant payee.

(c) Furthermore, the meaning of "*cost*" contended for by Wentworth runs contrary to the regime envisaged by the ISDA Master Agreement, as its practical effect would be that a certification would always be open to challenge on the basis that it might be possible to identify a lower cost of raising an incremental sum of money, even where the relevant payee had acted in good faith and rationally.

(9) Wentworth is also incorrect to contend at [71] that the information contained in the witness statement of Robert Sabin Bingham (the methodology underlying which will be disputed by the Senior Creditor Group) reflects any general understanding among banks as to the "cost" for Default Rate purposes.

(10) The Senior Creditor Group will also rely on expert evidence in response to expert evidence relied on by Wentworth, and in support of the position set out in the Senior Creditor Group's Position Paper.

Question 12: Whether the "cost (without proof or evidence of any actual cost) to the relevant payee (as certified by it) if it were to fund or of funding the relevant amount" is to be calculated based on obtaining:

(i) overnight funding;

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

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

12. **Senior Creditor Group's position**:

(1) The Senior Creditor Group's position is that a relevant payee may calculate its cost of funding on any of the bases set out in Question 12, provided such basis is certified by the relevant payee in good faith and rationally.

(2) Wentworth contends that:

(a) In relation to banks, the phrase "*cost…if it were to fund…the relevant amount" refers to its own "costs of funds*", which Wentworth treats as meaning the weighted average of interest payable on all borrowings divided by their total notional amount. This is incorrect for the reasons set out in the Senior Creditor Group's reply to Question 11.

(b) In relation to funds and other corporate entities (and, it is said, in the case of banks that actually borrowed money to fund the relevant amount), the relevant payee may calculate of its cost of funding on any basis "so long as it represents the lowest cost to the counterparty (and reflects changes in available rates over the period of funding)". This is also incorrect for the reasons set out in the Senior Creditor Group's reply to Question 11.

(3) With respect to the position set out in paragraphs [75] and [76] of Wentworth's Position Paper, the Senior Creditor Group observes that the compounding mechanism set out in each of sections 6(d)(ii) of the 1992 Master Agreement and 9(h)(iii) of the 2002 Master Agreement operates upon, and therefore does not affect the calculation of, the relevant payee's "rate per annum" for Default Rate purposes, but otherwise reserves its position pending clarification of Wentworth's case as to the correct construction of the relevant provisions.

Question 13: Whether the "cost (without proof or evidence of any actual cost) to the relevant payee (as certified by it) if it were to fund or of funding the relevant amount" should be calculated:

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

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

in each case, whether or not taking into account relevant market conditions.

13. **Senior Creditor Group's position:**

(1) The Senior Creditor Group's position is that a relevant payee may calculate its cost of funding on any of the bases set out in Question 13, provided such basis is certified by the relevant payee in good faith and rationally (see Questions 14 and 15 below).

(2) Wentworth contends at [82] and [83] that the Default Rate can only be calculated at the end of the period from the Early Termination Date until the date of payment and the true cost can only be captured by calculating the cost from time to time on a fluctuating basis.

(3) This is incorrect. The relevant payee may calculate its cost of funding at any point after the Early Termination Date and, provided it does so in good faith and rationally.

(4) The Administrators at [70] invite Wentworth and the Senior Creditor Group to consider whether the New York decision in *Finance One Public Company Limited v Lehman Brothers Special Financing No. 00 CIV. 6739 (CBM) (S.D.N.Y)* (which was referred to in the Senior Creditor Group's Position Paper in relation to Question 14) impacts on their analyses of Question 13.

(5) Contrary to the position taken by Wentworth, the relevant payee in the *Finance One* case was not required by the court to calculate its cost of funding only at the end of the period.

(6) Contrary to the position taken by the Administrators, the relevant payee's approach to self-certification in the Finance One case did not reflect a calculation of cost of funding on a fluctuating basis. Specifically, the Administrators appear to assume that the ten promissory notes reflected a calculation of the relevant payee's cost for Default Rate purposes on a fluctuating basis. However, as affidavit evidence filed by the Non-Defaulting Party in that case discloses, all ten notes were issued at a fixed rate in 1997 (the year that termination

occurred) and all ten remained outstanding at that rate at the time of the decision in 2003.

(7) Even if that were not the case and, as matter of fact, the relevant payee's approach to self-certification in the Finance One case did reflect a calculation of cost of funding on a fluctuating basis, it was (in accordance with the Senior Creditor Group's answer to Question 13) open to the relevant payee to calculate the cost of funding on that basis, provided it is certified by the relevant payee in good faith and rationally.

Question 14: Whether a relevant payee's certification of its cost of funding for the purposes of applying the "Default Rate" is conclusive and, if not, to what it is subject. In particular whether, in order for a payee's certification to be deemed conclusive, a relevant creditor is under any duty to act:

(i) reasonably;

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

(iii) otherwise than in its own interests.

14. **Senior Creditor Group's position:**

(1) The Senior Creditor Group contends that a relevant payee's certification of its cost of funding is conclusive provided that such certificate is made in good faith and rationally.

(2) The Senior Creditor Group agrees with the Administrators that the relevant payee's certification must be of its cost of funding as properly construed (based, in this case, in part on the Court's answers to Questions 10 to 18), rather than anything else.

(3) Wentworth contends that the certification must, in addition, be a certification of the lowest amount at which the relevant payee could have funded the relevant amount.

(4) This is incorrect:

(a) With respect to the costs identified at [11(3)(a) and 11(4)] of the Senior Creditor Group's Position Paper, the Default Rate definition does not compel the relevant payee to certify its cost on the basis of raising a sum equivalent to the relevant amount (actually or hypothetically) by way of incremental borrowing. Even where a relevant payee elected to do so, the amount it would have to "*pay*" (i.e. coupon and fees) in funding through incremental borrowing would not constitute its sole "*cost*", as additional costs would result from its increased leverage, and its "*cost*" should take account of such additional costs.

(b) With respect to the costs identified at [11(3)(b) and 11(5)] of the Senior Creditor Group's Position Paper, the meaning of "*cost*" contended for by Wentworth is inapposite, as such costs derive from the relevant payee being forced to fund the Defaulting Party in the sum of the relevant amount, rather than from any choice on the part of the relevant payee.

(c) Furthermore, the meaning of "*cost*" contended for by Wentworth runs contrary to the regime envisaged by the ISDA Master Agreement, as its practical effect would be that a certification would always be open to challenge on the basis that it might be possible to identify a lower cost of raising an incremental sum of money, even where the relevant payee had acted in good faith and rationally.

Question 15: If the answer to question 14 is that the relevant payee's certification of its cost of funding is not conclusive and one of the requirements (i) to (iii) set out in that question applies, where does the burden of proof lie in establishing, and what is required to demonstrate, that a relevant payee has or has not met such requirement?

15. **Senior Creditor Group's position:**

(1) The Senior Creditor Group and Wentworth agree that the Defaulting Party bears the burden of proving, on the balance of probabilities, that the relevant payee's certification of its cost of funding was made irrationally, otherwise than in good faith, or was not a certification of the payee's cost of funding as properly construed.

Question 16: Whether only the relevant payee (in accordance with the meaning of such term determined pursuant to question 10 above), or another party (whether authorised by the relevant payee or not) can provide certification of the cost of funding and, if the former, what the position should be if the relevant payee is not capable of providing such certification (for example because it has been wound up or dissolved).

16. **Senior Creditor Group's position:** The Senior Creditor Group and Wentworth agree that the relevant payee and anyone expressly or impliedly authorised by the relevant payee can provide certification of the cost of funding.

(1) Whether or not, in any particular case, the relevant payee has expressly or impliedly authorised another person to provide certification of the cost of funding on its behalf is a question of fact to be determined on a case-by-case basis.

(2) In circumstances where the relevant payee is incapable (either itself or through the agency of another) of certifying its cost of funding the relevant amount, the court will put itself in the shoes of the relevant payee to determine what decision it would have made had it determined its cost of funding properly: *Socimer Bank Ltd v Standard Bank Ltd* [2008] 1 Lloyd's Rep. 558 at [65].

Question 17: In circumstances where a relevant payee has not incurred any actual costs, what principles should be applied in determining the asserted costs "if it were to fund […] the relevant amount".

17. **Senior Creditor Group's position:**

(1) The Senior Creditor Group's position is as set out in its Position Paper.

Question 18: Whether the power of a party under section 7(b) of the 1992 form ISDA Master Agreement to transfer any amount payable to it from a Defaulting Party under Section 6(e) without the prior written consent of that party included the power to transfer any contractual right to interest under that agreement.

18. **Senior Creditor Group's position:**

(1) The Senior Creditor Group and Wentworth agree that the power of a party under section 7(b) of the 1992 ISDA Master Agreement to transfer any amount payable to it from the Defaulting Party under section 6(e) includes the power to transfer any right to interest on that amount.

Question 19: Whether the answer to questions 10 to 18 above (or any of them) is different if the underlying Master Agreement is governed by New York rather than English law.

19. **Senior Creditor Group's position:**

(1) The Senior Creditor Group's position is as set out in its Position Paper.

<u>German Master Agreement</u>

Question 20: Whether, in calculating the amount of interest due under section 3(4) of the German Master Agreement, it is possible (and if so, in what circumstances and to what extent) to include an

amount in respect of "further claims for damages" ("Damages Interest Claim") so that this would constitute part of the "rate applicable to the debt apart from the administration" for the purposes of Rule 2.88(9).

20. **Senior Creditor Group's position:**

(1) The parties agree that the true construction of section 3(4) of the German Master Agreement is a matter of German law.

(2) The Senior Creditor Group's position is that where a Damages Interest Claim would in substance result in an award of interest as damages, it constitutes part of the "*rate applicable to the debt apart from the administration*" within the meaning of r.2.88(9). In the alternative, if a Damages Interest Claim does not constitute part of the "*rate applicable to the debt apart from the administration*", then such claim ranks as a non-provable claim.

(3) Wentworth, by contrast, contends that there are no circumstances in which a Damages Interest Claim could constitute part of the *rate applicable to the debt apart from the administration*" within the meaning of r.2.88(9), even where such claim would in substance result in an award of interest as damages.

(4) Wentworth's primary argument on the construction of section 3(4) is that its drafting reflects, and needs to be construed in light of, section 288 BGB (Wentworth's Position Paper [101], [111]). Wentworth contends, by reference to section 288 BGB, that a right to make *"further claims for damages"* is distinct from the right to default interest (Wentworth's Position Paper [106], [108]).

(5) As to this:

(a) Wentworth is incorrect to conclude that a right to claim "further damage" under section 288(4) BGB is "distinct" from the right to default interest under section 288(1) BGB (Wentworth [106]). As a matter of German law, default interest is a sub-category of

damages, and not distinct from it. Accordingly, the BGH has expressly stated that the interest rate under section 288(1) BGB is a "minimum damage" and that section 288 BGB is "a special form of the principle set out in section 286(1) BGB that the debtor has to compensate any delay damage"[1].

(b) Furthermore, Wentworth's interpretation of section 288(3), as set out in [103]-[105], is incorrect. For example, section 288(3) is primarily focused on a legal provision stipulating a higher rate of interest (for example under a specific statute relating to civil procedure or commercial agreements or in a different legal area such as the law of tort) in respect of a different or concurrent claim arising from the same factual background. By contrast, further damage in the form of interest in respect of the same claim (e.g. breach of contract as a result of a payment default) is covered by section 288(4). In other words, where the default rate of interest specified in section 288(1) does not fully compensate the counterparty for its damage, in the form of interest, the further damage to which the counterparty would be entitled would fall under section 288(4). A contractually agreed rate for delayed payments (e.g. a deviation from the rate specified in section 288(1)) cannot fall under section 288(3) (because such interest is not on a different legal basis; it still arises under the contract)[2].

(c) In any event, it is not appropriate, as a matter of German law, to construe section 3(4) exclusively by reference to section 288 BGB simply because, in the German language version, the same words appear in section 288(4) as appear in the second sentence of section 3(4). Section 3(4) of the German Master Agreement does not incorporate section 288 BGB by reference, nor does it fully

[1] BGH, *decision* dated 26 April 1979 – BGHZ 74, 231

[2] BGH decision of April 28, 1988 – BGHZ 104, 337 and 399

replicate the language used or structure adopted by section 288 BGB.

Question 21: If the answer to question 20 is that a further claim for damages can be included as part of the "rate applicable to the debt apart from the administration" for the purposes of Rule 2.88(9), how in such circumstances is the relevant rate to be to be determined? In particular:

(i) in circumstances where the relevant claim under the German Master Agreement has been transferred (by assignment or otherwise) to a third party, is it the Damages Interest Claim which could be asserted by the assignor or the assignee which is relevant for the purposes of Rule 2.88(9)?;

(ii) where the relevant claim under the German Master Agreement has been acquired by a third party, in what circumstances (if any) is such a third party precluded from asserting a Damages Interest Claim under principles of German law?; and

(iii) where does the burden of proof lie in establishing a Damages Interest Claim, and what is required to demonstrate, that a relevant creditor has or has not met such requirement?

21. **Senior Creditor Group's position:** The Senior Creditor Group's position on Question 21 is as set out in its Position Paper. Neither Wentworth nor the Administrators have addressed this Question.

French Master Agreements

Question 22: Whether each of:

(i) Default interest pursuant to clause 9.1 of the FBF Master Agreement and the AFB Master Agreement;

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

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

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

22. **Senior Creditor Group's position:**

(1) The Senior Creditor Group and Wentworth agree that the *rate applicable to the debt apart from the administration"* for the purposes of r.2.88(9) is capable of including any entitlement to interest in accordance with the provisions referred to in sub-paragraphs (i) to (iii) of Question 22. The Administrators consider that the contrary position is not reasonably arguable. There is no disagreement between the parties on this issue.

(2) Although not included among the issues for determination in the Application, Wentworth contends that, as a matter of French law, compound interest will only be payable by a party if (i) it is expressly provided for by the terms of the contract, and (ii) the interest has been due for at least a year. The Senior Creditor Group agrees.

(3) The Senior Creditor Group also agrees that the AFTB and AFTI Master Agreements do not provide for compounding of the Late Interest Rate / Late Payment Interest (as applicable) and that, under those agreements, interest is payable on a simple basis unless otherwise agreed in the Schedule.

(4) By contrast, article 9.1 of the AFB and FBF Master Agreements expressly provides that default interest "*shall be capitalised if due for a period in excess of a year*". Accordingly, under those agreements, default interest is payable on a compound basis if due for a period in excess of a year.

(5) Wentworth states at [119] that the French court retains the power pursuant to Articles 1152 and 1231 of the French Civil Code to reduce the interest payable by the defaulting party in circumstances where the interest rate provided for in the contract is excessive. However, Wentworth does not develop the point and it is unclear whether Wentworth contends that the rates provided for under all or any of the French Master Agreements are excessive. For the avoidance of doubt, the Senior Creditor Group's position is:

(a) the general principles of French civil law set forth in Articles 1152 and 1231 of the French Civil Code, which would only apply in exceptional circumstances where the parties have contractually agreed damages or compensations which are manifestly excessive, are unlikely to apply at all to the default / late payment provisions of the French Master Agreements which constitute the industry standard terms in the French domestic market;

(b) even if Articles 1152 and 1231 of the French Civil Code did apply, the rates provided in the French Master Agreements, to the extent that they have not been amended by the parties, are not excessive within the meaning of Articles 1152 and 1231 of the French Civil Code; and

(c) in any event, unless and until an order is made pursuant to Articles 1152 and 1231 of the French Civil Code, the interest rate provided for in the contract is binding on the parties.

Question 23: Whether the "party" that receives the interest referred to in question 22 above pursuant to the FBF Master Agreement, the AFB Master Agreement, the AFTB Master Agreement and the AFTI Master Agreement refers to LBIE's original contractual counterparty or to a third party to whom LBIE's original counterparty has transferred (by assignment or otherwise) its rights under the relevant agreements.

23. **Senior Creditor Group's position:**

(1) Wentworth and the Senior Creditor Group agree that, pursuant to Article 1692 of the French Civil Code, the assignment of a claim includes the ancillary rights to the claim.

(2) The Senior Creditor Group's position is that, as matter of construction of the French Master Agreements and (in the case of the FBF and AFB Master Agreements), depending on the manner in which a transfer has

been effected, the relevant default / late payment interest rates are determined by reference to the position of the original contractual counterparty for the period before the date of the relevant transfer and by reference to the position of the third party for any period after the date of the relevant transfer.

(3) Wentworth contends that the default interest rate payable under each of the French Master Agreements is to be calculated by reference to the relevant rates applicable to the original counterparty both before and after the date of the relevant transfer.

(4) Wentworth appears to accept (at [120(4)]), and the Senior Creditor Group agrees, that Question 23 is to be determined as a matter of construction of the French Master Agreements. However:

(a) Wentworth's analysis (unlike the Senior Creditor Group's) fails to take any account of, or make any reference to, the relevant wording of the French Master Agreements; and

(b) Wentworth only addresses the position of a third party who has received a transfer of rights pursuant to a *cession de créance* under French law. It does not appear to address the position of a third party who has received a transfer of rights by means of *cession de contrat* under French law.

Question 24: Whether the terms:

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

(ii) "the highest rate charged by the European Central Bank for supplying liquidity to the payee" and "average overnight rate applicable to the payee" as they appear in the AFTB Master Agreement;

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

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

24. **Senior Creditor Group's position:**

(1) The Senior Creditor Group's position is that the "*overnight refinancing rate of the Party*" as it appears in Clause 9.1 of the FBF and AFB Master Agreement, "*the highest rate charged by the European Central Bank for supplying liquidity to the payee*" and "*the average overnight rate applicable to the payee…for the period in question*" as they appear in the AFTB Master Agreement and the "*the average of the daily rates to which the recipient of the payment has access during the relevant period*" as it appears in the AFTI Master Agreement is, in each case, counterparty specific and determined objectively and by reference to the relevant rates which would have been offered *to the relevant payees* by prime market participants at the relevant time.

(2) Wentworth, by contrast, contends that the relevant rates are not counterparty specific and are to be determined by reference to:

(a) in the case of Euro denominated FBF, AFB and AFTI Master Agreements, the European Overnight Index Average rate ("EONIA") for the period in question ([122(1)], [129]);

(b) in the case of non-Euro denominated FBF, AFB and AFTI Master Agreements the equivalent rate to the EONIA for the applicable contractual currency for the period in question ([122(2)], [130]);

(c) in the case of Euro denominated AFTB Master Agreements, the highest published rate charged by the European Central Bank for Euro denominated agreements ([127]); and

in the case of non-Euro denominated AFTB Master Agreements, the rate of the equivalent institution to the European Central Bank for the contractual currency ([126]).

(3) As to this:

(a) The relevant rates are defined to ensure that the non-defaulting counterparty would not be left out of pocket if it were to fill the gap left by the defaulting counterparty's non-payment by borrowing an amount equivalent to the unpaid termination sum. They are necessarily and unambiguously[3] counterparty specific.

(b) The EONIA, which Wentworth says applies in the context of FBF, AFB and AFTI Master Agreements, is not counterparty specific[4]. It represents the weighted average of all overnight interest unsecured lending transactions in the interbank market for Euros. Applying the EONIA rate to a non-defaulting counterparty with a higher refinancing rate would leave it out of pocket if it were to fill the gap left by the defaulting counterparty's non-payment by borrowing an amount equivalent to the unpaid termination sum.

(c) Wentworth seeks to re-write or ignore the language of the FBF, AFB and AFTI Master Agreements. In the case of the FBF and AFB Master Agreements[5], for example, it would require reading the "*overnight refinancing rate of the Party*" as if it read "*the EONIA, or in the case of currencies other than the Euro, the equivalent rate to EONIA for that currency for the period in question*". Such a construction is not available as a matter of French law.

(d) Similarly, Wentworth seeks to re-write or ignore the language of the AFTB Master Agreement. In the case of Euro denominated

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[3] i.e. in the FBF and AFB Master Agreements, the "*overnight refinancing rate* ***of the Party***" (emphasis added); in the AFTI Master Agreement, "*the average daily rates* ***to which the recipient of the payment*** *has access during the relevant period*" (emphasis added); and in non-euro denominated AFTB Master Agreements, "*for the euro, the highest rate charged by the European Central Bank* ***for supplying liquidity to the payee*** *of the delayed payment; for other Currencies, the average overnight rate* ***available to the payee of the delayed payment***" (emphasis added).

[4] Nor, it appears, is Wentworth's approach to the relevant rate in the AFTB Master Agreement.

[5] The same applies *mutatis mutandis* to each of the French Master Agreements.

AFTB Master Agreements Wentworth seeks to construe the phrase "*the highest rate charged by the European Central Bank for supplying liquidity to the payee"* by ignoring the counterparty specific language. In the case of non- Euro-denominated AFTB Master Agreements, Wentworth seeks to construe the phrase "*the average overnight rate applicable to the payee"* as though if it read "the Central Bank Rate for the relevant currency". Neither of these constructions are available as a matter of French law. As a matter of French law, if the payee under a Euro-denominated AFTB Master Agreement is not able to be supplied with liquidity by the European Central Bank, then to determine which rate should be applied to determine the relevant rate, it is necessary as a matter of contractual interpretation pursuant to Article 1156 of the French Civil Code to look to the common intent of the parties beyond the provisions of the contract to ascertain the purpose of the provision. The Senior Creditor Group's position is that, in those circumstances, the relevant rate for a payee under a Euro-denominated AFTB Master Agreement is (as in the case of non-Euro denominated AFTB Master Agreements) "*the average overnight rate available to the payee".*

(e) Further, and in any event, Wentworth's Position Paper ignores the 1% additional margin which applies in the case of the FBF, AFB and AFTI Master Agreements.

Question 25: Whether only the "party" pursuant to question 23 or another party authorised to act on behalf of the "party" can provide determination and notification of its cost of funding.

25. **Senior Creditor Group's position:**

(1) The Senior Creditor Group and Wentworth agree that the relevant payee and anyone expressly or impliedly authorised by the relevant payee can provide certification of the cost of funding. Whether or not, in any particular case, the relevant payee has expressly or impliedly authorised

another person to provide certification of the cost of funding on its behalf is a question of fact to be determined on a case-by-case basis.

(2) The Administrators do not consider that there is an arguable position other than that on which the Senior Creditor Group and Wentworth agree. Therefore there is no disagreement between the parties on this issue.

Question 26: What is the applicable standard, if any, by reference to which any statement by the party as to its "overnight refinancing rate", "average overnight rates" and "average of daily rates to which it has access" is constrained?

26. **Senior Creditor Group's position:**

(1) Contrary to the statement made at [99] of the Administrators' Position Paper, the Senior Creditor Group does not consider that it has taken the same position as Wentworth as to the applicable standard by reference to which a statement by the party as to its "*overnight refinancing rate*", "*average overnight rates*" and "*average of daily rates to which it has access*" is constrained.

(2) Wentworth's contention at [134] that the applicable interest rates are to be ascertained by reference to "the relevant published rates" is incorrect. The Senior Creditor Group repeats its reply to Wentworth's answer to Question 25.

(3) Where the relevant rates are determined by the Agent pursuant to its duties under Clause 5.5 of the FBF and AFB Master Agreements, such determination is, by virtue of the terms of Clause 5.5, binding in the absence of manifest error (subject to (3) below). The burden is on LBIE to prove the existence of a manifest error.

(4) In addition, a determination under Clause 5.5 of the FBF and AFB Master Agreements will not be binding if fraudulent or made otherwise

than in good faith. The burden is on LBIE to prove the existence of fraud or bad faith.

(5) The Senior Creditor Group does not accept Wentworth's apparent contention at [135(2)] that a determination under Clause 5.5 of the FBF and AFB Master Agreements can be challenged simply on the basis that it is incorrect, arbitrary, or not supported by objective evidence, except in circumstances where, as a consequence, it is subject to manifest error, fraud, or lack of good faith.

(6) Otherwise, the relevant rate is a question of fact to be determined objectively and by reference to the relevant rates which would have been offered to the relevant parties by prime market participants at the relevant time.

(7) The Senior Creditor Group agrees with Wentworth that in those circumstances, LBIE is entitled to require evidence of the calculation of the default rate which is claimed pursuant to Article 1315 of the French Civil Code.

Status of Payee

Question 27: Whether, and if so how, the answers to questions 10 to 26 would be impacted where the "relevant payee" is:

(i) A Credit Institution or Financial Institution;

(ii) A Fund Entity; or

(iii) A corporate or other type of counterparty.

27. **Senior Creditor Group's position:** In light of the invitation at [101] of the Administrators' Position Paper, the Senior Creditor Group confirms for the avoidance of doubt that its answers to Questions 10 to 26 do not differ depending on whether the "*relevant payee*" is a "*fund or corporate entity*" or a "*bank*" (even assuming, which is not accepted, that such categorisations can validly be

maintained for all relevant payee entities). The Senior Creditor Group has responded to Wentworth's position in its reply to Question 11.

CURRENCY CONVERSION CLAIMS

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

28. **Senior Creditor Group's position:**

(1) Wentworth contends that Currency Conversion Claims take into account and are required to give credit for Statutory Interest paid to the creditor.

(2) It contends that a foreign currency creditor's claim, whether representing principal or interest, is to be treated as having been discharged and satisfied by the aggregate of any payments that it has received, whether such payments represented dividends on its proved debt or payment of Statutory Interest out of any surplus.

(3) This is incorrect. As set out in the Senior Creditor Group's Position Paper at [28] it confuses the separate purposes of, and rights reflected in, Currency Conversion Claims and Statutory Interest:

(a) The existence of a Currency Conversion Claim reflects the creditor's contractual right to receive the full amount that it would have been entitled to receive in the foreign currency apart from the administration. Unless such a creditor receives payment of its Currency Conversion Claim in full, its underlying rights will not have been satisfied in full.

(b) Statutory Interest reflects a right conferred by the statutory scheme and serves the separate purpose of compensating creditors for being kept out of their money as a result of the insolvency. Unless a creditor receives payment of Statutory Interest in full in accordance with the Rules, its right to payment of Statutory Interest will not have been satisfied in full.

(4) Wentworth's contention is contrary to the purpose of the statutory scheme. This can be illustrated by considering the situation referred to by Wentworth at [141] where a creditor has a claim, denominated in a foreign currency, that does not carry a contractual entitlement to interest:

(a) In such a situation, on Wentworth's case, the foreign currency claim, which represents solely principal, is discharged and satisfied by any payment that the creditor receives by way of Statutory Interest at the Judgments Act Rate.

(b) The effect of this is that, contrary to the purpose of the statutory scheme, a creditor whose claim does not carry a contractual entitlement to interest, does or may not receive any compensation for delay if (but only if) its claim is denominated in a foreign currency.

(c) The fact that such a creditor may receive, in total, more than the principal amount of its claim is irrelevant (in the same way that it is irrelevant that a creditor with a claim denominated in Sterling that does not carry interest may receive, in total, more than the principal amount of its claim if one takes into account any payments of interest at the Judgments Act Rate).

(5) Wentworth is therefore incorrect to say, as it does at [141] that "*it would be absurd to regard that creditor as continuing to have a Currency Conversion Claim*". There is nothing absurd in a creditor with a foreign currency claim that does not carry interest being entitled, in the event of a surplus, both to payment of his debt in full and compensation for delay.

(6) The position is different where a creditor has a Currency Conversion Claim in respect of interest. As set out in the Senior Creditor Group's Position Paper at [28(6) and (7)], a Foreign Exchange Interest Claim arises only where the amount of interest that a creditor would have been entitled to receive in a foreign currency apart from the administration is

greater than the amount of Statutory Interest (converted into the relevant currency at the date of payment) it received in the administration. The quantification of a Foreign Exchange Interest Claim therefore takes into account Statutory Interest the creditor has received..

(7) The Senior Creditor Group's position, so far as [119] to [120] of the Administrators' Position Paper is concerned, is that they agree with the Administrators that there is no relevant distinction for these purposes between pure debt claims and claims for damages.

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

29. **Senior Creditor Group's position:**

(1) The Administrators contend that no Currency Conversion Claim can exist where the total amount of interest received by a creditor applying the Judgments Act Rate on a Sterling admitted claim, when converted into the relevant foreign currency on the date of payment, is less than the amount of interest which would accrue applying the Judgments Act Rate to the original foreign currency claim.

(2) This is because, so the Administrators say at [126], the creditor would never have been entitled to receive interest at a rate of 8% on its original Currency Conversion Claim, unless specified in the original contract.

(3) This is incorrect. As set out in the Senior Creditor Group's Position Paper at [29(1)] such a Currency Conversion Claim may exist where the Judgments Act Rate is the rate applicable to the debt apart from the

administration. That rate is, as the Administrators accept, not necessarily limited to a rate specified in the contract.

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

30. **Senior Creditor Group's position:**

(1) The Senior Creditor Group, York and Wentworth all agree that, if the amount of interest received by a creditor applying the "*rate applicable to the debt apart from the administration*" on a Sterling admitted claim, when converted into the relevant foreign currency on the date of payment, is less than the amount of interest that would accrue applying the "*rate applicable to the debt apart from the administration*" to the original foreign currency claim, the creditor has a Currency Conversion Claim. The Administrators consider that the contrary is not reasonably arguable.

(2) The answer to [129] of the Administrators' Position Paper is the same. If, as a result of the effect of exchange rate movements, there is a shortfall between the amount of interest received and the amount of interest which the foreign currency creditor was entitled to receive apart from the administration, a Currency Conversion Claim arises. It is irrelevant whether the amount of interest received was calculated on the Sterling admitted claim by reference to the Judgments Act Rate or by reference to the rate applicable to the debt apart from the administration.

Question 31: Whether:

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

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

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

31. **Senior Creditor Group's position:**

(1) The Senior Creditor Group and the Administrators (at [131]) agree that the issues raised by Questions 31 and 32 are highly fact specific.

(2) The Senior Creditor Group's position is that it is a question of fact as to which provisions of a GMSLA, GMRA or any other agreement a proof of debt relates. Where a claim has been admitted pursuant to a provision which, whether expressly or impliedly or whether as a consequence of a course of dealing between the parties or for any other reason, requires payment in a foreign currency, a Currency Conversion Claim can arise (regardless as to whether the Administrators could have, before admitting the claim, disputed a creditor's entitlement to submit its claim by reference to such provision).

(3) Wentworth contends that on a true construction of certain specific agreements referred to at [144] of its Position Paper, the creditor has no entitlement to be paid in a foreign currency and can assert no Currency Conversion Claim. As to this:

(a) The Senior Creditor Group does not accept the accuracy of Wentworth's construction of the provisions of the GMSLA, PB

and MLA referred to in its Position Paper. In particular, Wentworth is wrong to contend at [146(6)] that the Lender is relieved of its repayment and / or redelivery obligations under paragraph 8.4 of the GMSLA in circumstances where the Schedule to the GMSLA provides that "*the simultaneous delivery obligations set forth in the Agreement (including Paragraph 4.3 hereof) will not apply to Loans of Loaned Securities".* Where such a provision is included in a Schedule to the GMSLA, it operates to remove the requirement for *simultaneous* repayment and / or redelivery under paragraph 8.4, but does not disapply the repayment and / or redelivery obligations as a whole.

(b) In any event, Wentworth is wrong to contend that "*if LBIE fails to comply with the obligation to deliver collateral, the counterparty's right to recover damages is not a right to be paid in a foreign currency"* ([146(8)]). In circumstances where a foreign currency most truly expresses the loss suffered as a consequence of any breach of contract and / or where from the terms of the contract it appears that the parties have accepted a particular currency as the currency of account in respect of their obligations, an obligation to pay damages for any breach of contract is an obligation to pay a sum in a foreign currency: *The Folias* [1979] A.C. 685. This is a question of fact to be determined on a case-by-case basis.

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

32. **Senior Creditor Group's position:**

(1) See Question 31.

Question 33: Whether a Currency Conversion Claim can be established by a creditor where the creditor's right is derived from a transfer (whether or not by way of legal assignment) by LBIE's original counterparty (or any assignee of the original counterparty) which only transferred:

(i) the provable debt;

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

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

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

33. **Senior Creditor Group's position:**

(1) The Senior Creditor Group's position is that whether a creditor, whose rights are derived from a transfer, has a Currency Conversion Claim depends on, amongst other things, the true meaning and effect of the transfer, taking into account the factual matrix, determined in accordance with the relevant applicable law or laws.

(2) Question 33 is premised upon the existence of an assignment in which an assignor with a claim denominated in a foreign currency has assigned solely such part of his rights as are reflected by his right of proof, the right to receive a dividend on his proved debt or the Agreed Claim Amount.

(3) Assuming that particular fact pattern, Wentworth concludes that the assignee has no Currency Conversion Claim [148]. Given the premise of the question, that is correct. The conclusion follows tautologically from the premise.

(4) Wentworth also contends that, in those circumstances, the *assignor* also has no non-provable Currency Conversion Claim [149]. This is incorrect and based on a misconception of the basis of Currency Conversion Claims:

(a) The existence of a Currency Conversion Claim is based on a creditor's right to receive (and the debtor's obligation to pay) the full amount of its debt in a foreign currency.

(b) Wherever there is a shortfall between the full amount of the debt expressed in a foreign currency and the foreign currency equivalent of the amounts paid by the debtor by way of dividends, the debtor has not discharged its obligation to pay the full amount of the debt in a foreign currency. In those circumstances a Currency Conversion Claim arises.

(c) An assignment by a foreign currency creditor of solely such part of his rights as are reflected by his right of proof, the right to receive a dividend on his proved debt or the Agreed Claim Amount and receipt by the assignee of the sums to which he is entitled, does not discharge the debtor from its obligation to pay the full amount of the debt in a foreign currency. That obligation will be discharged if (and only if) the amount paid by the debtor by way of dividends is equal to the full amount of the debt expressed in a foreign currency as at the date of payment.

(d) If, following such an assignment, the amount paid by the debtor by way of dividends is less than the full amount of the debt expressed in a foreign currency:

(i) The debtor will not have discharged its obligation to pay the full amount of the debt in a foreign currency.

(ii) The assignor is entitled to assert a non-provable claim for the balance of the debt in the foreign currency.

(iii) The assignor is required to give credit for the foreign currency equivalent of the amounts paid by the debtor to the assignee by way of dividends.

EFFECT OF POST-ADMINISTRATION CONTRACTS

Question 34: Whether a creditor's Currency Conversion Claim has been released in circumstances in which the creditor entered into either:

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

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

(iii) the CRA.

34. **Senior Creditor Group's position:**

CDDs

(1) The Senior Creditor Group's position is that, as a matter of construction, taking into account the factual matrix, none of the CDDs released non-provable claims, including Currency Conversion Claims.

(2) The Administrators state, in relation to Question 35, at [146] that "*the purpose of the CDDs was to establish the quantum of creditors' agreed claims, with a view to them becoming established claims, and it would have made no commercial sense for creditors to have abandoned a contingent right to Statutory Interest merely in order to have certainty as to the amount for which they would be admitted to proof and there is no obvious reason why the Administrators, acting consistently with their statutory duties, would have seen fit to require creditors to abandon such right*". The same points concerning the purpose of the CDDs, the interests of creditors and the duties of the Administrators, apply equally to the question of whether such creditors intended to abandon a Currency Conversion Claim in addition to any claim to Statutory Interest.

(3) Despite their position in relation to Question 35 and despite the the fact that it was the Administrators who drafted the CDDs and required creditors to enter into them as a condition for participation in dividend distributions, the Administrators do not take a formal position in relation to Question 34 so far as the CDDs are concerned but reserve the right to comment upon this issue at a later stage.

(4) Wentworth's answer to Question 34 does not address the factual matrix to the CDDs or their purpose, but instead deals solely with their wording.

(5) Wentworth's position is that the effect of a Foreign Currency CDD and the effect of a Sterling CDD is different. According to it, a Foreign Currency CDD does not waive a Currency Conversion Claim, but a Sterling CDD does.

(6) There is no sensible reason why the Administrators and the creditors who signed CDDs would have intended the effect of the two types of document to be different in this respect, given, amongst other things, that:

(a) The purpose of both Foreign Currency CDDs and Sterling CDDs was to establish the quantum of creditors' agreed claims, with a view to them having established claims, so as to facilitate the determination of unsecured provable claims for the purposes of paying dividends out of the estate.

(b) Creditors who entered into Foreign Currency CDDs had their claims admitted by a two stage process. This process was adopted largely in the period prior to April 2011 although some Foreign Currency CDDs were entered into after that date.

(i) The first stage was that the creditor would enter into a Foreign Currency CDD. This agreed the amount of the creditor's claim in the currency of entitlement.

(ii) The second stage was entering into a deed by which the claim was admitted in Sterling as a provable debt (using the exchange rate on the date of administration). This deed did not contain any release language other than in respect of client money claims.

Wentworth accepts that creditors whose claims were admitted by this process did not release any Currency Conversion Claims.

(c) Creditors who entered into Sterling CDDs had their claims admitted by a single stage process. This process was adopted from around April 2011. Wentworth contends that such CDDs released Currency Conversion Claims.

(d) The question of whether a creditor, with a claim denominated in a foreign currency, entered into a Foreign Currency CDD or a Sterling CDD had nothing to do with whether the parties intended to preserve or waive a Currency Conversion Claim:

(i) Instead it depended on the period in which the claim was determined, in particular whether this was, in broad terms, before or after around April 2011 (although the dividing line was not a sharp one and in the period after April 2011 both forms of CDD were still used).

(ii) In most but not all cases, Foreign Currency CDDs were used at a time when there was greater concern in relation to client money claims or proprietary claims although they continued to be used thereafter where it was clear that the creditor had a client money claim.

(e) At no stage did the Administrators indicate that the effect of a Foreign Currency CDD was different from that of a Sterling CDD in that the latter, but not the former, would result in the waiver of any non-provable Currency Conversion Claim.

(f) If the effect of two documents was different this would, in the event of a surplus, have had the effect of treating creditors of LBIE unequally, depending on whether they happened to enter into a Foreign Currency CDD or a Sterling CDD (in

circumstances where in certain periods both forms were in use simultaneously).

(7) If Wentworth is correct, those creditors who happen to have signed Sterling CDDs, have lost their right to Currency Conversion Claims totalling, on the Administrators' estimate, about £430 million, which sum will instead now be distributed to the holders of subordinated debt and shareholders.

(8) The question of construction in relation to the CDDs, whether Foreign Currency CDDs or Sterling CDDs, is whether the meaning of the words used, ascertained objectively and construed in the light of the background matters known to the parties at the time of the agreement, reflected an intention to compromise and release any Currency Conversion Claim.

(9) In this regard:

(a) What the parties to the CDDs knew or had in contemplation at the time such documents were entered into are very important aspects of the factual matrix; see, for example *Priory Caring Services Limited v Capital Property Services Ltd* 129 Con LR 81 at [66].

(b) The Court's approach to the construction of the CDDs should be informed by the cautionary principle that, even in the context of a "*general release*", parties are unlikely to have intended to surrender rights and claims of which they were unaware; see *BBCI v Ali* [2002] 1 AC 251 at [10] and [17].

(10) Wentworth's construction of the Sterling CDD and, in particular of the Release Clause, in [157] fails to take into account the relevant factual matrix, as set out in the Senior Creditor Group's Position Paper at [34] and as further described in [34(6)] above, and, as a result, fails to reach a correct conclusion as to its meaning and effect.

(11) In particular, construed in the light of the relevant background:

(a) Clause 2.1 provides that a Creditor has an Admitted Claim in an amount equal to the Agreed Claim Amount.

(b) An Admitted Claim is defined in Clause 1.1. as an unsecured claim qualifying for dividends from the estate of the Company ("*an unsecured claim of a creditor of the Company which qualifies for dividends from the estate of the Company available to its unsecured creditors pursuant to the Insolvency Rules and the Insolvency Act*…").

(c) The reference in Clause 2.2 to the Admitted Claim constituting the Creditor's "*entire claim against the Company*", when construed against the factual matrix set out in the Senior Creditor Group's Position Paper, means that the Admitted Claim will be the entirety of the provable claims made against the Company.

(d) Clause 2.3 does not, on its proper construction, affect or extend to Currency Conversion Claims. Such a construction would extend the scope of the Sterling CDDs beyond their intended purpose, contrary to the commercial interests of the creditor and the statutory duties of the Administrator and so as to apply to non-provable claims that were not within the contemplation or knowledge of the parties at the time that such agreements were entered into. Construed against the relevant factual matrix, the language used is insufficiently particular to extend to Currency Conversion Claims.

(e) Clause 2.4 limits the ability of a Creditor to bring claims, actions, demands or issue proceedings against the Company or the Joint Administrators in respect of provable claims other than the Admitted Claim. The distinction between "*prove*" and "*Claim*" and the use of the latter concept, prevents a creditor from taking steps, otherwise than by proving, that would result in him

obtaining assets of the company contrary to the *pari passu* principle and to the prejudice of other unsecured creditors. It was not intended to deal with a situation where, after all proved debts and Statutory Interest had been paid in full, there was a surplus.

(12) The Senior Creditor Group contends, alternatively, that, in the event that it is not possible to give effect to the intention of the Administrators and the creditors as a matter of construction, the CDDs should be rectified so as to provide for and have the effect set out above.

CRA

(13) The Senior Creditor Group's position is that, as a matter of construction, taking into account the factual matrix, entry into the CRA entitles a creditor to a Currency Conversion Claim based on the USD sum payable under the CRA.

(14) Wentworth agrees that:

(a) The CRA expressly modified contractual entitlements, entitling creditors to have their rights determined on the basis set out in the CRA; see at [161(3)].

(b) The terms of the CRA did not give rise to a waiver of a Currency Conversion Claim; see at [158].

(15) The Senior Creditor Group's position is that the terms of the CRA expressly modified contractual entitlements by providing that all claims (including both claims that were originally denominated in USD and claims that were originally denominated in another currency) were, following accession to the CRA, denominated in USD. Wentworth does not seek to suggest otherwise.

(16) The vast majority of claims modified by the CRA were already denominated in USD prior to the creditors' accession to the CRA such that this modification would only have had a substantive effect in the minority of cases.

(17) Wentworth contends, however, that "*a large number of creditors that acceded to the CRA subsequently entered into a CDD in order to agree the amount of their claims under the CRA against LBIE*", and that, in such cases, "*the combined effect of the CRA and the CRA CDD is to release any Currency Conversion Claim*"; at [161].

(18) According to Wentworth, this is because the CRA CDD provided a streamlined procedure for agreeing those claims which were modified by the CRA and because the CRA CDD expressed such a claim in Sterling.

(19) Wentworth's argument at [158-161] that, although the CRA does not itself waive a Currency Conversion Claim, it does so in conjunction with any CDD that a CRA signatory subsequently signed, is incorrect and fails to reflect the true meaning of the CRA and any CRA CDD construed against the relevant background.

(20) If, as is common ground, a CRA does not waive or release a Currency Conversion Claim, the suggestion that the CRA combined with a CRA CDD does release such a claim is commercially nonsensical for the reasons given above in relation into CDDs generally, and because:

(a) A CRA signatory was not required to enter into a CDD to determine the amount of its unsecured claim (Lomas 10 at [63]). Where a creditor did not do so, Wentworth agrees that its claim was admitted to proof without it releasing a Currency Conversion Claim.

(b) Not all CRA CDDs expressed the agreed claim in Sterling. Where a claim was not expressed in Sterling, Wentworth agrees

that the claim was admitted to proof without any Currency Conversion Claim being released.

(c) If Wentworth is correct, those creditors who happen to have signed CRA Sterling CDDs, have lost their right to Currency Conversion Claim totalling, on the Administrators' estimate, about £280 million, which sum will instead now be distributed to the holders of subordinated debt and shareholders.

(d) Such an interpretation could not reflect the intention of the Joint Administrators who had a duty to treat creditors fairly; see, for example, *Re WW Duncan* [1905] 1 Ch 307 where a creditor had signed a receipt following payment of dividends "*in full and final discharge of my claim against this company*". Contributories contended that, as a result, he released any claim he had to interest in the event of a surplus. Buckley J rejected that contention, saying "*I decline to attribute such an intention to any liquidator; it would be a most dishonest thing to do. It is the liquidator's duty to see that the estate in his hands is distributed according to the rights of the parties, not to induce somebody to give away by a slip a right as to which the liquidator knows there is a real question to be determined.*".

(e) Nor would it reflect the intention of any creditor entering into both a CRA and a CRA CDD who, had it been aware of the distinction that Wentworth now draws, would have had no commercial rationale for entering into the CRA CDD.

(21) So far as the terms of the CRA are concerned:

(a) The entitlements of creditors, as modified by the CRA, are denominated in USD, and therefore include any Currency Conversion Claim which arises from a right to be paid in USD.

(b) The Net Financial Claim is defined in Clause 25.1 as the Net Contractual Position in respect of a signatory.

(c) The Net Contractual Position equals the aggregate of the "*Close-Out Amounts*" determined in respect of the signatory's Financial Contracts, such Close-Out Amounts being denominated in USD (see further in response to Question 35 below).

(d) The "*Close-Out Amounts*" are determined by reference to the terms of the Financial Contracts.

(e) The Net Financial Claim in USD is treated as an ascertained unsecured claim in the administration of LBIE but this is not its only attribute; it also has all other substantive and ancillary rights of a contractual claim in USD including the non-provable aspects.

(f) There is no provision in the CRA excluding non-provable aspects of the Close-Out Amounts from the Net Financial Claim, and those non-provable aspects therefore remain for the purpose of seeking to make a Currency Conversion Claim.

(22) Such an interpretation accords with the commercial purpose of the CRA (see further Question 35 below).

(23) The fact that a creditor who entered into the CRA may, in certain cases, have subsequently also entered into a CRA CDD does not affect the position.

(24) Wentworth has referred to one form of CRA CDD incorporating a Release Clause as an example of a Sterling CDD that it contends operates so as to release any Currency Conversion Claim. There were many other forms of CRA CDD, some of which expressed the Agreed Claim Amount in a foreign currency. In relation to the form of CDD that Wentworth has selected (and any others in materially similar terms relied

upon by Wentworth), the Senior Creditor Group contends that Wentworth's interpretation is incorrect.

(25) The purpose of agreeing the Minimum Net Financial Claim Amount was, on the true construction of that CRA CDD and, in particular, Clause 2 thereof, solely for the purpose of proof of debt and quantifying the amount of the CRA claim which would qualify for dividend purpose from the estate of the Company. See, in particular:

(a) Recitals E and G of the CRA CDD.

(b) The definition of Minimum Net Financial Claim Amount, which states a Sterling number but then makes clear that this is the Minimum Net Financial Claim in its currency of entitlement converted into pounds Sterling at the "official exchange rate" set out in r.2.86(2) of the Insolvency Rules (i.e. for proof of debt purposes).

(c) Clause 2.1.2 and the reference to "*shall constitute an Ascertained Claim*", which term is defined in the CRA as "*an ascertained, unsecured claim in the winding-up of the Company or any distribution of the Company's assets generally to its unsecured creditors*".

(d) The restricted waiver, release and discharge in Clause 2.1.4 which relates to certain procedural rights under the CRA and does not extend to a waiver, release or discharge of non-provable claims such as Currency Conversion Claims.

(26) In this respect, the purpose and intended effect of a CRA CDD was no different from that of the CDDs for non-CRA signatories, and the Senior Creditor Group repeats the points made above in that respect.

(27) The Administrators do not take a formal position in relation to Question 34 so far as the CRA and any CRA CDD are concerned, whilst reserving

the right to comment upon this issue at a later stage (despite the fact that it was the Administrators who drafted the CRA and CRA CDDs and required creditors to enter into them), but do state a position in relation to Question 38. However, the points made at [146] of the Administrators' Position Paper apply equally to the question of whether creditors intended to abandon a Currency Conversion Claim when entering into either the CRA or a CRA CDD.

(28) The Senior Creditor Group contends, alternatively, that, in the event that it is not possible to give effect to the intention of the Administrators and the creditors as a matter of construction, the CRA should be rectified so as to provide for and have the effect set out above.

Question 35: Whether a creditor's claim to Statutory Interest has been released in whole or in part in circumstances in which the creditor entered into either:

(i) a CDD incorporating a Release Clause; or

(ii) the CRA.

35. **Senior Creditor Group's position:**

CDDs

(1) The Senior Creditor Group's position is that, as a matter of construction, taking into account the factual matrix, none of the CDDs released non-provable claims, including claims for Statutory Interest.

(2) The Administrators agree that claims to Statutory Interest were not released by entering into a CDD.

(3) As the Administrators correctly state at [146]: "*the purpose of the CDDs was to establish the quantum of creditors' agreed claims, with a view to them becoming established claims, and it would have made no commercial sense for creditors to have abandoned a contingent right to Statutory Interest merely in order to have certainty as*

to the amount for which they would be admitted to proof and there is no obvious reason why the Administrators, acting consistently with their statutory duties, would have seen fit to require creditors to abandon such right".

(4) Wentworth's position is that the effect of a CDD on the right to Statutory Interest under r.2.88 is different, depending on whether one is concerned with "*the rate applicable to the debt apart from the administration*" or the Judgments Act Rate. Their position is that, by entering into a CDD, the Administrators and the relevant creditor intended:

(a) to abandon any right to interest pursuant to r.2.88(9) at the rate applicable to the debt apart from the administration; but

(b) to retain the right to interest under r.2.88(9) at the Judgments Act Rate.

(5) As the Administrators explain, there is no sensible reason why the Administrators and the creditors who signed CDDs would have intended creditors to give up any right to interest at the rate applicable to the debt apart from the administration and to limit their right to interest solely to interest at the Judgments Act Rate.

(6) To construe the CDDs in the manner contended for by Wentworth would be to conclude that the Administrators and creditors had intended to bring about a result that prejudiced some creditors with contractual claims as compared to those with no existing right to interest.

(7) Nor is this the meaning and effect of the CDDs, construed in the light of the factual matrix set out in the Senior Creditor Group's Position Paper at [34(2)] and [35(1)] for the reasons set out in the Senior Creditor Group's Position Paper at [35(2)] and in the Administrators' Position Paper at [143] to [145]. See also *In Re WW Duncan* [1905] 1 Ch 307, referred to in Question 34(17) above.

(8) The Senior Creditor Group contends, alternatively, that in the event that it is not possible to give effect to the intention of the Administrators and the creditors as a matter of construction, the CDDs should be rectified so as to provide the effect set out above.

CRA

(9) The Senior Creditor Group's position is that the CRA did not release a claim to Statutory Interest.

(10) The Administrators agree that the CRA did not release a right to Statutory Interest under r.2.88(9) at the Judgments Act Rate. They contend, however, that it did release any right to interest under r.2.88(9) at a "*rate applicable apart from the administration*".

(11) The purpose of the CRA was to expedite the return of trust assets and, consistently with the Administrators' approach in [146] in relation to the CDDs:

(a) It would have made no commercial sense for creditors to have abandoned a contingent right to Statutory Interest when entering into a CRA and there is no reason why the Administrators, acting consistently with their statutory duties, would have seen fit to require creditors to abandon such a right.

(b) It would have made even less sense for them to have abandoned their right under r.2.88(9), in the event of a surplus, to interest at the rate applicable apart from the administration, whilst retaining their right to interest at the Judgments Act Rate.

(12) On the construction of the CRA, in the light of the factual matrix, in any case where a Financial Contract provides for interest to be payable, that right of interest remains the contractual rate for the purpose of r.2.88(9):

(a) A CRA signatory is entitled to have its "*Net Contractual Position*" determined in accordance with the terms of the CRA: Clause 4.4.2.

(b) The Net Contractual Position equates to the aggregate of the "*Close-Out Amounts*" determined in respect of its Financial Contracts (Clause 24.2).

(c) Each Close-Out Amount is determined by reference to the Contractual Valuation Provisions (subject to the Overriding Valuation Provisions in Clause 20.4): see Clause 21.2.1. These consist of "*any terms in such Financial Contract which provide for the calculation of an amount or amounts payable by one party to the other as a result of the termination of such Financial Contract*." On the true construction of the CRA, such provisions extend to interest provisions, including those that govern the calculation of default interest due following termination.

(d) Clause 20.4.7 of the Overriding Valuation Provisions specifies that "*in determining the Close-Out Amount in respect of a Financial Contract, no interest shall accrue on any unpaid Liability of the Company from the Administration Date save to the extent that such interest would accrue under Rule 2.88 of the Insolvency Rules*" (emphasis added).

(e) Clause 20.4.7 in terms does not prevent any provision of the Financial Contract which provides for the calculation of the amounts payable in the form of interest from being the reference rate for the purpose of r.2.88(9) as and when a surplus is available.

(13) Such a construction accords with the commercial purpose of the CRA and with common sense. The CRA was not intended to deprive signatories of the benefit, in the event of a surplus, of the economic terms of Financial Contracts that would otherwise have been enforceable.

Equally, it was not intended to deprive signatories of the benefit of any other rate of interest applicable to a claim apart from the administration.

(14) By analogy, the Senior Creditor Group further or alternatively relies on the argument made by the Joint Administrators at [145] in respect of CDDs that the "*right to receive Statutory Interest is a right which is consequential and parasitic on the creditor having an Admitted Claim, in the same way as the right to receive dividends*" and that "*it forms part of the bundle of rights arising on the coming into existence of the Admitted Claim*".

(a) A CRA signatory's Net Financial Claim gives rise to an Ascertained Claim, which in turn becomes (subject to mandatory conversion into Sterling) an Admitted Claim.

(b) The CRA should not be construed to thwart the right to receive Statutory Interest at a rate provided for in the Financial Contract or other rate applicable but for the administration. There is no difference in principle in this regard between the CRA and CDD analysis.

(c) It would be un-commercial to construe the express references in the CRA to rights to Statutory Interest "*under Rule 2.88*" (Clause 20.4.7) and as "*provided in Rule 2.88*" (Clause 25.1) more narrowly than the express confirmation in the CDDs preserving a claim to Statutory Interest. Such references are to r.2.88, and not merely to the Judgments Act Rate.

(d) The Administrators could not (consistent with their duty to act fairly as between creditors) have intended that creditors with an existing right to contractual interest at a rate higher than the Judgments Act Rate would be deprived of such a right.

(15) The Senior Creditor Group contends, alternatively, that, in the event that it is not possible to give effect to the intention of the Administrators and

the creditors as a matter of construction, the CRA should be rectified so as to provide and have the effect set out above.

Question 36: If a CDD or the CRA has the effect of releasing a Currency Conversion Claim, Statutory Interest claim or other non-provable claims, whether such release(s) should in the circumstances be enforced.

36. **Senior Creditor Group's position:**

(1) The Senior Creditor Group's position is as set out in its Position Paper.

Question 37: How are claims to be calculated where a CDD (or any other agreement pursuant to which an unsecured claim is agreed or admitted) compromises a number of claims, with differing rates of interest applicable or in different currencies, without indicating how the agreed or admitted claim amount in the CDD (or any other agreement) derived from and relates to those underlying claims?

37. **Senior Creditor Group's position:**

(1) References in the Senior Creditor Group's Position Paper to each "*component debt*" mean, consistent with r.13.12(1), each debt or liability to a creditor to which the company was subject at the date of the administration. The admitted amounts of each such debt or liability comprise the creditor's total Admitted Claim.

(2) The admitted amount of each component debt should be agreed or determined by reference to all available relevant information (including records and working papers of the Administrators that bear on their determination of the Admitted Claim Amount in any CDD).

Question 38: Whether (and if so in what circumstances) Part VII of the CRA, which specifies that claims of acceding creditors are to be calculated in US dollars, is capable of giving rise to a Currency Conversion Claim.

38. **Senior Creditor Group's position:**

(1) The Senior Creditor Group's position is that, if the Sterling sum received by a CRA signatory is less than the amount of its entitlement in USD (as modified by the CRA) due to foreign exchange rate movements it will have a Currency Conversion Claim.

(2) Contrary to the position adopted in [159] of the Administrators' Position Paper, Part VII of the CRA is capable of giving rise to a Currency Conversion Claim.

(3) The relevant factual matrix to the CRA includes those matters set out in [34(3)] of the Senior Creditor Group's Position Paper, and also includes the following facts and matters:

(a) The vast majority of claims against LBIE were already denominated in USD prior to the relevant creditors' accession to the CRA (see also [34(13)] above).

(b) The functional currency used in the LBIE administration has been USD.

(c) The CRA was put to LBIE's creditors after the failed attempt to promulgate a scheme of arrangement under Part 26 Companies Act 2006. The Scheme had been advanced on the basis that it would operate in USD, and that claims would be converted into USD for that purpose. The CRA was described in information provided to creditors as having substantially the same provisions as the Scheme.

(d) The Administrators' presentations regarding the CRA to proposed CRA signatories made clear that the provisions of the CRA were intended to determine and agree the amount of claims of CRA signatories. No suggestion was made in those presentations or in the supporting documentation circulated with the CRA that, by entering into the CRA, any creditors would be giving up any non-provable claims.

(4) The Administrators' contention at [159.6] that the NFC is a new claim "*which exists only for the purposes of receiving a dividend from the insolvent estate*" is incorrect and would, as a matter of interpretation of the CRA, fail to give full effect to the contractual rights of the CRA creditors:

(a) In exchange for the releases granted under the CRA, a CRA signatory is entitled to "*New Claims*" which include, *inter alia* (see Clause 4.4.2):

(i) the right to have its "*Net Contractual Position*" determined on the basis set out in the CRA;

(ii) the right to claim as a new obligation of the Company any NFC which derives from its Net Contractual Position; and

(iii) an "*Ascertained Claim*", being an ascertained unsecured claim in the winding-up of the Company or any distribution of the Company's assets generally to its unsecured creditors, in the amount of its NFC.

(b) The definition of NFC in Clause 25.1 includes a statement that the NFC represents "*an amount due and owing by the Company*" to the CRA Signatory, "*which shall constitute an ascertained unsecured claim of that Signatory in the winding-up of the Company or any distribution of the Company's assets to its unsecured creditors*".

(c) The first part of this definition is omitted from the reference to the definition of NFC in [159.6] of the Administrators' Position Paper. Contrary to the Administrators' position, the second part of the definition does not state that such a claim exists "*only*" for the purposes of receiving a dividend from the insolvent estate, which word is not used.

(d) Read as a whole, in its proper context, and by contrast to the definition of Ascertained Claim, the Net Financial Claim created by the CRA is a contractual obligation of LBIE (based on its existing contractual obligation but subject to the modifications set out in the CRA) which is not limited merely to a right to receive dividends on such part of its claim as is admissible to proof.

(e) A USD claim pursuant to the CRA is, accordingly, capable of giving rise to a Currency Conversion Claim (like any other foreign currency contractual obligation) if the Sterling sum received by a CRA signatory is less than the amount of its entitlement in USD due to foreign exchange rate movements.

(f) In circumstances where the vast majority of claims against LBIE were denominated in USD prior to the relevant creditors' accession to the CRA, the Administrators could not have intended, consistently with the purpose of the CRA and their duties to creditors when recommending that creditors enter into the CRA, that claims that were originally denominated in USD (and so eligible for a Currency Conversion Claim) should lose that Currency Conversion Claim simply because the creditor had acceded to the CRA which re-stated their claims in USD.

(5) Contrary to the positions adopted in [170] and [171] of Wentworth's Position Paper:

(a) The CRA contained provisions intended to determine and agree the amount of claims. In order to do so, there were certain modifications of pre-administration contractual entitlements. The modification of pre-administration contractual rights pursuant to the CRA does not preclude the assertion of a Currency Conversion Claim in respect of the modified entitlement in the event of a surplus.

(b) The CRA does not provide (expressly or implicitly) that conversion of Close-Out Amounts into USD for the purposes of calculating a signatory's Net Financial Claim is "*for administrative convenience only*" and such a statement misunderstands the purpose and commercial effect of the CRA when considered against the relevant factual matrix.

COMPENSATION FOR TIME TAKEN TO DISCHARGE NON-PROVABLE CLAIM

Question 39: Whether a creditor entitled to Statutory Interest, Currency Conversion Claims and / or other non-provable claims is entitled to any form of compensation for or in respect of the time taken for such claim to be discharged and, if so, whether such compensation is taken into account as part as the correct methodology for calculating Statutory Interest and / or the distribution of the surplus, or should take the form of interest at the Judgments Act Rate, damages for loss, restitution or another form.

39. **Senior Creditor Group's position:**

(1) Wentworth and the Administrators contend that there is no basis upon which creditors are entitled to compensation for the time taken to discharge non-provable claims.

(2) The following paragraphs are without prejudice to the Answer to Question 2 above and the *Bower v Marris* Calculation.

Currency Conversion Claims

(3) The Senior Creditor Group contends that, in relation to claims denominated in a foreign currency, a creditor has a non-provable claim for damages for loss caused by the non-payment of its claim on the date that the claim fell due for payment.

(4) As set out in their Position Paper at [39(4) and (5)] such a claim arises on entirely orthodox principles:

(a) A creditor with a claim denominated in a foreign currency was entitled to payment in the relevant foreign currency on the date that his claim fell due for payment.

(b) Such a creditor has a non-provable claim for loss and damage suffered as a result of the non-payment of his claim on that date; *Sempra Metals v Inland Revenue Commissioners* [2008] 1 AC 561.

(5) Wentworth contends at [174] that there is no basis upon which such a creditor is entitled to compensation because "*compensation for the late payment of a sum (i.e. interest) is recoverable only where the creditor has a pre-existing statutory or contractual right to it*".

(6) This is incorrect. The right does not have to be statutory or contractual. It may, following the decision of the House of Lords in *Sempra Metals* in 2008, be a claim for damages at common law for loss caused by the late payment of money.

(7) The Administrators contend at [171] that there is no basis upon which such a creditor is entitled to compensation because "*a non-provable claim only falls to be paid after Statutory Interest has been paid*" and "*Rule 2.88(7) does not itself stipulate a precise time at which Statutory Interest will become payable*".

(8) This is incorrect:

(a) A creditor with a claim denominated in a foreign currency was entitled to payment in the relevant foreign currency on the date that his claim fell due for payment.

(b) Such a creditor has a claim for any loss and damage suffered as a result of the non-payment of his claim on that date; *Sempra Metals v Inland Revenue Commissioners* [2008] 1 AC 561.

(c) The creditor's underlying entitlement to payment on the relevant date and his claim for loss and damage as a result of non-payment of his claim on that date, are unaffected by the administration; *Wight v Eckhardt* [2004] 1 AC 147.

(d) The fact that the rules governing the conduct of that administration provide for such part of the creditor's claim as is non-provable to be paid only after the payment of Statutory Interest, does not change the fact that the debt was not paid when it fell due for payment nor the fact that the creditor suffered loss and damage as a result of such non-payment.

(e) Accordingly, the creditor has a non-provable claim for loss and damage caused by such delay.

(f) The question of when, in accordance with the proper administration of the estate, any surplus is applied in discharging that non-provable claim does not deprive a creditor of such a right. Its only consequence is to determine the actual length of such delay and thus the amount of any claim for loss and damage for delay.

(g) If this was not the case, then the effect of the administration would be that the surplus would be required to be distributed to shareholders, despite the fact that a creditor with a claim denominated in a foreign currency had a right to damages for late payment which had not been satisfied in full, which would be contrary to principle.

Statutory Interest

(9) The Senior Creditor Group contends that creditors have a non-provable claim for damages for loss caused by non-payment of Statutory Interest in respect of the period between the date of payment of debts proved and the date on which Statutory Interest is paid.

(10) Wentworth contends at [174] that there is no basis upon which such a creditor is entitled to compensation because "*compensation for the late*

payment of a sum (i.e. interest) is recoverable only where the creditor has a pre-existing statutory or contractual right to it".

(11) This is incorrect. The right to Statutory Interest can include a right to payment of interest at "*the rate applicable apart from the administration*". This can include, for example, a rate pursuant to a contract. A creditor who is not paid interest on the date when, as a matter of contract, he was entitled to it, has a claim for damages for late payment of that amount of interest. R.2.88 does not extinguish that claim which, if and to the extent not reflected in the amount paid by way of Statutory Interest, is a non-provable claim.

(12) The right to Statutory Interest also includes a right to payment of interest at the Judgments Act Rate, if this is greater than the rate applicable apart from the administration.

(13) The Administrators contend that there is no obvious basis upon which a creditor is entitled to compensation for loss caused by non-payment of Statutory Interest at the Judgments Act Rate in respect of the period between the date of payment of debts proved and the date on which Statutory Interest is paid.

(14) This is incorrect:

(a) The right to interest at the Judgments Act Rate, in circumstances where the creditor has no other entitlement to interest, is a right pursuant to r.2.88. R.2.88(7) provides that "*any surplus remaining, after payment of the debts proved, shall … be applied in paying interest on those debts*".

(b) In accordance with r.2.88(7), the relevant creditors are entitled to interest at the Judgments Act Rate after payment of the debts proved.

(c) The mere fact there is, at present, a dispute as to how the surplus should be applied, which requires determination by the court, is irrelevant. It is correct that, pending resolution of that dispute, the Administrators will not be in breach of duty for failing to apply the surplus. However, the effect of the subsequent determination will be to declare the rights of the parties and to declare, if the Senior Creditor Group's position is accepted, that the relevant creditors were entitled to have the surplus applied in payment of interest to them after payment of the debts proved.

(d) In such circumstances, the relevant creditors will have a claim for damages arising from the fact that the surplus was not applied in payment of interest to them after payment of the debts proved, as and when, absent such dispute, this could properly have occurred in accordance with the Rules, but was only applied some months or potentially even years later.

(e) If the position was that all debts could be proved but payment of the relevant amount of Statutory Interest on such debts could be paid only years later, without compensation, this would defeat the intention of the legislature that creditors should receive interest at the Judgments Act Rate. The relevant sum, if only paid years later, would no longer represent the rate of interest which the legislature considered represented an appropriate amount of compensation.

(f) This approach accords with the established principle that prejudice suffered by reason of delay in the administration of an insolvent estate should be remedied before any sums are treated as being available for distribution to holders of subordinated debt or shareholders; see *Canada Deposit Insurance Corp v Canadian Commercial Bank* (1993) 21 CBR (3d) 1 at [22].

(g) This is particularly so in circumstances where there is sufficient cash to pay the claims of creditors in full, and a failure to compensate creditors for a delay in the payment of claims would benefit the shareholders. In such circumstances, the shareholders would have a perverse incentive to extend the process of administration for as long as possible.

General

(15) In the absence of compensation, the longer the delay in paying Statutory Interest or Currency Conversion Claims, the greater the detriment to creditors, and the greater the benefit to shareholders. The result of this is that, whilst those claims continue to remain unpaid, the shareholders will continue to benefit from any interest earned on or increase in the value of the approximately £6.5 billion of cash and other assets currently held by LBIE, while the creditors receive no compensation for the time value of their claims.

ROBIN DICKER QC
RICHARD FISHER
HENRY PHILLIPS

South Square
3-4 South Square
Gray's Inn

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