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

# REPLY POSITION PAPER OF THE FIFTH RESPONDENT

## Introduction

1. This Reply Position Paper is on behalf of the Fifth Respondent, York Global Finance BDH, LLC ("**York**"). It is filed and served pursuant to paragraph 5 of the Order of David Richards J dated 25 June 2014.

**Statutory Interest**

Construction of rule 2.88

2. *Question 2*: As explained in its Position Paper, York's position is that post-administration interest is calculated on the basis of allocating dividends first to accrued post-administration interest at the date of the relevant dividend payment and then in reduction of the principal.

3. As to the position adopted by Wentworth and the Joint Administrators:

(1) It is accepted by both Wentworth and the Joint Administrators that, prior to 1986, the rule in Bower v Marris applied to determine the calculation of interest in the event of a surplus in both bankruptcy and liquidation. However, contrary to Wentworth and the Joint Administrators, the application of the rule was not founded on or limited to the notion that, in the event of a surplus, creditors were remitted to their contractual rights.

(2) This is not least because the rule in Bower v Marris applies in bankruptcy where, since 1824, creditors whose debts do not bear contractual interest are nevertheless entitled to statutory post-insolvency interest. This was the position at the time of the decision in Bower v Marris itself and there is nothing in the reasoning in the decision to suggest either that the rule is founded on or limited to the notion that a creditor is remitted to his contractual rights in the event of a surplus or that it applies differently between the position where a creditor has a contractual right to interest and the position where he does not.

(3) The cornerstone of the argument of Wentworth and the Joint Administrators is that so far as liquidation (and administration) is concerned the Insolvency Act 1986 effected a fundamental change in the law by extending the right to post-insolvency interest to creditors

whose debts did not bear a contractual rate of interest *thereby* disapplying the rule in Bower v Marris. However, this reasoning is unsound and is based on a *non sequitur*. In particular:

(a) The effect of the changes to post-insolvency interest effected by the 1986 Act were to extend the position in bankruptcy, where a creditor whose debt did not bear contractual interest was entitled to post-insolvency interest, to liquidation and to remedy the anomaly between bankruptcy and liquidation in this respect which had come to prominence in the decision in Re Rolls Royce Ltd [1974] 1 WLR 1584. As the Cork Report stated (at [1392]): "*We consider that there should be one set of rules relating to the interest on debts in all forms of insolvency proceedings.*"

(b) This change was not, therefore, intended to disapply Bower v Marris in the case of liquidation, nor did it have that effect. Rather, the purpose of the change was to bring the rules in liquidation into alignment with those applicable in bankruptcy. Moreover, (a) in bankruptcy the rule in Bower v Marris applies to both contractual and non-contractual post-insolvency interest and (b) the rule is not founded on the notion of a creditor being remitted to his contractual rights in the event of a surplus. There is therefore no basis for concluding that the intention was that rule would not continue to apply in liquidation.

(c) Tellingly, neither Wentworth nor the Joint Administrators explain whether it is their position that the rule in Bower v Marris continues to apply in relation to bankruptcy post the 1986 Act. If it does do so, then on the argument advanced by Wentworth and the Joint Administrators this would lead to an arbitrary and unprincipled distinction between liquidation/administration and bankruptcy. If it does not do so, then on the argument advanced by Wentworth and the

Joint Administrators, it would imply that in the 1986 Act Parliament intended to effect a change in the law by abolishing the rule in Bower v Marris. However, there is nothing at all to suggest that this was the intention.

(4) The fact that the rule in Bower v Marris is not founded on or limited to the notion of a creditor being remitted to his contractual rights is also evidenced by the various cases in which the rule has been applied to non-contractual, statutory interest including Attorney-General of Canada v Confederation Trust Co (2003) 65 OR (3d) 519 and the wills and probate cases concerning the right of a legatee to receive interest on his legacy (see Thomas v Montgomery (1828) 2 Simons 348; Whittingstall v Grover (1886) 55 LT 213, 217; In re Prince (1935) 51 TLR 526; In re Morley's Estate [1937] Ch 491)[1].

4. Wentworth and the Joint Administrators also rely on the language in rule 2.88(7) referring to the "*surplus remaining after payment of the debts proved*" and providing for such surplus to be used for paying "*interest*" on "*those debts*".

(1) However, contrary to Wentworth's Position Paper at [7] and the Joint Administrators' Position Paper at [10], the application of the rule in Bower v Marris is not purely a point of statutory construction. The 1986 Act and the 1986 Rules are not a code in the civil law sense. There are various examples of non-statutory principles which operate as glosses on the statutory scheme e.g. the rule against double proof, the anti-deprivation principle, the rule in Cherry v Boultbee, and the rules relating to the operation of insolvency set-off (the hindsight principle and the retroactivity principle). In any case, the provisions of the rules have to be construed in the context of the way in which the statutory scheme operates.

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1 See RSC Order LV rule 64 which subsequently became Order 44 rule 9 then Order 44 rule 10 and see CPR PD 40A para. 15.

(2) As explained in the authorities, proving is a mechanism of convenience to facilitate the distribution of the estate of the insolvent debtor on a *pari passu* basis amongst creditors (In re Humber Ironworks and Shipbuilding Co. (No. 2) (1868-69) L.R. 5 Ch. App. 88, 92). The process of proving in a liquidation does not remove the substantive rights of creditors. "*The winding up leaves the debts of the creditors untouched. It only affects the way in which they can be enforced ... The winding up does not either create new substantive rights in the creditors or destroy old ones.*" (Wight v Eckhardt [2004] 1 A.C. 147 P.C. per Lord Hoffmann at [27]; and see the Joint Administrators' Position Paper at [107(6)]).

(3) In a liquidation or distributing administration the position is as follows: (a) the creditor submits a proof in respect of his claim; (b) where the proof is admitted, the creditor becomes entitled to dividends at the declared rate on the admitted proof; (c) payments are then made to the creditor in discharge of his right to receive dividends on his admitted claim. Following the distribution of the estate, and the conclusion of liquidation/administration, all of the creditor's rights against the debtor remain intact except that the creditor is bound to give credit for the dividends which he has received.

(4) There is nothing in this process which deprives a creditor of the right to rely on the usual rule that the law will apply a payment made by a debtor to discharge interest before applying it to the earliest items of the principal. If, for example, a further asset of the debtor is subsequently discovered the creditor is entitled to recover the full amount of his loss from the debtor by treating the dividends which he has received as having first been allocated to interest. But, in any case, the language of rule 2.88(7) refers to payment (i.e. in the sense of receipt of dividends on the proved debt), not discharge, and does not remove the ordinary right of a creditor to rely on the usual rule that the law will apply a payment made by a

debtor to discharge interest before applying it to the earliest items of the principal.

(5) There is therefore nothing in the statutory language in rule 2.88 which precludes the operation of the rule. Indeed, the basic formulation of the relevant statutory provisions has not changed. At the time of Bower v Marris section 132 of the Bankruptcy (England) Act 1825 post-bankruptcy interest was only payable "*after the Creditors who have proved under the Commission shall have been paid*". However, this language was not treated as any bar to the application of the rule[2].

5. Finally, the Joint Administrators' argument on this question is inconsistent with their own statements of the applicable policy at [21]-[23] and [34.6] of their Position Paper. As the Joint Administrators state, "*the fundamental object of Statutory Interest is to confer on a creditor, in the event of a surplus, a right to interest which the insolvency regime has prevented it from establishing either by proving or commencing its own proceedings*". York agrees. In order to achieve this object, it is necessary to apply the rule in Bower v Marris to give effect to the usual rule that the law will apply a payment made by a debtor to discharge interest before applying it to the earliest items of the principal and thereby enable the creditor to recover the full amount of his loss.

6. *Question 3*: York does not take a position on Question 3 and therefore does not take any position on the sub-issues identified at [31.1] and [31.2] of the Joint Administrators' Position Paper. It is noted that these further sub-issues do not arise if York is correct as to the application of the rule in Bower v Marris.

7. *Question 4*: As stated in its Position Paper, York's position is that the words "*the rate applicable to the debt apart from the administration*" in rule 2.88(9) of the 1986 Rules are apt to include the rate of interest applicable to a foreign judgment.

8. The Joint Administrators agree with this position at [34] of their Position Paper. So far as footnote 6 of the Joint Administrators' Position Paper is concerned (which it is

2 See also Re Langstaffe [1851] O.J. No. 238 at [10] and Bromley v Goodere (1743) 1 Atkyns 75.

assumed was intended to refer to [34.5(iii)] rather than [34.5 (ii)] of the Joint Administrators' Position Paper):

(1) The relevant principle is that a creditor should be entitled to interest at a rate equivalent to the rate which he would have been able to obtain if he had commenced a hypothetical individual enforcement process in respect of his claim against the debtor rather than being forced to enforce his claim through the collective enforcement process of insolvency.

(2) As to (a) of footnote 6 of the Joint Administrators' Position Paper, there is a claim to interest at the foreign judgment rate in every case where the creditor could have sued in a foreign jurisdiction, or commenced an arbitration, and obtained judgment which would have attracted the application of interest under the applicable foreign rules/legislation, but has instead pursued this claim through the collective enforcement process of insolvency. For these purposes, it is irrelevant whether the creditor was legally prevented by the effect of the statutory moratorium from suing or whether it would have served no practical purpose for the creditor to have sued and obtained a judgment given the insolvency of the debtor or whether he simply elected to enforce his claim through the collective process of insolvency.

(3) As to (b) of footnote 6, the Joint Administrators are under a misconception and, in particular, are confusing the question of the *rate* of interest applicable to a debt with the *time* from which such interest begins to accrue. The language "*the rate applicable to the debt apart from the administration*" in rule 2.88(9) of the 1986 Rules is concerned with the former, not the latter. The latter question of the period during which interest accrues is dealt with by rule 2.88(7) (and by Questions 7 and 8 below). For the purposes of rule 2.88(9), in the case of a contingent and future debt, it is sufficient to identify the rate of interest which would have been applicable if and when the creditor

was able to sue, irrespective of whether the creditor was in fact able to do so at the date of commencement of the administration.

9. Wentworth's Position Paper at [29] is misconceived. This is because it confuses the position absent the liquidation/administration (i.e. "*apart from the administration*") with the position under the liquidation/administration itself. The language "*the rate applicable to the debt apart from the administration*" is directed at what the position would have been if the collective enforcement process of insolvency had not taken place and instead the creditor had been liberty to bring individual enforcement action. The points made at [29] of Wentworth's Position Paper to the effect that a creditor should not be able to retain the fruits of an individual enforcement action brought in breach of the stay arising from liquidation/administration therefore miss the point, as the language is directed to the hypothetical situation where there is no collective insolvency process and therefore no stay in place.

Period during which the debts "*having been outstanding since LBIE entered administration*" for the purposes of rule 2.88(7)

10. *Question 7*: As stated in its Position Paper, York's position is that post-administration interest is payable in respect of an admitted provable debt which was a contingent debt as at the date of administration from the date of administration.

11. As to the position adopted by Wentworth:

(1) Wentworth accepts that, in both liquidation and administration, the proof and distribution process notionally occurs on the date of commencement of the liquidation or administration and that claims are valued as at the date of the commencement of the liquidation or administration (Wentworth's Position Paper at [43]). Wentworth also appears to accept, as it has to, that debts which are contingent or future at the date of the commencement of the liquidation or administration are provable as "*debts*" and for these purposes are valued at the date of the commencement of the liquidation or administration: see rule 13.12 of the 1986 Rules.

(2) As explained in York's Position Paper, it follows for the purposes of the statutory scheme that claims, including contingent and future claims, are "*outstanding*" from the date of the commencement of the liquidation or administration and that creditors are kept out of their money from that date.

(3) Wentworth nevertheless asserts that this is not the case. On analysis, its argument reduces to an assertion that "*outstanding*" means "*due*" as a matter of ordinary language. This is not so. It would, for example, be normal to speak of the presently "*outstanding*" principal under a term loan facility which does not mature and become repayable until some time in the future. But, in any case, "*outstanding*" was clearly not used by the draftsman in the sense of "*due*" in the 1986 Rules: see rule 2.105(2)[3].

(4) Wentworth does not address the effect of insolvency set-off which applies to contingent and future claims against the company and operates to produce a net balance owed to the creditor as at the date of the commencement of the administration which is provable in the administration.

12. As to the position adopted by the Joint Administrators:

(1) The Joint Administrators accept that a debt which is contingent at the date of the administration can be admitted to proof (Joint Administrators' Position Paper at [44.1]). However, they do not address the consequences of the operation of the statutory scheme including the notional distribution of the debtor's company assets on the date of the liquidation/administration.

(2) The Joint Administrators assert that if statutory interest was payable from the date of administration certain contingent creditors would receive a windfall. This is wrong.

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[3] See also rule 6.217(3)(b) of the 1986 Rules.

(a) Debts which are contingent as at the date of commencement of the administration are subject to estimation under rule 2.81 of the 1986 Rules. Such estimation may include a discount for futurity so as to produce a net present value for the debt: see Goode, Principles of Corporate Insolvency, 4th ed., at [4.39] and Re MF Global UK [2013] EWHC 92 (Ch) at [54].

(b) Where the contingency has not occurred at the time of the declaration of dividend, then the creditor will receive a dividend on the estimated value of his claim, including a discount for futurity.

(c) Where the contingency has occurred by the date of declaration of dividend, then by the operation of the hindsight principle the estimated value of the debt will fall to be revised as the amount now quantified following the occurrence of the contingency. In this case, there is no discount for futurity but that is because the law treats the now quantified amount as being the amount due at the date of commencement of the insolvency: "*If by that time the contingency has occurred and the claim has been quantified, then that is the amount which is treated as having been due at the bankruptcy date.*" (Stein v Blake [1996] 1 AC 243, 252)

(d) Where the contingency has not occurred at the date of declaration of dividend, and by that date will never occur, then by operation of the hindsight principle the estimated value of the debt will fall to be revised to zero. Such a creditor therefore will receive no dividend and no interest.

(e) If contingent creditors in the situations described in (b) and (c) were denied post-insolvency interest on their claims from the date of commencement of the liquidation or administration, then this would in fact result in a windfall for other creditors.

(4) Like Wentworth, the Joint Administrators do not address the operation of insolvency set-off.

13. The Joint Administrators refer at [45] of their Position Paper to creditors "*who have refrained from terminating transactions with LBIE for several years after its entry into administration*". As to this:

(1) If, and insofar as, this comment is directed at York (or creditors in a like position) it is misplaced. The agreements between the LibertyView Funds and LBIE contained no mechanism which enabled LibertyView unilaterally to close out the agreements, as the Joint Administrators have acknowledged.

(2) Moreover, absent agreement between the parties[4], the only way in which the LibertyView Funds could have crystallised their claims against LBIE would have been to return the borrowed cash and securities to LBIE[5]. However, there would have been no rational basis for doing this (and thereby increasing the LibertyView Funds' exposure to LBIE, an insolvent company) in circumstances where there was no assurance that LBIE would perform its side of the agreements by then returning collateral (and, indeed, an overwhelming likelihood that it would not).

(3) By contrast, LBIE had the right to close out the positions at any time by demanding repayment of its cash and securities loans from the LibertyView Funds and enforcing its security over the collateral. However, it did not do so.

14. *Question 8*: As stated in its Position Paper, York's position is that post-administration 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.

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4 For example, the CRA contained provisions which sought to close out relevant agreements by mutual agreement.

5 Alternatively, actions by LBIE following its entry into administration may have given rise to accrued claims for damages, as to which all rights are reserved.

15. Wentworth appears to agree with this position at [52]-[55] of its Position Paper. However, Wentworth is wrong to suggest that the same analysis does not also apply to contingent debts. Wentworth's position leads to arbitrary and unprincipled distinction between debts which are merely future and debts which are contingent and future.

16. The Joint Administrators' argument at [48] of their Position Paper is wrong. This is because it does not take account of the operation of rule 2.105 of the 1986 Rules. The operation of that rule, which discounts future debts back to a net present value as at the date of commencement of the administration, shows that future debts are "*outstanding*" for the purposes of the statutory scheme as from that date. Further, the points made by the Joint Administrators at [48.6] of their Position Paper merely reflect a legislative choice as to how and when discounting should apply. This choice is consistent with the approach which the law takes generally to contingent and future debts which subsequently accrue before dividends are paid i.e. the crystallised amount is treated as having been due at the date of commencement of the insolvency (see paragraph 12(2)(c) above).

17. *Question 6*: As to Question 6, York's position is that the question is based on a false premise. Rule 2.88(9) is concerned with identifying the *rate* of interest applicable to a debt, not the time period over which such interest is treated as accruing. The latter point is dealt with by rule 2.88(7) and, as explained above, debts are outstanding for the purposes of rule 2.88(7) as from the date of commencement of the administration.

**Currency Conversion Claims**

18. *Questions 28 to 30*: York's position remains as set out in its Position Paper.

19. *Questions 31 to 32*: The position taken by Wentworth at [146(8)] of its Position Paper is wrong. Wentworth asserts that, where LBIE failed to comply with its obligation to deliver collateral, the relevant creditor will not have a currency conversion claim. However:

(1) It is irrelevant that the contract does not provide in terms of a right of payment of a debt in a foreign currency. What matters is whether, absent the insolvency, the creditor has a right to obtain payment in a foreign currency. In the case of damages, this means a right to obtain damages in a foreign currency.

(2) In the case of creditors in the position of the LibertyView Funds, they not only had the right to obtain judgment in a foreign currency (in the LibertyView Funds' case, US dollars) but it was inevitable that any judgment would have been in US dollars. This would have been the case even on the hypothesis that the LibertyView Funds had sued in England.

(3) This is sufficient to give rise to a currency conversion claim as York is entitled to claim the difference between what it would have had absent the insolvency of LBIE, *viz.* a US dollars judgment, and what it has received, *viz.* dividend payments in Sterling.

(4) In any event, Wentworth's argument is irrelevant to the position of the LibertyView Funds since they have agreed foreign currency debt claims against LBIE pursuant to the terms of the CDDs entered into with LBIE. The currency conversion claims of the LibertyView Funds arise from the conversion of those foreign currency debts into Sterling.

**Effect of Post-Administration Contracts**

20. *Question 34*: As to Question 34(i), the Release Clauses in Foreign Currency CDDs do not as a matter of construction have the effect of releasing currency conversion claims. (York takes no position on Questions 34(ii) and (iii) as those questions are not relevant to the LibertyView Claims.)

21. As to Question 34(i):

(1) Given that LBIE was a party to the Foreign Currency CDDs, it is unclear why the Joint Administrators are not taking a position on this point (Joint Administrators' Position Paper at [138]).

(2) The points made by the Joint Administrators at [143] of their Position Paper apply with equal force to currency conversion claims under Foreign Currency CDDs. In particular:

(a) the Foreign Currency CDDs were concerned with *quantification* of the relevant creditor's claim (in a foreign currency) and not with *distribution*;

(b) they represented an agreement as to the *quantum* of the claim in the relevant foreign currency;

(c) the Foreign Currency CDDs were not intended to, and do not, have claims arising out of the subsequent treatment of the agreed foreign currency claim for the purpose of effecting a distribution (i.e. the conversion of that claim to Sterling for the purposes of distribution).

(3) As to [139.1] of the Joint Administrators' Position Paper, in light of the context and factual matrix relating to the Foreign Currency CDDs entered into by the LibertyView Funds, the general release language was not apt and effective to release currency conversion claims. In circumstances where the purpose of the Foreign Currency CDDs was to agree the amount of foreign currency claims against LBIE, the general release language was not apt or effective to release claims arising out of the subsequent treatment of the foreign currency debt claims. If this had been the intention, specific language would have been used.

(4) Similarly, the logic which appears to underlie Wentworth's Position Paper at [155] applies equally where creditor has a damages claim to which he was entitled payment of in a foreign currency.

22. *Question 36*: York's position remains as stated in its Position Paper, namely, that if, contrary to York's position, the Release Clauses in the Foreign Currency CDDs do as a matter of construction have the effect of releasing currency conversion claims, then such releases should not in the circumstances be enforced.

**Compensation for Time Taken to Discharge Non-Provable Claims**

23. *Question 39*: York's position remains as stated in its Position Paper. Contrary to the Joint Administrators' Position Paper at [168], rule 2.88(7) does create an obligation on the LBIE Administrators to pay post-administration interest ("*shall ... be applied in paying interest*") and the breach of such obligation may gave rise to a damages claim for the lost time value of money (see e.g. Sempra Metals Ltd v Inland Revenue Commissioners [2008] 1 AC 561).

Tom Smith QC

Robert Amey

Served this 31 October 2014 by Michelmores LLP of 48 Chancery Lane, London WC2A 1JF (Ref: PJS/CNM/109072-1)

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