IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

No. 7942 of 2008

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

B E T W E E N

(1) ANTHONY VICTOR LOMAS
(2) STEVEN ANTHONY PEARSON
(3) PAUL DAVID COPLEY
(4) RUSSELL DOWNS
(5) JULIAN GUY PARR
(THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION))

Applicants

-and-

(1) BURLINGTON LOAN MANAGEMENT LIMITED
(2) CVI GVF (LUX) MASTER SÀRL
(3) HUTCHINSON INVESTORS LLC
(4) WENTWORTH SONS SUB-DEBT SÀRL
(5) YORK GLOBAL FINANCE BDH LLC

Respondents

REPLY SUBMISSIONS OF YORK GLOBAL FINANCE BDH LLC ON SUPPLEMENTAL ISSUE 1(A) ARISING FROM THE WATERFALL II PART A JUDGMENT

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1. These reply submissions are made on behalf of York Global Finance BDH LLC ("**York**") in relation to Supplemental Issue 1(a) arising from the Waterfall II Part A Judgment.

2. In its submissions dated 7 December 2015 ("**Initial Submissions**"), York argued that the words "*the rate applicable to the debt apart from the administration*" in rule 2.88(9) of the Insolvency Rules did not include a contractual rate of interest which only applies after the Date of Administration due to action taken by the creditor post-administration.

3. Wentworth supported York's position. The Administrators and the SCG have disagreed. York's response to the arguments raised by the Administrators and the SCG is as follows.

4. In these reply submissions, York has sought only to make points which are additional to those made in its original written submissions. York maintains all of the points made in its original written submissions. It has not addressed every point in the written submissions of the other parties. The fact that a particular point has not been addressed does not mean that it is accepted.

Policy of rule 2.88(9)

5. The question in relation to Issue 1(a) is a relatively simple one – what did the legislature intend when allowing a comparison to be made under rule 2.88(9) between the Judgments Act rate and a "*rate applicable to the debt apart from the administration*"?

6. It is clear on the face of rule 2.88 that the legislature intended that the Judgments Act rate should be the Judgments Act rate applicable on the date of administration (rule 2.88(6)). It is consistent with this that any other interest rate to be compared against the Judgments Act rate under rule 2.88(9) should be the interest rate applicable to the relevant debt as at the same date. This is logical and simple and is consistent with the explanation in the White Paper cited in the Administrators' written submissions (paragraph 39(1)) that uses the present tense "applies to the debt" to refer to the relevant higher contractual interest rate.

7. Moreover, it is unlikely that the intention was to allow creditors to improve their position after the date of administration by increasing the rate that actually "applies" to their debt. As the Judge noted in paragraph 180 of the Waterfall IIA Judgment, if the Judgments Act rate went up after the date of administration that would not change the Judgments Act rate applicable under rule 2.88 for existing administrations. Yet, on the position of the Administrators and the SCG, a creditor could include in its contract a right (without limit) to increase the rate of interest by taking steps subsequent to the commencement of the administration. This approach would, however, be inconsistent with the concept of comparing a fixed Judgments Act rate with a rate that was "in fact" applicable to the debt apart from the administration.

Validity of the analogy between a foreign judgment rate of interest and a default rate of interest under the ISDA Master Agreement

8. In its Initial Submissions, York relied on the decision of David Richards J in the Part A judgment that "*the rate applicable to the debt apart from the administration*" was not capable of referring to a foreign judgments rate of interest where a foreign judgment had not yet been obtained at the Date of Administration. Notably, David Richards J held that such a rate was not applicable even where a foreign judgment had actually been obtained post-administration.

9. As York submitted, for the purposes of determining "*the rate applicable to the debt apart from the administration*", there is no meaningful distinction between a creditor who had a contractual right to obtain a foreign judgment which would carry interest at a particular rate, and a creditor who had a contractual right to close out a swap and obtain a right to a close-out sum which would carry interest at a particular rate. If the former is unable to claim the higher rate that would be applicable to the foreign judgment, the latter is similarly unable to claim the higher rate that would be applicable to the close-out sum.

10. In their written submissions dated 14 December 2015, the Administrators sought to draw a distinction between:

(1) a rate of interest which becomes applicable due to a post-administration foreign judgment; and

(2) a rate of interest which becomes applicable due to a pre-administration contract.[1]

11. However, invoking the concept of rights which arise pre- and post-administration does not assist for present purposes:

(1) in practice, in the vast majority of situations any foreign judgment would be obtained on the basis of, and in enforcement of, pre-existing rights under a pre-existing contract;

(2) accordingly, both the right to obtain a foreign judgment (which carries interest at the foreign judgments rate) and the right to designate an Early Termination Date (which results in the early termination amount carrying interest at the Default Rate) arise as a result of a pre-administration contract; and

(3) equally, both scenarios involve something happening (be it obtaining a foreign judgment or the early termination of a swap) post-administration which would then trigger the application of a particular rate of interest.

12. The two situations are, for present purposes, indistinguishable. This can be illustrated with an example.

(1) David Richards J held that even where a foreign judgment is actually obtained after the Date of Administration, any foreign judgments rate of interest is still not capable of being "*the rate applicable to the debt apart from the administration*" because the right to interest did not presently exist as at the Date of Administration.

(2) Suppose that pre-administration, a creditor had commenced proceedings against LBIE in a foreign jurisdiction and had received a draft judgment in its

[1] See paragraph 20 of the Administrators written submissions, and also paragraphs 25 and 30, which seek to draw the same distinction again in slightly different language. The SCG seeks to draw a similar distinction at paragraph 17 of its written submissions.

favour (which, when handed down, would carry interest at the foreign judgments rate).

(3) At the Date of Administration, the outcome (and the creditor's right to the foreign judgments rate) is a foregone conclusion, but final judgment is not handed down until the day after the Date of Administration.

(4) According to the decision of David Richards J in Part A, the creditor would not be entitled to the foreign judgments rate under Rule 2.88. This is so even though, as at the Date of Administration, the right to the foreign judgment rate of interest was certain to arise.

13. It is difficult to see how the creditor's right to interest at the foreign judgments rate in the example above is any more 'ethereal'[2] or dependent on post-administration events than the right of an ISDA creditor to default interest. Indeed, while the judgment creditor in the example may receive his judgment the day after the Date of Administration with interest at a pre-determined rate, the ISDA creditor may need to take a number of steps post-administration before he is entitled to interest at the Default Rate, including the designation of an Early Termination Date under section 6(a), the delivery of a an effective (i.e. fully compliant) calculation statement[3] under section 6(d)(i) and the calculation of the Default Rate itself, which involves the vexed calculation of the Non-defaulting Party's cost of funding.

14. At paragraph 30 of their written submissions the Administrators argue that "*a right under a post-administration judgment does not accrue unless and until the judgment is awarded [but] ... rights under a contract accrued (in the sense of becoming binding on the parties) when the contract was first entered into*". This is, however, misconceived.

(1) So far as the accrual of rights is concerned, as the Supreme Court explained in Morgan Stanley v Tael [2015] 4 All ER 545, "*accrue*" generally describes the coming into being of a right or an obligation, so that the person in question

[2] See the Part A judgment at [182].

[3] The preparation of the calculation statement can itself be a very complicated and time-consuming exercise involving the Non-defaulting Party calculating the Close-out Amount (2002 ISDA Master Agreement) or obtaining quotations from Reference Market-makers or calculating its Loss (1992 ISDA Master Agreement).

then has an accrued right, or is subject to an accrued liability, as the case may be (at [42]). The Supreme Court specifically commented that this is the meaning which "*accrual*" usually bears, in particular, in relation to interest and other payments. It follows that, in relation to both an interest rate arising under the terms of a contract which is contingent on steps being taken under that contract and an interest rate arising under a foreign judgment which is contingent on such a judgment being obtained, it cannot be said that the creditor has any accrued right to such interest rate as at the date of the administration when the relevant contingencies have not occurred. The concept of accrual of rights therefore does not assist the Administrators but, on the contrary, highlights the lack of any relevant distinction between a right to interest under a foreign judgment and a right to interest under a contract dependent on further steps being taken: in neither case does the creditor have an accrued right to interest prior to the relevant contingency (be it, obtaining a judgment or taking the relevant steps under the contract) being satisfied.

(2) So far as the question of when rights become "*binding*" is concerned, there is no relevant distinction between a contractual rate and a foreign judgment rate. In both cases, it can be said that the interest rate is "*binding*" on the parties at the time of entry into the contract since it may then be the case that, subject to the satisfaction of the relevant contingencies, the interest rate may in fact become applicable to any debt which has accrued. The notion of rights becoming "*binding*" is in any case not a helpful concept in answering the question since the issue for present purposes is whether the relevant interest was in fact "*applicable*" to the debt at the date of the commencement of the administration.

15. The Administrators' reliance on *Webb* v *Stenton* (1883) 11 QBD 518 at paragraph 31 is equally misplaced. That case decided that a debt is not "*owing or accruing*" if it depends on some contingency which may not happen. Accordingly, it cannot be said that a creditor's right to interest at the Default Rate under the ISDA Master Agreement is "*accruing*" at the Date of Administration if that right depends on a contingency (i.e. the creditor designating an Early Termination Date).

16. For the same reason, the SCG is wrong to argue at paragraph 17(7) of its written submissions that as at the Date of Administration, the ISDA creditor necessarily has an "*existing right*" to be paid the Default Rate on the early termination amount, that "*No steps need to be taken*" to establish it and that all that is required is "*assessing or quantifying the applicable rate*". The creditor's right is (in the case of a swap which does not provide for automatic early termination) contingent upon the creditor designating an Early Termination Date – something that might never happen.

17. The immediate source of the right to interest (be it the delivery of a calculation statement pursuant to a contract or the obtaining of a judgment pursuant to a contract) makes no difference. A rate of interest which is not actually applicable at the Date of Administration is not a "*rate applicable to the debt apart from the administration.*" If a foreign judgments rate of interest pursuant to a foreign judgment which is obtained the day after the Date of Administration cannot be recovered under Rule 2.88, then neither can interest under a contract which does not become due until some step is taken after the Date of Administration.

The distinction between a contractual rate which begins to run before the Date of Administration and a contractual rate which begins to run after the Date of Administration

18. The Administrators seek to support their argument at paragraph 55 of their written submissions by saying that

> "no distinction is to be drawn between a contractual rate under a pre-administration contract which begins to run on the day ***before*** the Date of Administration and a contractual rate under a pre-administration contract which begins to run on the day ***after*** the Date of Administration. Such a distinction makes no difference for the purpose of identifying the provable debts (see Rule 13.12(1)(a) and (b)) and it would therefore be surprising and anomalous to find that it has any relevance when considering the position in respect of interest on provable debts."

19. It is not clear what point is sought to be made here. It is uncontroversial that a provable debt may arise in relation to a debt which accrued post administration in relation to liabilities or obligations incurred pre-administration. But that is a different point and does not assist in answering the question of the rate applicable for the

purposes of rule 2.88(9). As David Richards J specifically held in the Part A Judgment at paragraph 182:

> "The determination of the existence of debts and liabilities for the purposes of proof, governed by rule 13.12, is irrelevant to the meaning of the phrase 'the rate applicable to the debt apart from the administration' in rule 2.88(9)"

20. Contrary to the Administrators' position, if a creditor's right to a particular rate of interest is contingent on his taking some step after the Date of Administration, then that rate of interest is not "*the rate applicable to the debt apart from the administration*". As David Richards J expressly held in terms in the Part A Judgment at paragraph 177, those words "*cannot be read as including a hypothetical rate which would be applicable to a debt if the creditor took certain steps*".

The relevance of Issues 6-8

21. The SCG argues that the Judge's decision on Issues 7-8 (that interest on contingent and future debts runs from the Date of Administration) and on Issue 6 (that when calculating "*the greater of the rate specified under paragraph (6) and the rate applicable to the debt apart from the administration*" the amount payable under the latter rate is calculated from the Date of Administration) somehow answers the present question.

22. None of the Judge's findings on those issues however assists with the present question. That interest is payable on contingent and future debts from the Date of Administration does not tell one the rate at which that interest is payable, and in particular it says nothing about whether a rate which is only applicable if some post-administration step is taken is a "*rate applicable to the debt apart from the administration*". It is entirely consistent with a statutory scheme based on a notional distribution of the insolvency estate on the date of commencement of insolvency that all debts should be treated as outstanding from the date of administration but that has nothing to do with the rate of interest on such debts that should be taken into account for the purposes of the rule 2.88(9) comparison.

23. The SCG's reliance on the Judge's finding in respect of Issue 6 appears to result from a misunderstanding of what the Judge decided. At paragraph 16(4) of its written

submissions, the SCG says that the Judge held at paragraph 225 of the Part A Judgment that "*the 'rate applicable to the debt apart from the administration' is the rate which applies to such debts when they become due and payable*". This is not what David Richards J decided at all. In paragraph 225 of the Part A Judgment the Judge stated as follows:

> "I conclude therefore on Issues 7 and 8 that, in the case of both future and contingent debts, interest is payable under rule 2.88(7) from the date that the company entered administration, not from the date (if any) on which any such debt fell due for payment in accordance with its terms. The parties are agreed that it follows that the comparison under Issue 6 is between judgment rate and the rate applicable apart from the administration, in each case from the date of administration."

24. The Judge's ruling on Issue 6 (which was agreed between the parties) was that if, for example, a contract provided for all sums payable under it to bear interest at 10%, and a year after the Date of Administration, a debt fell due under the contract, then instead of the creditor being entitled to the higher of (a) 8% since the Date of Administration and (b) 10% since the debt became payable, he would simply be entitled to interest at 10% from the Date of Administration.

25. It was no part of the Judge's ruling that, where the interest rate itself depends on some contingency or varies over time (for example, if the contract provided for a higher "default" interest rate after the date of administration), the creditor is entitled to whatever interest rate happens to apply on the date that such interest (or higher rate interest) becomes payable, even if no such rate would otherwise have been applicable on the Date of Administration.

The Financial Collateral Arrangement (No.2) Regulations 2003

26. The Administrators' reliance on the Financial Collateral Arrangement (No.2) Regulations 2003 is also misplaced. The 2003 Regulations implement the European Parliament and Council Directive 2002/47/EC on financial collateral arrangements, which was itself aimed at, inter alia, ensuring that domestic legal systems did not impose uncommercial impediments to financial collateral takers who wished to realise collateral on the insolvency of their counterparty.

27. Regulation 12 implements Article 7 of the Directive, which requires member states to enact measures enabling a collateral-taker to realise collateral swiftly without regard to any local formalities (such as obtaining the permission of the court or insolvency officeholder) which might otherwise apply. There is nothing in the 2003 Regulations which has any bearing on how interest is to be calculated.

28. If the 2003 Regulations did have the effect of preventing domestic rules from depriving a creditor of interest to which he would otherwise be entitled, then it would be unlawful for a creditor to be deprived of the right to prove for post-administration interest altogether (which is what Rule 2.88(1) does, subject to the right to recover such interest after payment of proved debts in accordance with Rule 2.88(7)). This could not have been intended by the draftsman of either the Directive or the Regulations.

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