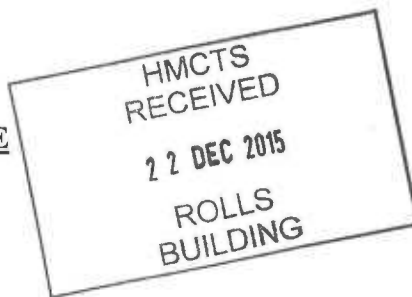


**IN THE HIGH COURT OF JUSTICE**  
**CHANCERY DIVISION**  
**COMPANIES COURT**



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**

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**SUBMISSIONS OF**  
**YORK GLOBAL FINANCE BDH LLC ON SUPPLEMENTAL ISSUES**  
**ARISING FROM THE WATERFALL II PART A JUDGMENT**

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1. These submissions are made on behalf of York Global Finance BDH LLC ("York") in relation to Supplemental Issues 1(b), 1(c), 2, 3, 4 and 5 arising from the Waterfall II Part A Judgment. Of these issues, York (in order to avoid duplication with the anticipated submissions of other Respondents) makes submissions at this stage only on Issues 1(b), 1(c) and 2 (with Issue 1(a) being the subject of separate submissions made to Hildyard J). York reserves the right to make reply submissions on the other issues if York has any non-duplicative reply submissions in light of the submissions of other Respondents or the Joint Administrators.
2. Issue 2 is addressed first, with Issues 1(b) and (c) following. The submissions on Issues 1(b) and (c) cross-refer to the submissions made to Hildyard J on Issue 1(a) which are attached hereto.

## **Issue 2**

3. Supplemental Issue 2 is "*Whether and (if so) in what circumstances and in what manner a Currency Conversion Claim can arise from the discharge of a debt by way of set-off pursuant to Rule 2.85(3)*".

## **Nature of Currency Conversion Claim**

4. The starting point in the analysis is to recall the nature of a Currency Conversion Claim. In Waterfall I, a Currency Conversion Claim was defined in the following way (Declaration (ii)):

*"Creditors of LBIE whose provable contractual or other claims are denominated in a foreign currency, the amount of which was converted into sterling as at the date of the commencement of the administration of LBIE for the purpose of proving a debt, are entitled to claim against LBIE for any currency losses suffered by them as a result of a decline in the value of sterling as against the currency of the claim between the date of the commencement of the administration of LBIE and the date or dates of payment or payments of distributions to them in respect of their claims, giving such credit, if any, as may be required, for benefits received under the insolvency regime (as to which no declaration is made) (such claim a "Currency Conversion Claim")."*

5. In the Court of Appeal, the declaration on this issue was upheld.

6. In Waterfall II, in the application notice the Joint Administrators defined a Currency Conversion Claim as being:

*"A non-provable claim against LBIE arising out of the difference between: (i) the amount of the creditor's entitlement to payment in a foreign currency; and (ii) the amount received by it in respect of its proved debt, converted into the foreign currency as at the date of payment."*

7. The definition of Currency Conversion Claim in the Application notice has subsequently been modified in the Part A Order (it being recognised that this was not a comprehensive definition pending the determination of the present issue) as follows:

*"For the purposes of this order, "Currency Conversion Claim" means a claim for an unpaid portion of a debt that arises if: (a) a creditor had a claim enforceable against the company denominated in a foreign currency; (b) that claim is converted into sterling at the prevailing rate as at the date of administration under Rule 2.86; (c) between that date and the date or dates of the dividends, sterling depreciates against the foreign currency, with the result that; (d) the dividends paid to the creditor are, when converted into the foreign currency at the respective dates of payment, in aggregate lower than the claim denominated in the foreign currency."*

8. Accordingly, the starting point in determining the existence of a Currency Conversion Claim is the foreign currency debt owed to the creditor as it stood on the date of administration. A Currency Conversion Claim is the unpaid portion of that foreign currency debt. As Wentworth remarks in paragraph (7)(b) of its Grounds of Appeal on the Part B judgment in the Waterfall II application: *"A Currency Conversion Claim, being founded on a remission to the creditors rights under its underlying contract (specifically the right to be paid in the original foreign currency), is merely the unsatisfied balance of the underlying claim"*.

9. Where a foreign currency creditor receives payment of his claim solely by way of dividends from the insolvent estate, then part of the creditor's original foreign currency debt will remain unpaid where the foreign currency value of the sterling dividends at the respective dates when they are received is less than the amount of the original foreign currency debt.

10. In essence, therefore, a Currency Conversion Claim arises where the foreign currency value of what is received by the creditor at the time it is received is in aggregate less than the amount of the original foreign currency debt.
11. There is no difficulty in applying this analysis where the foreign currency creditor receives payment by way of set-off, rather than solely by way of dividends. In the case of set-off, the foreign currency creditor likewise receives the benefit of a sterling amount in discharge or partial discharge of its claim. If sterling has depreciated in the period between the date of commencement of the administration and the date when the creditor receives the benefit of the sterling amount by way of set-off, with the result that part of the original foreign currency debt remains unsatisfied, then the foreign currency creditor should likewise have a Currency Conversion Claim for the undischarged balance.

### **Operation of Insolvency Set-Off**

12. Upon the conversion of an administration to a "*distributing administration*" at the time the administrators give notice under rule 2.95 of their intention to make distributions to creditors, two things happen to foreign currency debts owed by the company:
  - (1) Pursuant to rule 2.86, for the purpose of proving, the foreign currency debt is converted into sterling at the official exchange rate prevailing on the date when the company entered administration; and
  - (2) Pursuant to rule 2.85, to the extent that the company has a cross-claim against the creditor, mandatory insolvency set-off comes into effect, reducing the amount for which the creditor can prove to the balance of the account taken under rule 2.85(3).
13. The operation of insolvency set-off takes effect by reference to sterling amounts:
  - (1) For the purposes of set-off, rule 2.86 is also applied (see rule 2.85(6)(a)) so that the foreign currency debt owed by the company is converted into sterling.

- (2) Similarly, if the cross-claim by the company is in a foreign currency, then this is likewise converted into sterling to the extent required for the purposes of set-off (*ibid*).
  - (3) Both the taking of the account under rule 2.85 and the conversion of provable claims to sterling for the purposes of proof under rule 2.86 use the same exchange rate i.e. the official exchange rate prevailing on the date of administration.
14. Accordingly, the effect of insolvency set-off is that the foreign currency creditor receives the benefit of a sterling amount in discharge of its claim, being the sterling amount of the company's claim against the creditor which is discharged by way of set-off.
15. For the purposes of a Currency Conversion Claim, such a recovery made by the creditor by way of set-off is the same as a recovery made by way of dividends paid on proved debts. In both cases the creditor receives the benefit of a sterling sum which reduces the amount of the foreign currency debt that is owed by the debtor company to the creditor.

### **The statutory scheme**

16. The operation of rules 2.85 and 2.86 is consistent with the underlying statutory scheme under which the liquidation and distribution of the assets of an insolvent company are treated as notionally taking place on the date of the winding-up order: *In re Dynamics Corporation of America*, 762; *M.S. Fashions Ltd v BCCI SA* [1993] Ch. 425, 432; *Stein v Blake* [1996] 1 A.C. 243 H.L.(E.), 252.
17. Consistent with that underlying statutory scheme, in a distributing administration, the effect of mandatory set-off is to treat claims against the company that are no longer provable following the taking of the set-off account as being notionally discharged on the date of administration.

18. The statutory scheme results in a creditor for a debt that is not provable following mandatory set-off as not being paid "late", in contrast to a creditor who does prove and must wait for dividends on their proved debt. This explains why no statutory interest is payable from the date of administration on the claims that are not provable following such set-off and why no interest is payable from the date of administration to the company on the liabilities set-off against such claims.
19. To that extent at least, mandatory set-off does operate as a substantive permanent alteration of the creditor's (and the debtor's) contractual rights.
20. However, in a distributing administration (where, unlike in a liquidation, mandatory set-off does not take effect on the same day as the official exchange rate used in such a set-off) it does not necessarily follow that a creditor whose debt is not provable following set-off has been paid "in full" when considering that question by reference to the original foreign currency amount of their debt (rather than the sterling amount at which that debt was valued in mandatory set-off). Since both (i) mandatory set-off and (ii) the process of proof and payment of dividends and statutory interest all occur in sterling, it is hard to think of a logical policy reason for the two different ways in which a foreign currency debt may be dealt with in the statutory scheme resulting in a different outcome in terms of the foreign currency entitlements of a creditor.

### **Timing of the Payment**

21. Pursuant to rule 2.85(3), the set-off account is taken as at the date of the notice under rule 2.95. The set-off takes effect by reference to the amount of the liabilities owed by and to the company determined as at the date of administration and produces a net balance by reference to this date (see rule 2.85(2)). However, the creditor only receives the benefit of the set-off once the notice has been given under rule 2.95 and the operation of rule 2.85 is triggered. Accordingly in a distributing administration (unlike in a liquidation), it is only at this point that the creditor can be said to have received any "payment" by way of set-off.

22. Indeed, at any point prior to the giving of the rule 2.95 notice, the creditor would be at risk of the company bringing an action against him for the full amount of the company's cross-claim against the creditor. Conversely, subject to the statutory moratorium, the creditor would be able to assert the full amount of its claim against the company. This shows that it is only when the rule 2.95 notice is given, and rule 2.85 is triggered, that the creditor can be said to have received payment of any part of its claim.

### **Currency Conversion Claim arising from Set-Off**

23. As explained above, in the case where a foreign currency creditor receives payment of his claim by way of dividends, a Currency Conversion Claim will arise where sterling depreciates as against the relevant foreign currency between the date of the administration and the date of the dividend(s). In these circumstances, the dividend(s) paid to the creditor will, when converted into the foreign currency at the respective dates of payment, be in aggregate lower than the original foreign currency amount of the claim. Accordingly, part of the original foreign currency claim remains undischarged and there is therefore a currency conversion claim for this amount.
24. The position is the same where the foreign currency creditor receives payment of his claim by way of set-off rather than by way of dividends.
25. Again, a currency conversion claim will arise where sterling depreciates as against the relevant foreign currency between the date of the administration and the date when the creditor receives payment by way of set-off i.e. when the rule 2.95 notice is given. In these circumstances, the sterling amount received by the creditor by way of set-off will be lower than the original foreign currency amount of the claim.
26. This is best illustrated by looking at some numerical examples:
- (1) The first example, as set out in the first row of the table attached as an Appendix to these submissions, assumes that at the commencement of the administration a creditor has a claim of US\$100 against LBIE and LBIE

has a cross-claim of £55.75 against the creditor<sup>1</sup> by way of set-off. Applying the prevailing exchange rate at the date of the administration, £55.75 corresponds to US\$100 and so mandatory set-off results in the creditor having no provable claim on LBIE and its only recovery in the administration is the discharge of a debt of £55.75 owed to LBIE.

- (2) For the purposes of set-off, the US\$ is converted to sterling at the rate of US\$1.79370: £1, being the rate applicable on 15 September 2008.
- (3) On the other hand, the actual exchange rate on 4 December 2009 when the rule 2.95 notice was given and set-off took effect was US\$1.65:£1.
- (4) The value (in the currency of the original claim at the time of administration) of the sterling set-off which the creditor in fact received at 4 December 2009 (i.e. the value of the £55.75 liability to LBIE under the cross-claim, being discharged by set-off at that time) was therefore US\$8.01 less than the foreign currency value notionally paid by the creditor in such set-off (i.e.  $£55.75 \times 1.79370$  (US\$100) -  $£55.75 \times 1.65$  (US\$91.99) = US\$8.01) (see Column 9 of the table).
- (5) Put another way, if at 4 December 2009, the creditor had gone into the market to acquire £55.75 of sterling to discharge LBIE's claim then he could have done so for only US\$91.99, as opposed to being obliged to use the entire US\$100 of his claim discharged by way of set-off to discharge that liability to LBIE.
- (6) The creditor should have a Currency Conversion Claim for this US\$8.01 amount.

27. The above example concerns a case where the claim is in dollars and the cross-claim is in sterling. However, the issue arises equally in relation to other currency combinations, as illustrated by the attached table in the Appendix.

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<sup>1</sup> £55.75 is selected as it corresponds to US\$100 at the prevailing exchange rate at the time of the administration.



- (1) The second row of the table shows an example of a claim of US\$100 and a cross-claim of US\$100.
  - (2) As with the first example, the creditor has received the benefit of a set-off in sterling in the amount of £55.75 (both the claim and the cross-claim having been converted into sterling for the purposes of set-off). This is based on the exchange rate of US\$1.79370:£1 applicable at the time of entry into the administration.
  - (3) However, the actual exchange rate on 4 December 2009 when the set-off took effect was US\$1.65:£1. This means that the value (in the currency of the claim at the time of administration) of the sterling set-off which the creditor in fact received at 4 December 2009 was again US\$8.01 less than the foreign currency value notionally paid by the creditor in such set-off (i.e.  $£55.75 \times 1.79370$  (US\$100) -  $£55.75 \times 1.65$  (US\$91.99) = US\$8.01) (see Column 9).
  - (4) Again, the creditor should have a Currency Conversion Claim for this US\$8.01 amount.
28. In the case of the second example set out above (claim and cross-claim both in dollars), it may be argued that, although the set-off takes place in sterling, the net result of the set-off is that the creditor has received the benefit of a discharge of a US\$100 liability owed to LBIE (see Column 8 of the table). On this basis, it may be said that the creditor has not suffered any currency conversion loss (the notional "gain" on its liability matching, on an equivalent currency basis, the loss on its claim).
29. However, applying this approach, leads to different results in the case of other currency pairs:
- (1) In the example given in the third row in the table, of a claim in dollars and an off-setting cross-claim in euros, the creditor would be considered to have made a gain of US\$6.30 on its liability (see Column 8 of the

table) but a loss of US\$8.01 on its claim (see Column 9 of the table). This is because the appreciation of the euro against the dollar between the date of the administration and the date when the set-off took effect means that it would have cost the creditor more in dollars to have obtained the discharge of the euro liability as at the date when the set-off took effect. This then raises the question of whether the creditor would be required to account to LBIE for such gain.

- (2) Conversely, in the example given in the fourth row of the table, of a claim in dollars and an off-setting cross-claim in Turkish lira, the creditor would be considered to have made a loss of US\$14.72 on its liability (see Column 8), as a result of the depreciation of the Turkish lira against the dollar, as compared with a loss of US\$8.01 on its claim. If gains on the discharge of a liability (in the same or a different currency to the claim) are to be taken into account, then how does the creditor take account of the loss on its liability?

30. As Column 8 of the table shows, applying this approach to different currency pairs results in differing results, notwithstanding that in each case there was an equal and opposite set-off between the claim and the cross-claim and that the set-off in each case took place in sterling. This tends to support the conclusion that the correct approach, as set out in Column 9 of the table, is to focus on the sterling value of the sterling set-off received by the creditor and to treat this as the equivalent of a sterling dividend payment. This reflects the nature of the set-off (which takes place in sterling) and results in a consistent result across the different currency pairs.
31. Finally, it should also be noted that if insolvency set-off in administration does not give rise to any Currency Conversion Claim then this, in effect, grants debtors a free option to decide how and when foreign currency liabilities owed by the debtor should be discharged, either by reference to (i) the prevailing exchange rates (by making payment at such time) or (ii) historical exchange rates at the date of administration (by relying on insolvency set-off). There is no reason of policy or principle why debtors should be granted this free option.

## Issue 1(b)

32. Consequential Issue 1(b) asks:

*“How is an independent right to interest that 'arises outside or other than from the administration' to be determined when calculating interest on a non-provable Currency Conversion Claim if such a rate would only accrue on a debt that was contingent or future at the Date of Administration if some action was taken after the Date of Administration? How are such rights to be assessed if the creditor did not in fact exercise such rights?”*

33. This issue arises out of declaration (vi) of the Order of David Richards J made following the Part A judgment, which provides:

*“If and to the extent that a creditor has a non-provable claim (including but not limited to a Currency Conversion Claim<sup>2</sup>) in respect of a sum on which interest is payable apart from the administration at any time during the period after the Date of Administration (as defined in the Application Notice), the creditor has a non-provable claim in respect of such interest (if any) as may have accrued on that non-provable claim in that period.”*

34. That part of the order provides that there is a non-provable claim for interest *“as may have accrued”* but does not specify what interest *“may have accrued”* or what interest rate is applicable for these purposes. Indeed the inclusion of the words "such interest (if any)" clearly contemplates that no interest may have accrued on some claims.

### **York's primary position**

35. York's primary position is that, if a particular rate of interest would only apply to the relevant debt if some action was taken by the creditor after the Date of Administration, then such interest is not interest that *“may have accrued”* for the purposes of declaration (vi). This is obviously true where the creditor has not taken whatever action would have

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<sup>2</sup> For the purposes of this order, and without prejudice to further issues as to the definition being raised in written submissions, “Currency Conversion Claim” means a claim for an unpaid portion of a debt that arises if: (a) a creditor had a claim enforceable against the company denominated in a foreign currency; (b) that claim is converted into sterling at the prevailing rate as at the date of administration under Rule 2.86; (c) between that date and the date or dates of the dividends, sterling depreciates against the foreign currency, with the result that; (d) the dividends paid to the creditor are, when converted into the foreign currency at the date of payment, lower than they would have been using the exchange rate as at the date of administration.

entitled him to the higher rate of interest but for the administration. But it is also true where the creditor purports to take such action after the Date of Administration.

36. As David Richards J held at paragraph 169 of the Part A judgment, the entitlement to interest on a non-provable debt “*is dependent on a remission to contractual or other rights existing apart from the administration and it follows that no interest is payable on a currency conversion claim where the underlying foreign currency obligation is not itself interest-bearing*” (emphasis added). As the Judge went on to say at paragraph 177, the applicable interest rate apart from the administration does not include “*a hypothetical rate which would be applicable to a debt if the creditor took certain steps*”.
37. Accordingly, a creditor cannot improve his position post-administration by taking some step in an effort to gain, retrospectively, the right to a rate of interest which he did not in fact enjoy as at the Date of Administration. Applying the language of paragraph 169 of the judgment, such interest rate is not a rate existing “*apart from the administration*”.

#### **York's secondary position**

38. If York is wrong on its primary position, and the words “*such interest ... as may have accrued*” do not exclude rates which are contingent on a creditor taking some step after the Date of Administration, then logically those words must also embrace *any* situation where a creditor can take some step after the Date of Administration to gain a higher rate of interest on his debt.
39. Accordingly, for example, it must include the situation where a creditor whose US dollar debt is subject to a New York jurisdiction clause obtains a judgment in New York, after the Date of Administration, carrying the New York Judgments Rate.
40. To allow foreign Judgments Interest to creditors who obtain a foreign judgment post-administration but not to those who could obtain such a judgment but decline to do so would simply encourage a scramble for foreign judgments in the wake of the administration which would simply increase the costs of the administration through potentially thousands of cases seeking leave to lift the stay on commencing proceedings

at a time when no-one could sensibly have known that it was worth the time and expense of taking such steps. There cannot be any sensible policy reason for such an outcome.

41. This is reflected in the language of the Part A judgment, which directs an inquiry as to what rate would have been applicable “*apart from the administration*” (Part A judgment paragraph 169), i.e. what would have happened absent the administration. Accordingly, it is necessary to ignore any acts or omissions caused by the administration itself (such as the decision not to seek leave and thereafter to commence proceedings).
42. On this analysis, a creditor who, apart from the administration, could have taken some step to gain a higher interest rate, but does not in fact take that step (or takes that step at some point after the Date of Administration) is to be treated as being entitled to that higher interest rate as at the Date of Administration.

#### **Issue 1(c)**

43. Supplemental Issue 1(c) is

*“In a case where contractual interest first starts to run on a provable debt at some point after the Date of Administration, is the “rate applicable” for the period from the Date of Administration to the date when contractual interest first starts to run:*

- (i) the rate of interest which is payable once the interest is running (so that such rate is treated as being applicable for the whole of the post-administration period); or*
- (ii) a zero rate*

*Further for the purposes of Rule 2.88(9) should Statutory Interest be calculated by assessing the greater of the “rate applicable” and Judgments Act 1838 rate separately for the periods prior to and post the commencement of contractual interest or should such assessment be performed taking the periods together.”*

44. For the reasons set out in York’s written submissions and reply submissions on Supplemental Issue 1(a) enclosed with these submissions, this question does not in fact arise since there is no “*rate applicable*” in respect of statutory interest under rule 2.88(9) if there was no rate actually applicable to the relevant debt on the Date of Administration.

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22 December 2015

## Appendix

1	2	3	4	5	6	7	8	9
Claim amount	Liability amount	Exchange rate for claim in set-off	Exchange rate for liability in set-off	Exchange rate for claim at time of set-off, if claim discharged by LBIE in sterling cash at time of set-off	Exchange rate and cash cost if liability paid by creditor in sterling at time of set-off	Notional exchange gain/loss in sterling terms on liability at time of set-off <sup>3</sup>	Notional "value" obtained by creditor from set-off (if this is based on the value, in the currency of the claim, of the liability discharged)	Exchange loss on claim at time of set-off <sup>4</sup>
\$100	£55.75	1.79370 (i.e. \$100 = £55.75)	N/A	1.65	N/A	None	£55.75 (worth \$91.99 at the £/\$ rate of 1.65) so loss of \$8.01	£55.75 x 1.65 = \$91.99 (loss of \$8.01)
\$100	\$100	1.79370 (i.e. \$100 = £55.75)	1.79370 (i.e. \$100 = £55.75)	1.65	1.65 (i.e. \$100 = £60.6)	\$100 would have cost £60.6 to pay off so gain of £4.85	\$100	£55.75 x 1.65 = \$91.99 (loss of \$8.01)
\$100	Euro 70.47	1.79370 (i.e. \$100 = £55.75)	1.2641 (i.e. Euro 70.47 = £55.75)	1.65	1.1024 (i.e. Euro 70.47 = £63.9)	Euro 70.47 would have cost £63.9 to pay off so gain of £8.15	Euro 70.47 (worth \$106.3 at then \$/euro rate of 1.5090) so gain of \$6.3	£55.75 x 1.65 = \$91.99 (loss of \$8.01)
\$100	Turkish Lira <sup>5</sup> 127	1.79370 (i.e. \$100 = £55.75)	2.2782 (i.e. TL 127 = £55.75)	1.65	2.4919 (i.e. TL 127 = £50.9)	TL 127 would have cost £50.9 to pay off so loss of £4.85	TL 127 (worth \$85.28 at then \$/TL rate of 0.6715) so loss of \$14.72	£55.75 x 1.65 = \$91.99 (loss of \$8.01)

<sup>3</sup> In other words, would it have been more or less expensive for the debtor to pay off its liability at prevailing exchange rates rather than by way of set-off.

<sup>4</sup> In other words, how much of the \$100 claim could be said to be paid off by taking the sterling set-off value and converting that to dollars at the time of set-off.

<sup>5</sup> Turkish Lira is shown as an illustration of a currency that depreciated against sterling throughout this period. This does not imply that this is a relevant currency in the LBIE administration.