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

CHANCERY DIVISION

COMPANIES COURT

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

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.A.R.L.

(3) HUTCHINSON INVESTORS LLC

(4) WENTWORTH SONS SUB-DEBT S.A.R.L.

(5) YORK GLOBAL FINANCE BDH, LLC

(6) GOLDMAN SACHS INTERNATIONAL

Respondents

GOLDMAN SACHS INTERNATIONAL'S SKELETON ARGUMENT FOR THE PRE-TRIAL REVIEW LISTED FOR 9 OCTOBER 2015

All references to the numbered trial bundles are in the form {Bundle/Tab/Page}. References to the PTR bundle are in the form {PTR/Tab/Page}.

Recommended Pre-Reading (Estimated Time of 2 hours):

The parties' skeleton arguments;

The position paper of Goldman Sachs dated 23 July 2015 {2/13/256};

The reply position papers of the Joint Administrators dated 20 August 2015 {2/17/404} and Wentworth dated 6 August 2015 {2/16/398};

The reply position paper of Goldman Sachs dated 4 September 2015 {2/18/423}.

I. INTRODUCTION

1. This is the skeleton argument of Goldman Sachs International (**"Goldman Sachs"**) for the Pre-Trial Review of Part C of the Waterfall II Application.

2. Goldman Sachs is party to the Waterfall II Application to make submissions on the proper interpretation of the term "Default Rate" in the ISDA Master Agreement. This issue is covered by Issues 11-14 and 27 of the revised Application Notice of the Joint Administrators of Lehman Brothers International (Europe) (**"the Joint Administrators"** and **"LBIE"**).

3. "Default Rate" is defined in Clause 14 of the ISDA Master Agreement as follows:

   *"**"Default Rate"** means a rate per annum equal to the cost (without proof or evidence of any actual cost) to the relevant payee (as certified by it) if it were to fund or of funding the relevant amount plus 1% per annum.*"

4. Goldman Sachs' position is that the definition of "Default Rate" permits a relevant payee to certify a cost of funding that takes into account any source of funding that it used or could have used to fund the "**Relevant Amount**", including (in particular) the cost of equity funding, subject to the certification being provided rationally and in good faith.

5. Goldman Sachs' position on this issue is broadly aligned with that of the First to Third Respondents (**"the Senior Creditor Group"**), though Goldman Sachs puts forward distinct arguments from those raised by the Senior Creditor Group. Goldman Sachs' position is opposed by the Fourth Respondent (**"Wentworth"**), which argues that the definition of Default Rate should be limited to permit only the certification of a cost of borrowing. The Joint Administrators have put forward a number of arguments on both sides of the dispute, to ensure that all relevant arguments are before the Court.

II. ISSUES ARISING AT THE PTR

6. As matters stand, there are three issues that concern Goldman Sachs and which may arise at the PTR:

   (1) The scope of the "agreed" issues;

   (2) The scope of Issues 11 and 12; and

   (3) Trial timetable.

7. Goldman Sachs' positon on each of these points is set out briefly below.

(1) The scope of the "agreed" issues

8. The Joint Administrators have put forward a draft note of "agreed issues", setting out the positions agreed between the parties in relation to Issues 14-16, 18 and 27.[1]

9. There is a dispute as to the formulation of the agreed response to Issue 14 of this note, concerning the basis on which a certification of the Default Rate can be challenged.[2] Issue 14 reads as follows:

   "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

[1] {PTR/4/1}.
[2] The same issue arises in relation to Issue 15, concerning the burden of proof in challenging such a certification. The wording of Issue 15 should follow the wording of Issue 14.

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."*

10. Goldman Sachs considers that the correct answer to this issue is as follows:

"A relevant payee's certification of its cost of funding for the purposes of applying the Default Rate is conclusive, other than in circumstances where it is:

(i) *is made irrationally; or*

(ii) *is made otherwise than in good faith."*[3]

11. This answer follows from Goldman Sachs position as set out in its position paper of 23 July 2015. At paragraph 17 of this position paper Goldman Sachs[4] stated that:

"Provided a relevant payee's certification of its cost of funding is made rationally and in good faith (in the sense in which those terms are used in Socimer International Bank Ltd v. Standard Bank of London Ltd [2008] EWCA Civ 116; [2008] 1 Lloyd's Rep 558) it will be conclusive."

12. By contrast, the Joint Administrators and Wentworth consider that the correct answer to Issue 14 is as follows (additional text underlined):[5]

"A relevant payee's certification of its cost of funding for the purposes of applying the Default Rate *is not conclusive. Such certification is susceptible to challenge on the basis that it:*

(i) *contains manifest error;*

[3] As is set out in Cleary Gottlieb's emails and letters on behalf of Goldman Sachs of 29 September 2015 {PTR/4/7}, 6 October 2015 {PTR/4/43} and 7 October 2015 {PTR/4/77}.
[4] {PTR/4/36}.
[5] Joint Administrators' letter of 6 October 2015 {PTR/4/49}.

(ii) *is made irrationally (in the sense of being arbitrary, capricious, perverse or a decision to which no reasonable person having the relevant discretion could have subscribed);*

(iii) *is made otherwise than in good faith; or*

(iv) *is something other than the relevant payee's "cost … if it were to fund or of funding the relevant amount" (as those words may be construed by the Court)."*

13. The Joint Administrators and Wentworth continue to put forward the "agreed" issues in this form.

14. The short answer to this point is that, to the extent that there is a genuine dispute as to the formulation of the "agreed" issue, it is obvious that there is in fact no agreement on this issue at all. Goldman Sachs' formulation follows from the position that it set out in its position paper. If the Joint Administrators and Wentworth do not agree with it, then the correct answer to this issue will be a matter for trial.

15. In any case, for the avoidance of doubt, Goldman Sachs' position is as follows:

(1) Goldman Sachs considers that the starting point is that the certification *is* conclusive, subject to limited rights of challenge. The opening words of the answer to Issue 14 should reflect this position.

(2) Goldman Sachs does not agree that the certification can be challenged on the additional ground of *"manifest error"*. To the extent that this ground of challenge merely requires that the certification must be calculated on a basis that a reasonable party could have adopted, it adds nothing to the requirement that the certification be given rationally. To the extent that it goes further, there is no basis for it in the definition of Default Rate.

(3) Goldman Sachs also disagrees that there is any separate ground of challenge on the basis that the certification "*something other than the relevant payee's "cost … if it were to fund or of funding the relevant amount" (as those words may be construed by the Court)."* The proper interpretation of the definition of Default Rate is, of course, relevant to a challenge on rationality or good faith grounds. To the extent that no reasonable party could have believed that a certification fell within the definition of Default Rate as properly interpreted, or did not in

fact honestly believe that it did so, the certification could be challenged accordingly. However, if a certification is rationally and honestly considered to fall within the definition, no challenge should be possible.

(4) While it does not consider it necessary to state as much in the answer to Issue 14, Goldman Sachs would be willing to accept that the requirement of rationality encompasses the requirement to avoid reaching an *"arbitrary, capricious [or] perverse"* decision or *"a decision to which no reasonable person having the relevant discretion could have subscribed"*. These additional words reflect the requirements set out in *Socimer International Bank Ltd v. Standard Bank of London Ltd [2008] EWCA Civ 116; [2008] 1 Lloyd's Rep 558*, as cited in Goldman Sachs' position paper.

16. If the other parties are willing to agree Issue 14 on this basis then it can be included in the list of "agreed issues". However, if this is not the case then the correct answer to this issue will be a matter for argument at trial.

(2) The formulation of Issues 11 and 12

17. Goldman Sachs' case is that the definition of Default Rate encompasses the use of any type of funding to fund the Relevant Amount. This was set out clearly in its position papers.[6]

18. Goldman Sachs understands that it is common ground that the current formulation of Issues 11 and 12 accommodates this argument:

(1) When Goldman Sachs joined the Waterfall II Application it drew attention to its understanding that its arguments fell within the scope of the existing issues, while reserving the right to apply to modify the issues if any other party argued that they were too narrow to cover Goldman Sachs' case.[7]

(2) In due course Goldman Sachs set out its full case in its position paper dated 23 July 2015 {2/17/404}. In their reply position papers the Joint Administrators

[6] See, for example, para. 4 of Goldman Sachs' position paper of 23 July 2015 {1/13/258}.
[7] Paragraph 10 of the First Witness Statement of Jonathan Kelly in support of its joinder application {2/5/207} and at para. 3 of its skeleton argument for its joinder application {6/5/253}.

and Wentworth both engaged with the merits of Goldman Sachs' argument, without taking any procedural point that it was outside the scope of the Issues. The Joint Administrators specifically acknowledged that Goldman Sachs argued that the words "*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"* could include the *"cost of equity funding"*.[8]

19. It is therefore assumed that all parties accept that Goldman Sachs' case falls within the scope of the existing issues.

20. Nonetheless, Goldman Sachs considers that there is a small risk that a point may yet be taken on the formulation of Issues 11(1)-11(2), suggesting that elements of Goldman Sachs' argument do not fall within them. In particular, Goldman Sachs notes that (interpreted strictly) Issue 11(1) relates to *"the cost to fund or of funding the relevant amount by borrowing the relevant amount"*, while Issue 11(2) relates to *"the actual or asserted average cost to the relevant payee of raising money to fund or of funding all its assets by whatever means, including any cost of raising shareholder funding."* There therefore appears to be scope for the argument that Goldman Sachs' case, which is that the definition of Default Rate encompasses the cost to fund or of funding the Relevant Amount by *any* means, is not caught by Issue 11.

21. Separately, Goldman Sachs considers that Issue 12, which currently refers only to borrowing, should apply to cover any type of funding. It has put forward its case in its position paper on this basis.[9]

22. Out of an excess of caution, Goldman Sachs has therefore proposed that either:

    (1) The parties confirm that the current formulation of Issues 11 and 12 can accommodate Goldman Sachs' case; or

    (2) Alternatively, that minor amendments be made to Issue 11(1) to ensure that it is in issue that the parties may certify "the *actual or asserted cost to the relevant payee to fund or of funding the relevant amount by whatever means"*, and to Issue 12 to ensure that it relates to all types of funding.[10]

[8] Joint Administrators' Position Paper of 20 August 2015, para. 22 {1/17/411}.
[9] Goldman Sachs' position paper of 23 July 2015, paras. 11-12 {1/13/267}.
[10] A copy of the proposed amendments can be found at {PTR/4/32}.

23. It is hoped that these proposals, which are intended to ensure that no late procedural objections are taken to Goldman Sachs' case, will be uncontroversial. The Joint Administrators have indeed confirmed, by letter dated 7 October 2015, that they consider that Goldman Sachs' case as set out in its position papers is covered by the current formulation of Issues 11 and 12.[11] However, Wentworth has not yet done so. It is therefore requested that Wentworth do so at the PTR, if not before.

(3) Trial timetable

24. The Joint Administrators have set out a proposed trial timetable, by letter dated 30 September 2015 {PTR/4/13}.

25. Goldman Sachs have agreed to this timetable, by letter dated 6 October 2015 {PTR/4/45}, subject to one qualification.

26. The qualification concerns whether the Joint Administrators will be the first party to make substantive submissions in relation to the English law issues on the interpretation of the definition of Default Rate.

27. The Joint Administrators general approach to date has been to advance arguments where they consider that *"there are matters of material significance not raised by the Respondents or an arguable alternative to a common position taken by the Respondents"* or where *"all available arguments"* have not otherwise been canvassed.[12] By contrast, where all relevant arguments have been raised by the Respondents, the Joint Administrators have not sought to make further submissions.

28. Goldman Sachs considers that it is appropriate for the Joint Administrators to continue with this approach at trial. It therefore agrees that the Joint Administrators should provide a (neutral) introduction to the parties' submissions, as set out at EL/1 of the Joint Administrators' proposed timetable. However, it proposes that the Joint Administrators' substantive submissions on the English law issues should be advanced after Wentworth's substantive submissions (EL/4 in the Joint Administrators' proposed timetable) and before Goldman Sachs' reply submissions (EL/5). This should ensure

[11] Joint Administrators' letter of 7 October 2015, paras. 2 and 4 {PTR/4/67}.
[12] Joint Administrators' Position Paper of 20 August 2015, paras. 4-5 {1/17/405-406}.

that the Joint Administrators continue to fulfil their role of ensuring that all tenable arguments are before the Court, while avoiding repetition or pre-emption of the Respondents' submissions.

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8 October 2015

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