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

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

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

2. Supplemental Issue 1(a) is:

> "*Whether, and in what circumstances, the words 'the rate applicable to the debt apart from the administration' in Rule 2.88(9) of the Rules include, in the case of a provable debt that is a close-out sum under a contract, a contractual rate of interest that began to accrue only after the close-out sum became due and payable due to action taken by the creditor after the Date of Administration*".

Approach

3. Supplemental Issue 1(a) derives from Issue 4 in the Waterfall II Part A application. Issue 4 was:

> *"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 rate."*

4. In his Part A judgment, David Richards J answered this issue in the negative in circumstances where the creditor had not in fact obtained a relevant foreign judgment as at the date of commencement of the administration. As explained further below, the essence of the Judge's reasoning was that the words "*the rate applicable to the debt apart from the administration*" cannot be read as including a hypothetical rate of interest which would be applicable if the creditor took certain steps, but which was not in fact applicable at the date of the administration because such steps had not in fact been taken by the creditor at that time (Part A judgment, para. 172).

5. These submissions are made on the basis that the relevant conclusions of David Richards J are correct[1] and that the Court is, through making a determination following these written submissions, seeking only to apply those existing conclusions to a particular fact pattern not previously considered by the Court.

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[1] York has appealed the finding in respect of Issue 4 and fully reserves the right to contend before the Court of Appeal that the conclusions of David Richards J in relation to Issue 4 were incorrect.

Context

6. The context in which this question arises is as follows:

   (1) admitted ISDA Claims (the term used by LBIE to aggregate claims under ISDA master agreements and German and French master agreements) aggregate £4.4 billion, out of a total admitted claims pool in the LBIE estate of £12.2 billion (Lomas 12 para. 8);

   (2) the Senior Creditor Group, Wentworth and Goldman Sachs hold approximately £1.1 billion, £1.6 billion and £0.1 billion of ISDA Claims respectively – or in aggregate 65% of all ISDA Claims (Lomas 12 para. 8);

   (3) the amount of statutory interest payable on all admitted claims applying dividends first to payment of admitted claims would be approximately £5.1 billion, assuming all statutory interest is paid at a rate of 8% simple per annum (Lomas 12 para. 15.1);

   (4) statutory interest on ISDA Claims at 8% simple would be approximately £1.7 billion, but if statutory interest were payable on ISDA Claims at Default Rates of 8%, 12% or 18% compound, the total statutory interest on ISDA Claims would be approximately £2.1 billion, £3.7 billion and £6.8 billion respectively (Lomas 12 para. 11).

7. It is therefore a very material point for the holders of the £7.8 billion of admitted claims in the LBIE estate that are not ISDA Claims to determine whether ISDA Claims can be entitled both to a rate of interest in excess of the 8% Judgments Act rate and to the compounding of any such interest. The point is material not only because of the increase in the amount of interest payable from the LBIE estate that an affirmative answer to this question would entail but also because of the

significant delay in paying statutory interest in full that will inevitably arise whilst the Default Rate applicable to each ISDA Claim is properly determined.

8. York is the only respondent to the Application who clearly can be said to be representative of those £7.8 billion of admitted claims since the claims of the LibertyView funds which York represents as a respondent to the Waterfall II application consist only of prime brokerage related claims and not ISDA Claims[2].

9. It is apparent from the numbers disclosed in Lomas 12 that, if there is a higher statutory interest rate payable on ISDA Claims, the effect is to take the share of entitlements to statutory interest on ISDA Claims from (a) £1.7 billion out of £5.1 billion – i.e. 33% to (b) in the highest example given, £6.8 billion out of £10.2 billion – i.e. 66%. It is also apparent that, if ISDA Claims are entitled to higher statutory interest, then there may well be insufficient surplus to pay any non-provable claims – such as Currency Conversion Claims.

10. A material diversion of the surplus towards payment of higher statutory interest rights on ISDA Claims particularly adversely affects the holders of non-ISDA Claims who did not benefit from a contractual rate of interest in excess of 8%. Such creditors (apart from possible recoveries on any non-provable Currency Conversion Claims) have, as things stand, no entitlement to recover anything other than statutory interest at 8% simple with no compensation payable at all for the delay in paying such statutory interest since June 2014 (the first date on which most admitted proved claims received dividends equal to 100% of their admitted claims in sterling).

The Part A Judgment

11. For the purposes of the Part A hearing, the parties were agreed that if a creditor had actually obtained a foreign judgment before the commencement of the

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[2] It is understood by York that both the Senior Creditor Group and Wentworth hold some prime brokerage related claims but it will be obvious from the size of the potential higher entitlements on ISDA Claims that both such respondents have material economic incentives to seek to increase the statutory interest and other entitlements on their ISDA Claims, effectively at the expense of creditors not represented in the Application other than through York.

administration then the interest rate applicable on that foreign judgment would be a rate applicable to the debt apart from administration (Part A judgment, para. 172).

12. The question was whether an interest rate which would be applicable to a judgment debt which had not yet been obtained at the date of the administration was also a rate applicable to the debt apart from the administration. As to this, the Judge's conclusion was that (Part A judgment, para. 177):

> *"[t]he words the 'rate applicable to the debt apart from administration'* ***cannot be read as including a hypothetical rate which would be applicable to a debt if the creditor took certain steps****"*
>
> (emphasis added)

13. He stated that the words "*should be given their obvious meaning of the rate* ***in fact applicable*** *to the debt*" (emphasis added).

14. Accordingly, the Judge's conclusion was that the concept of a "*rate applicable to the debt apart from the administration*" required the relevant interest rate to be *in fact* applicable to the debt as at the date of commencement of the administration. A rate which, at the commencement of the administration, was only contingently applicable because its application depended on further steps being taken did not suffice for these purposes.

15. It follows from this that the references in paras. 180 and 181 of the judgment to the "*rights*" of the creditors existing as at the date of the commencement of the administration were to present and accrued rights of the creditor to receive interest on the relevant debt and not to merely contingent rights to interest i.e. rights the accrual of which was dependent on one or more further steps being taken subsequent to the commencement of the administration. A contingent right to interest, the accrual of which was dependent on some future step being taken, would not constitute a rate of interest "*in fact*" applicable to the debt as at the date of administration.

16. The further point which the Judge made was that there may also be a difference between the debt existing as at the date of the administration and any subsequent debt to which a right to interest attaches. He noted in this respect (Part A judgment, para. 180):

> *"If the creditor does not have a judgment at the date of administration, the debt proved by the creditor is not a judgment subsequently obtained but the debt as at the date of administration. In the case of an unascertained claim, the later judgment quantifies the claim but it is not the judgment debt which is the subject of proof."*

17. The essence of the Judge's conclusion, therefore, was that the words "*the rate applicable to the date apart from the administration*" mean the interest rate which was in fact applicable to the debt as at the date of the administration. For these purposes, it was necessary to determine whether the creditor had a present right to the relevant interest rate in relation to the debt which existed as at the date of the administration (and which a creditor later proves for). Further, a right to interest which a creditor would be able to obtain if further steps were taken is not a right to interest which is presently applicable to the debt as at the date of commencement of the administration.

The Nature of ISDA Claims

18. ISDA Claims arise under various different forms of master agreement. However, such claims share common characteristics. In particular, where the relevant transactions had not been closed out as at the date of the administration of LBIE, then the claims of the relevant counterparty against LBIE were merely contingent, relating to open derivative transactions.

19. Taking the 1992 ISDA Master Agreement:

(1) Prior to the occurrence or effective designation of an Early Termination Date, each party was required to make the payments or deliveries specified in the relevant Confirmation (Section 2(a)(i));

(2) Unless there had been a default in performance, there was no contractual right to interest on such payments or right to compensation

for late delivery (which in any case was only applicable to the extent provided for in the Confirmation or elsewhere in the Master Agreement) (Section 2(e));

(3) Following the occurrence or effective designation of an Early Termination Date, no further payments or deliveries are required to be made under the relevant transactions and there is instead determination of the payment due on Early Termination pursuant to Section 6(e) (Section 6(c)(ii));

(4) For the purposes of determining such amount ("the Termination Amount"):

(a) if "*Market Quotation*" is specified, then there is a netting of the Settlement Amount and any amounts which had been already accrued due but which were unpaid ("the Unpaid Amounts"). For such purposes, the Unpaid Amounts and any Market Quotations are converted into the Termination Currency;

(b) if "*Loss*" is specified, then the relevant sum is the good faith reasonable determination by the non-defaulting party of its total loss in the Termination Currency.

(5) Section 6(d)(ii) then provides:

"An amount calculated as being due in respect of any Early Termination Date under Section 6(e) will be payable on the day that notice of the amount payable is effective (in the case of an Early Termination Date which is designated or occurs as a result of an Event of Default) and on the way which is two Local Business Days after the day on which notice of the amount payable is effective (in the case of an Early Termination Date which is designated as a result of a Termination Event). Such amount will be paid together with (to the extent permitted under applicable law) interest thereon (before as well as after judgment) in the Termination Currency, from (and including) the relevant Early Termination Date to (but excluding) the date such amount is paid), at the Applicable Rate. Such interest will be calculated on the basis of daily compounding and the actual number of days elapsed."

20. Insofar as material for present purposes, the provisions of the 2002 ISDA Master Agreement are broadly the same as those of the 1992 Master Agreement: see Section 2(a)(i), Section 6(c)(ii), Section 6(d)(ii) and Section 9(h) of the 2002 Master Agreement. Section 6(e) of the 2002 Master Agreement differs from Section 6(e) of the 1992 Master Agreement as to the detail of the calculation of the payments on Early Termination, but that detail is not material for present purposes. Similarly, Section 9(h) of the 2002 Master Agreement differs from Section 2(e) of the 1992 Master Agreement as to entitlement to interest and compensation for late payment and delivery under open transactions, but such differences are not relevant to the rights to interest on a Termination Amount that are the subject of this supplemental issue 1(a).

21. The structure of the 2001 FBF Master Agreement is also essentially the same as the ISDA Master Agreements described above. Thus:

(1) Prior to the Termination Date, each party is required to make the payments or deliveries set out in the relevant Confirmation (Articles 5.1 and 5.2);

(2) Unless there had been a default in performance, there was no contractual right to interest on such payments (Article 9.1) or right to compensation for late delivery (Article 9.2);

(3) Following the occurrence of a Termination Date, there are no longer any obligations to make payment or delivery under the relevant transactions and this is replaced by the obligation to make payment of the Settlement Amount (Article 7.3);

(4) The Settlement Amount is determined in accordance with Article 8.1. This is based on the netting of the Replacement Values for each terminated transaction, such Replacement Values being based on market quotations, and any unpaid amounts ("the Amounts Due") at the Termination Date. For these purposes, any Replacement Values or Amounts Due which are not in the Termination Currency are to be converted into the Termination Currency (Article 8.1.3).

(5) As to the payment of the Settlement Amount, Articles 8.2.4 and 8.2.5 provide:

> "**8.2.4** The Party owing the Settlement Amount (or amount mentioned in Article 8.2.3, as the case may be) shall pay it to the other Party within three Business Days from receipt of the notice mentioned in Article 8.2.1. In the event that the Settlement Amount is due by the Non-Defaulting Party to the Defaulting Party following the occurrence of an Event of Default, the Non-Defaulting Party shall be irrevocably authorised to set-off, within the limits provided for by the law, such amount against any other amount due to it by the Defaulting Party in respect of any dealings between the Parties.
>
> **8.2.5** In the event of delay in payment, interest, calculated in accordance with the provisions of Article 9.1, shall be added to the Settlement Amount (or the amount mentioned in Article 8.2.3, as the case may be)."

22. There are therefore a number of common features of the claims against LBIE which arise under the Master Agreements described above:

(1) Where there had been no Early Termination Date/Termination Date at the date of the administration, the relevant claims of the counterparty consisted of:

(a) contingent rights to payment and delivery under the open transactions; and

(b) a right to payment of any Unpaid Amounts/Amounts Due in favour of that party (of which there may or may not have been any).

(2) The contingent rights to payment and delivery in (1)(a) did not attract any right to interest or compensation for late delivery under the Master Agreements unless and until a default in performance of the obligations occurred;

(3) Upon occurrence of an Early Termination Date/Termination Date, the claims set out in (1) were replaced by a right to receive payment of the

amounts due on termination (i.e. the Termination Amount/the Settlement Amount). This is a different sum, determined in accordance with the contractual machinery in the relevant Master Agreement and after netting out the relevant sums, and which may be denominated in a different currency to that of the original transactions.

(4) Such amounts then fell due for payment in accordance with Section 6(d)(ii) of the ISDA Master Agreements and Article 8.2.4 of the FBF Master Agreement.

(5) A right to interest on such amounts would accrue if and when there had then been a default in making such payment by the due date.

Applying the Judge's Reasoning to ISDA Claims

23. In York's submission, in a case where the creditor's right at the date of the administration comprise rights under open transactions under a Master Agreement, then it cannot be said that any of the contractual rights to interest provided under the Master Agreements are a "*rate applicable to the debt apart from the administration*".

24. First, the contractual interest rate which may be applicable under the terms of the relevant Master Agreement to the Termination Amount/Settlement Amount following a default in payment of that amount cannot be said to be a "*rate applicable to the debt apart from the administration*".

25. As the Judge observed, the reference in rule 2.88(9) to the "*debt*" is to the debt proved in the administration (Part A judgment, para. 180).

26. Where transactions remain open as at the date of administration, then the relevant debts as at that date comprise: (a) the contingent payment and delivery rights under the open transactions and (b) any Unpaid Amounts/Amounts Due. These are the debts which are proved in the administration by the creditor. These debts are, however, legally distinct from the debt which subsequently accrues due following termination i.e. the Termination Amount/Settlement Amount.

27. In particular:

(1) the right to the Termination Amount/Settlement Amount arises under a different contractual provision of the Master Agreement from the rights to receive payments and deliveries under the open transactions;

(2) a claim to recover the Termination Amount/Settlement Amount would therefore be pleaded on a different basis to a claim based on the rights to receive payment and deliveries under the open transactions;

(3) the right to the Termination Amount/Settlement Amount may be in a different currency (i.e. the Termination Currency) to the payments due under the open transactions; and

(4) the right to the Termination Amount/Settlement Amount is determined following the application of a specific contractual machinery set out in the Master Agreement (which may e.g. involve obtaining market quotations);

(5) the right to the Termination Amount/Settlement Amount is also a net liquidated amount determined following (a) the conversion of unliquidated delivery obligations to liquidated sums and (b) the netting of all the relevant sums in accordance with the provisions of the relevant Master Agreement;

(6) moreover, the Termination Amount/Settlement Amount is not a right to damages arising out of the non-performance by the defaulting party of its obligations under the open transactions – rather it is contractual amount which becomes due under and in accordance with the terms of the Master Agreement upon specified events occurring.

28. As noted above, in paragraph 180 of the Part A Judgment, David Richards J drew a clear distinction between: (a) a foreign currency debt as at the date of the administration and (b) a subsequent judgment based on that debt. He said that: "*In the*

case of an unascertained claim, the later judgment quantifies the claim but it is not the judgment which is the subject of proof."

29. Applying this logic, similarly, in the case of ISDA Claims, where the relevant transactions are open at the date of administration, the later Termination Amount/Settlement Amount quantifies the claim but is not itself the debt which is the subject of proof. The debts which are the subject of proof are the contingent rights to payment and delivery under the open transaction together with any Unpaid Amounts/Amounts Due (if any) as these are the subsisting debts at the commencement of the administration (see Rule 13.12 of the Insolvency Rules 1986).

30. It follows that any interest rate applicable to the subsequent Termination Amount/Settlement Amount is not in any case a rate applicable to the debt apart from the administration for the purposes of Rule 2.88(9). To conclude otherwise is to confuse the debts which are the subject of the proof with the subsequent Termination Amount/Settlement Amount which is a different debt (albeit one which has the practical effect of quantifying the debts which are the subject of the proof).

31. The further point is that, in any event, the entitlement to interest under Section 6(d)(ii) of the ISDA Master Agreements and Article 8.2.4 of the FBF Master Agreement is dependent on an effective notice of the amount payable being given: see Goldman Sachs International v Videocon Global Limited [2014] EWHC 4267 (Comm) at [17]. An "effective notice" is one that contains all the relevant information required by the Master Agreement to show how that Termination Amount has been determined. Accordingly, such entitlement to interest is in any case contingent and dependent on such an effective notice being given and, absent this having taken place at the time of commencement of the administration, cannot be said to be rate applicable to the debt at that time.

32. Secondly, it equally cannot be said that the contractual interest rate which may be applicable under the terms of the relevant Master Agreement to the payment and delivery obligations under any open transactions is a "*rate applicable to the debt apart from the administration*".

33. The contractual rights to interest for late payment and compensation for late delivery under open transactions are provided for as follows:

(1) Section 2(e) of the 1992 ISDA Master Agreement:

> "Prior to the occurrence or effective designation of an Early Termination Date in respect of the relevant Transaction, a party that defaults in the performance of any payment obligations will, to the extent permitted by law and subject to Section 6(c), be required to pay any interest (before as well as after judgment) on the overdue amount to the other party on demand in the same currency as such overdue amount, for the period from (and including) the original due date for payment to (but excluding) the date of actual payment, at the Default Rate ... If, prior to the occurrence or effective designation of an Early Termination Date in respect of the relevant Transaction, a party defaults in the performance of any obligation required to be settled by delivery, it will compensate the other party on demand if and to the extent provided for in the relevant Confirmation or elsewhere in this Agreement."

(2) Section 9(h)(i)(1) of the 2002 ISDA Master Agreement is in similar terms as regards interest on defaulted payments. Section 9(h)(i)(2) expands the right to compensate for defaulted deliveries by providing for a right of interest on the fair market value of the delivery obligation.

(3) Articles 9.1 and 9.2 of the FBF Master Agreement provide for rights to interest and compensation for late payments and deliveries.

34. The first point is that the application of the contractual rights to interest under the ISDA Master Agreements described in paragraph 33 above are in any case dependent on steps being taken subsequent to the commencement of the administration. First, the defaulting party must fail to make the relevant payment. Secondly, the creditor must then make a demand for the relevant interest. Since the application of the interest rate is dependent on steps being taken subsequent to the administration then, following the logic of the Judge, it cannot be said to be a rate applicable to the debt as at the administration.

35. In this respect, there is no material difference, as a matter of principle or policy, between a creditor taking steps subsequent to the administration to obtain a judgment

based on his contractual rights and taking steps subsequent to the administration by serving a demand. In both cases, the creditor is invoking and relying on his existing contractual rights in order to obtain greater rights. If an interest rate applicable as a result of obtaining a judgment by invoking those contractual rights is not a rate applicable to the debt apart from the administration, then the same applies to an interest rate applicable as a result of invoking contractual machinery e.g. by serving a demand or notice.

36. The second point is that the rights to interest under the ISDA Master Agreements are only applicable contingently since they are always subject to being disapplied by the occurrence or designation of an Early Termination Date. The contractual rates expressly only apply *prior* to the occurrence of an Early Termination Date. Where an Early Termination Right has been designated or occurred there is no continuing entitlement to such rights of interest.

37. The third point is that, insofar as the relevant rights under the open transactions under ISDA Master Agreements at the date of administration concern rights to *delivery* rather than rights to *payment*, it is difficult to see how there can be any interest rate applicable to such claims as at the date of the administration.

(1) Under the 1992 ISDA Master Agreement, there is no right to interest and, even if a right to compensation for late delivery can be said to be a right to interest (which it cannot), there is no right to compensation except as provided for in the relevant Confirmation.

(2) Under the 2002 ISDA Master Agreement, there is a right to interest for late delivery (albeit subject to being disapplied by the relevant Confirmation) but this is dependent on the party entitled to delivery having determined the fair market value of the delivery obligation at the delivery date in good faith and using commercially reasonable procedures. Where this has not been done as at the date of administration, then this is a further reason why such interest is not a "*rate applicable to the debt apart from the administration*".

Conclusion

38. For all these reasons, the Court is invited to conclude in answer to Supplemental Issue 1(a) that "*the rate applicable to the debt part from the administration*" in Rule 2.88(9) of the Rules does not include, in the case of a provable debt that is a close-out sum under a contract, a contractual rate of interest that began to accrue only after the close-out sum became due and payable due to action taken by the creditor after the date of the administration.

Tom Smith QC
Robert Amey

South Square
Gray's Inn
London
WC1R 5HP

7 December 2015