No. 7942 of 2008

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT
IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE)
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 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

SUPPLEMENTAL NOTE
ON BEHALF OF THE ADMINISTRATORS

Introduction

1. This Supplemental Note has been lodged on behalf of the Joint Administrators of Lehman Brothers International (Europe) (in Administration) (the "**Administrators**") to address the questions raised by Mr Justice Hildyard (the "**Judge**") in respect of Supplemental Issue 1(a), which were sent to the parties' legal representatives by the Judge's clerk by email dated 27 May 2016.

The Judge's Questions

(i) The Judge's first question

2. The first question in the email from the Judge's clerk dated 27 May 2016 is:

> "*What if any reliance the parties respectively place on the Tael decision; whether a contractual right which is subject to a contingency which has not yet been and may never be fulfilled can be said to be an 'accrued right'; whether a rate of interest can be said to 'apply' (a) in the case of a right that has not yet accrued or (b) where the right can be said to have accrued, but the conditions to which it is subject before any entitlement crystallises have not been fulfilled*".

3. As to the first part of this question, the Administrators submit that:

(1) In *Tael One Partners Ltd v Morgan Stanley & Co International plc* [2015] UKSC 12, [2015] Bus LR 278, the Supreme Court was required to construe the words "*interest or fees ... which are expressed to accrue by reference to the lapse of time*" in condition 11.9(a) of the LMA standard terms and conditions for par trade transactions.

(2) The word 'accrue' does not appear in Rule 2.88(9), which refers to the "*rate applicable to the debt apart from the administration*".

(3) Since the Court is concerned with a question of statutory construction as to the meaning of Rule 2.88(9), which does not use the concept of accrual, the Supreme Court's remarks about the meaning of the word 'accrue' in *Tael* at [42] are irrelevant.

(4) The reference to 'accrued rights' was introduced into the argument by York in its written submissions on Supplemental Issue 1(a) dated 7 December 2015 at [15] when it contended that the references to "*rights*" in the Waterfall IIA Judgment at [180]-[181] were references to "*present and accrued rights*". The concept of accrued rights thus features in the argument only as part of York's gloss on the reasoning of Mr Justice David Richards. It does not derive from Rule 2.88.

(5) The Administrators' response to York's point was to say that "*rights under a [pre-administration] contract accrued (in the sense of becoming binding on the parties) when the contract was first entered into*" (see the Administrators' written submissions on Supplemental Issue 1(a) dated 14 December 2015 at [30]).

(6) York replied to this by citing the *Tael* decision in support of the contention that interest accrues only when it becomes payable (see York's written submissions in reply on Supplemental Issue 1(a) dated 21 December 2015). York says that there cannot be an 'accrued right' to interest, where the interest has not yet accrued.

(7) However, York's reply misunderstands the Administrators' argument:

(i) The Administrators referred to a right which had "*accrued (in the sense of becoming binding on the parties) when the contract was first entered into*".

(ii) In that sense, a party may have an accrued contractual right to future or contingent interest, even where the interest itself has not yet accrued.

(iii) There is thus a difference between accrued *rights* and accrued *interest*: the former is York's gloss on the words used by Mr Justice David Richards in the Waterfall IIA Judgment; whilst the latter is what appears in condition 11.9(a) of the LMA standard terms and conditions.

4. As to the second part of the Judge's first question:

(1) Declaration (xi) in the Waterfall IIA Order confirms that, for the purpose of establishing "*whichever is the greater of the rate specified under paragraph (6) and the rate applicable to the debt apart from the administration" (as required by Rule 2.88(9) of the Rules), the comparison required is of the* ***total amounts*** *of interest that would be payable under Rule 2.88(7) of the Rules based on each method of calculation (including the compounding of interest), rather than only the numerical rates themselves*" (emphasis added).

(2) The total amount of interest at the "*rate applicable to the debt apart from the administration*" is the total amount of money to which the creditor would have been entitled by way of interest, other than pursuant to Rule 2.88(7).

(3) That amount must be calculated by applying the terms of the contract.

(4) If the terms of the contract provide for the interest to become payable on a contingency which has not occurred, the total amount of post-administration interest on the basis of the "*rate applicable to the debt apart from the administration*" will be nil, because there will have been no interest falling due in that period according to the terms of the contract. In such a case, the creditor will be entitled instead to interest at the Judgments Act rate.

(5) The fact that the contingency to which the interest is subject may *never* occur is not determinative. What matters is whether it has occurred at any point prior to the payment in full of the proved debt. If it has occurred prior to the payment in full of the proved debt, the total amount of interest at the contractual rate must be calculated in accordance with the terms of the contract for the period between the occurrence of the contingency and the payment in full of the proved debt.

5. In their written submissions on Supplemental Issue 1(c)[1], the Administrators set out the following hypothetical example:

(1) A creditor has a contingent claim against a company;

(2) In order for the claim to become presently due and payable, it is necessary for the creditor to take a particular step (e.g. the service of a close-out notice);

(3) The contract provides that, after the taking of that step, and for as long as the debt is due and payable but unpaid, simple interest shall accrue at 15% per annum;

(4) The debtor company goes into administration;

[1] The Administrators deal with Supplemental Issue 1(c) in more detail below

(5) 363 days after the Date of Administration, the creditor serves a close-out notice with the result that (a) the debt becomes due and payable in the sum of £1,000,000; and (b) simple interest begins to run on that amount at 15% per annum in accordance with the terms of the contract;

(6) On the basis of the hindsight principle, the creditor's claim is admitted in full;

(7) 365 days after the Date of Administration (i.e. only two days after the service of the close-out notice), the administrators pay a dividend of 100p in the £; and

(8) There is a surplus available for the payment of statutory interest.

6. In their written submissions on Supplemental Issue 1(c), the Administrators submitted that, in this example, what is required to be compared for the purposes of Rule 2.88(9) is (a) the total amount of interest that would be payable at the Judgments Act Rate for 365 days and (b) the total amount of interest that would be payable under the contract apart from the administration for that same period, i.e. 15% per annum for only two days. Since the former would be greater than the latter, the creditor would be entitled to the former as statutory interest on the proved debt under Rule 2.88(7).

7. In summary, therefore, the Administrators submit that:

(1) A rate may 'apply' to a debt for the purposes of Rule 2.88(9) even where it remains contingent and interest at that rate has not yet started to run; but

(2) For the purposes of the comparison required by Rule 2.88(9), the total amount of interest at the "*rate applicable to the debt apart from the administration*" must be calculated on the basis set out in the contract, so that, where the rate remains contingent and interest at that rate has not yet started to run, the total amount of interest at the "*rate applicable to the debt apart from the administration*" will be nil and the creditor will be entitled to interest at the Judgments Act rate.

(ii) The Judge's second question

8. The second question in the email from the Judge's clerk dated 27 May 2016 is:

> "*Whether, to constitute 'the rate applicable to the debt apart from the administration', the rate to which the creditor is contractually entitled must be one that would have been available at the Date of Administration had any contingencies to which the contractual entitlement is subject been fulfilled at that time*".

9. The Administrators submit that the answer to this question is "Yes".

(1) For the purpose of calculating the total amount of interest at the "*rate applicable to the debt apart from the administration*" (as Rule 2.88(9) requires), it is not necessary for interest to have been accruing at that rate as at the Date of Administration.

(2) Where the interest is subject to a contingency which occurs at some point in the period between the Date of Administration and the payment in full of the proved debt, the amount of interest at the contractual rate must be calculated in accordance with the terms of the contract, by reference to the period of time between the occurrence of the contingency and the payment in full of the proved debt.

(3) Therefore, as the Administrators have explained in their written submissions on Supplemental Issue 1(c) (as further explained below), if the contingency does not occur before the payment in full of the proved debt, the total amount of interest at the "*rate applicable to the debt apart from the administration*" will be nil and the creditor will be entitled to interest at the Judgments Act rate.

10. In summary of the Administrators' reasoning:

(1) The concept in Rule 2.88(9) is the "*rate applicable to the debt apart from the administration*". This concept makes it necessary to identify the rate that would have been applicable to the debt apart from the administration.

(2) That rate may be a rate under a pre-administration contract, even where, as a matter of contract, interest had not yet started to run as at the Date of Administration.

(3) As explained in the Administrators' written submissions on Supplemental Issue 1(c), the relevant task is to compare (i) the total amount of interest that would have accrued at the Judgments Act rate for the period from the Date of Administration to the payment in full of the proved debts and (ii) the total amount of interest that would have accrued under the contract, but for the administration.

(4) In calculating the latter, it is necessary to apply the terms of the contract. Therefore, where interest would not have been accruing at the contractual rate as a matter of contract (e.g. because the contingency to which it was subject was never fulfilled), the Administrators submit that the contractual amount of interest will be nil and that the creditor will be entitled to the Judgments Act rate.

(5) Similarly, if interest would (as a matter of contract) have begun to accrue at the contractual rate at some point after the Date of Administration (e.g. because the contingency to which it was subject was fulfilled on that date), the total amount of the interest at the contractual rate will be calculated on the basis that contractual interest would only have run during the period after that date.

(6) So, for example, if (as a matter of contract) a debt would begin to accrue interest only on the service of a close-out notice, and the creditor served a close-out notice two months after the Date of Administration, the calculation of the total amount of interest at "*rate applicable to the debt apart from the administration*" (as required by Rule 2.88(9)) would have to take account of the fact that no contractual interest was payable before the service of the close-out notice.

(ii) The Judge's third question

11. The third question in the email from the Judge's clerk dated 27 May 2016 is:

> "*Whether 'the rate applicable to the debt apart from the administration' may be a floating or variable rate, or whether the actual rate must be fixed as at the Date of Administration*".

12. The Administrators submit that the "*rate applicable to the debt apart from the administration*" can be a floating or variable rate and that, where it is such a rate, the amount of interest at the "*rate applicable to the debt apart from the administration*" must be calculated taking account of the fluctuations in that rate. In summary:

(1) As mentioned above, declaration (xi) in the Waterfall IIA Order confirms that, for the purpose of establishing "*whichever is the greater of the rate specified under paragraph (6) and the rate applicable to the debt apart from the administration" (as required by Rule 2.88(9) of the Rules), the comparison required is of the* ***total amounts*** *of interest that would be payable under Rule 2.88(7) of the Rules based on each method of calculation (including the compounding of interest), rather than only the numerical rates themselves*" (emphasis added).

(2) The total amount of interest at the "*rate applicable to the debt apart from the administration*" is the total amount of money to which the creditor would have been entitled by way of interest, other than pursuant to Rule 2.88(7).

(3) That amount must be calculated by applying the terms of the contract. Where the contract provides for the creditor to be entitled to a floating or variable rate, those terms must be applied to calculate the total amount of the creditor's entitlement.

(4) Consequently, if the "*rate applicable to the debt apart from the administration*" is a floating or variable rate, that floating or variable rate will be the relevant rate for the purposes of Rule 2.88(9). In the Administrators' submission, there is nothing in Rule 2.88(9) to exclude a floating or variable rate.

(5) Further, where the rate is a floating or variable rate, it will not be 'fixed' or crystallised by reference to the level at which it stood on the Date of Administration. Rather, it will continue to be a floating or variable rate.

The wider context: Supplemental Issues 1(b) and 1(c)

13. The Administrators wish to draw the Judge's attention to the fact that some of the arguments in respect of Supplemental Issue 1(a) and the Judge's additional questions are similar to arguments advanced by the parties in respect of Supplemental Issues 1(b) and 1(c), which have been referred to Lord Justice David Richards (but not yet determined by him).

14. First, the Judge's second question in respect of Supplemental Issue 1(a)[2] and Supplemental Issue 1(b)[3] both address a scenario in which, as at the Date of Administration, there was a contract between LBIE and a creditor which provided for interest to accrue in favour of the creditor upon the occurrence of a contingency which had not yet occurred. The Administrators consider that the analysis in respect of each of these questions is different, because:

(1) the Judge's second question on Supplemental Issue 1(a) is addressing the scenario in the context of statutory interest on a provable debt; whereas

(2) Supplemental Issue 1(b) is addressing the scenario in the context of contractual interest on a non-provable debt (specifically, a non-provable Currency Conversion Claim).

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2 The Judge's second question in respect of Supplemental Issue 1(a) asks: "*Whether, to constitute 'the rate applicable to the debt apart from the administration', the rate to which the creditor is contractually entitled must be one that would have been available at the Date of Administration had any contingencies to which the contractual entitlement is subject been fulfilled at that time*".

3 Supplemental 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?*"

15. The former is governed by the wording of Rule 2.88(9), whilst the latter is governed by the concept of remission to contractual rights. The analysis will, therefore, be different.

16. However, there is an overlap in the arguments that have been raised by York in respect of Supplemental Issue 1(a) and Supplemental Issue 1(b):

    (1) In the context of Supplemental Issue 1(a), York relies on the conclusion of Mr Justice David Richards (as he then was) in respect of Issue 4 in the Waterfall IIA Judgment. Specifically,

        (i) Mr Justice David Richards held in the Waterfall IIA Judgment at [177] that the words "*rate applicable to the debt apart from the administration*" in Rule 2.88(9) "*cannot be read as including a hypothetical rate which would be applicable to a debt if the creditor took certain steps*" and "*should be given their obvious meaning of the rate in fact applicable to the debt*".

        (ii) York relies on those conclusions to say that "*[a] rate which, at the commencement of the administration, was only contingently applicable … [does] not suffice for these purposes*" (York's written submissions on Supplemental Issue 1(a) dated 7 December 2015, [14]).

        (iii) York says that "*[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*" (ibid., [15]).[4]

    (2) In the context of Supplemental Issue 1(b), York contends that the position in respect of contractual interest on a non-provable debt is precisely the same as the position in respect of statutory interest on a provable debt.

[4] The Administrators disagree with York's contentions on Supplemental Issue 1(a), as set out in the Administrators' written submissions dated 14 December 2015. In summary, they contend that a contractual right which existed as at the Date of Administration will constitute a "*rate applicable to the debt apart from the administration*", even if it is fulfilled after the Date of Administration.

(i) In this context, York relies again on the conclusion of Mr Justice David Richards in respect of Issue 4 in the Waterfall IIA Judgment.

(ii) York says that "*[its] primary position is that the same approach should be adopted for these purposes as applies for Rule 2.88(9). That rule directs an inquiry as to the 'rate applicable to the debt apart from the administration'. Such a rate does include a rate which would only be applicable if certain steps were taken by the creditor, but were not in fact taken as at the date of the commencement of the administration*" (York's written submissions in reply on Supplemental Issues 1(b) and 2 dated 20 January 2016).[5]

17. Secondly, there is a similarity between the Judge's third question on Supplemental Issue 1(a)[6] and Wentworth's arguments in respect of Supplemental Issue 1(c).[7]

18. A major part of Wentworth's argument in respect of Supplemental Issue 1(c) is premised on the assumption that "*the rate applicable to the debt apart from the administration*" may be a floating or variable rate and that, where it is a floating or variable rate, there is nothing in Rule 2.88(9) to provide for it to be 'fixed' or crystallised by reference to the position as it stood as at the Date of Administration.

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5 The Administrators disagree with York's arguments on Supplemental Issue 1(b), for the reasons set out in their written submissions dated 13 January 2016. In the Administrators' submission, the contractual rate applies to the non-provable Currency Conversion Claim in accordance with the terms of the contract, so that the commencement of the running of interest and the identification of the period for which interest continues to run will be governed by the terms of the contract.

6 The Judge's third question in respect of Supplemental Issue 1(a) is: "*Whether 'the rate applicable to the debt apart from the administration' may be a floating or variable rate, or whether the actual rate must be fixed as at the Date of Administration*".

7 Supplemental Issue 1(c) asks: "*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 purpose of Rule 2.88(9) should Statutory Interest be calculated by assessing the greater of the 'rate applicable' and the Judgments Act 1838 rate separately for the periods prior to and post the commencement of contractual interest or should such assessment be performed by taking the periods together?*"

19. In Wentworth's written submissions dated 22 December 2015, Wentworth explains that there are two different approaches for calculating the total amount of interest payable on the basis of the "*the rate applicable to the debt apart from the administration*":

(1) The "*First Approach*" is to calculate the total amount on the basis that interest at the "*rate applicable to the debt apart from the administration*" begins to run on the date when, contractually, such interest began to accrue; whilst

(2) The "*Second Approach*" is to calculate the total amount on the basis that the contractual rate, which, according to the terms of the contract, did not begin to run until some point after the Date of Administration, is nevertheless deemed to apply for the whole of the post-administration period (notwithstanding that, under the terms of the contract, it applied only for the latter part of that period).

20. Wentworth contends that the First Approach is correct (and the Administrators have lodged written submissions agreeing with Wentworth's answer on this point).

21. In support of the First Approach, Wentworth relies on an example in which the contractual rate is 6% per annum before the scheduled repayment date and 9% per annum after the scheduled repayment date (see Wentworth's written submissions dated 22 December 2015, [4]). Wentworth also submits that that "*[the] position is analytically no different from the case of an actual … debt, but with a contractual right to interest which fluctuates from time to time*":

> "*For example, a present debt that carries a rate of interest linked to a benchmark rate which dramatically increases after the first year, resulting in a rate of 6% for the first year and 9% thereafter. When considering the rate applicable apart from the administration, it is self-evidently necessary to have regard to the rate from time to time in determining whether the total amount of interest payable for the relevant period at the contractual rate is greater than the total amount of interest payable for the same period at the Judgments Act rate*" (ibid., [6]).

22. Wentworth's written submissions on Supplemental Issue 1(c) are thus premised on the assumption that "*the rate applicable to the debt apart from the administration*" may be a contractual right to interest which fluctuates from time to time, such as a floating or variable rate.

23. Wentworth relies on this by way of analogy to show that where the debt was contingent as at the Date of Administration and contractual interest had not yet begun to run on it, the "*rate applicable to the debt apart from the administration*" for the period prior to the date on which contractual interest began to run will be nil (see, in particular, Wentworth's written submissions dated 22 December 2015, [7]-[11]). On this basis, Wentworth submits that the "*First Approach*" is correct (ibid., [12]).[8]

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23 June 2016

[8] As mentioned above, the Administrators agree with Wentworth in respect of Supplemental Issue 1(c). What is required to be compared for the purposes of Rule 2.88(9) is (a) the total interest that would be payable at the Judgments Act Rate for the relevant post-administration period and (b) the total interest that would be payable apart from the administration for that same period, taking into account *inter alia* that contractual interest was accruing only for part of that period (and that the amount of interest at the contractual rate for the first part of the period was therefore nil).