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) RUSSELL DOWNS
(4) JULIAN GUY PARR
(in their capacity as the joint administrators of the above-named company)

Applicants

-and-

(1) BARCLAYS CAPITAL INC
(2) WENTWORTH SONS SUB-DEBT SARL

Respondents

POSITION PAPER OF THE ADMINISTRATORS IN REPLY TO THE POSITION PAPERS OF BARCLAYS AND WENTWORTH

Introduction

1. This position paper is filed by the Administrators in reply to the position paper of Barclays ("**B-PP**") and the position paper of Wentworth Sons Sub-Debt SARL ("**Wentworth**") ("**W-PP**"), pursuant to the order of Mr Justice Hildyard dated 29 November 2016 (as amended by consent orders dated 10 March 2017 and 25 May 2017). The defined terms and abbreviations set out in the Application, Downs 10 and the Administrators' original position paper ("**A-PP**") are adopted herein. References to the parties' position papers are set out in the form: "**[position paper/paragraph]**".

2. The purpose of this reply position paper is as follows:

   (1) For the benefit of the parties and the Court, **Annex 1** contains a tabular summary of the positions adopted by the Administrators, Barclays and Wentworth on each Issue.

   (2) In relation to each Issue, the Administrators identify the arguments put forward by Barclays and Wentworth with which they agree and disagree (and, where appropriate, provide brief reasons for their position). The Administrators also identify any points made by Barclays and Wentworth which they consider to be irrelevant to the Issues in this application.

   (3) Where it is apparent that there is (or may be) common ground between the parties on a particular Issue, the Administrators invite the parties to adopt an agreed position.

3. By way of summary, the Administrators consider that the following Issues comprise the key contested Issues which the Court will be required to determine (the "**Disputed Issues**"): 3, 5, 6, 7, 9(1), 9(3), 10, 11, 12, 13, 15, 16, 17 and 18. It is envisaged that the parties will focus on the Disputed Issues in their evidence, skeleton arguments and oral submissions at trial. The Administrators consider that the remaining Issues (namely Issues 4, 7(1), 7(2), 7(3), 7(4), 8, 9(2), 9(4), 14 and 19) are capable of being the subject of an agreed position on the terms set out below.

4. Unless expressly stated otherwise, the Administrators' position remains as stated in A-PP.

5. The Administrators note that Barclays and Wentworth have sought to divide the Issues into various sub-groups (which differ from the sub-groups proposed by the Administrators in the Application). Having regard to the sub-groups suggested by Barclays and Wentworth, the Administrators propose that the Issues should be divided as follows:

   (1) **Part A: the existence of and relationship between Barclays' claims** (Issues 4 to 8). The Disputed Issues in Part A are 5, 6 and 7.

   (2) **Part B: the effect of set-off on Barclays' claims** (Issues 3 and 9). The Disputed Issues in Part B are 3, 9(1) and 9(3).

   (3) **Part C: admission of the Barclays Proof** (Issues 10 to 14). The Disputed Issues in Part C are 10, 11, 12 and 13.

   (4) **Part D: Barclays' claim to Statutory Interest** (Issues 17 to 19). The Disputed Issues in Part D are 17 and 18.

   (5) **Part E: currency issues** (Issues 16 and 15). The Disputed Issues in Part E are 16 and 15.

Part A

The existence of and relationship between Barclays' claims

ISSUE 4

To the extent that Barclays (i) does not have a Client Money Entitlement in respect of some or all of the ETD Trades; or (ii) has a Client Money Entitlement but is estopped or otherwise precluded from asserting such Client Money Entitlement in respect of some or all of the ETD Trades, does Barclays have an Unsecured Claim in respect of such ETD Trades?

6. The Administrators have adopted the following position on Issue 4 (A-PP/27):

> "*[t]o the extent that Barclays: (i) does not have a Client Money Entitlement in respect of some of the ETD Trades; or (ii) has a Client Money Entitlement but is estopped or otherwise precluded from asserting such Client Money Entitlement in respect of some of the ETD Trades, the Administrators consider that Barclays is not (by that reason alone) deprived of any Unsecured Claim in respect of such ETD Trades.*"

7. Barclays concurs with the Administrators' position: see B-PP/11-18. Wentworth does not address Issue 4 at all.

8. In the circumstances, the Administrators invite the parties to adopt an agreed position on Issue 4 on the terms set out above.

ISSUE 5

To the extent that Barclays has a Client Money Entitlement in respect of some or all of the ETD Trades (and is not estopped or otherwise precluded from asserting such Client Money Entitlement), does Barclays also have a Parallel Unsecured Claim?

9. Issue 5 is one of the Disputed Issues. The Administrators contend that, where Barclays has a Client Money Entitlement in respect of a given ETD Trade (and is not estopped or otherwise precluded from asserting the Client Money Entitlement),

Barclays also has a Parallel Unsecured Claim in respect of that ETD Trade:[1] see A-PP/31-38. Barclays concurs with this position: see B-PP/11-18.

10. Wentworth adopts a contrary position. Wentworth contends that, where Barclays has a Client Money Entitlement in respect of a given ETD Trade, Barclays does not have a Parallel Unsecured Claim in respect of that ETD Trade: see W-PP/4-13.

11. Wentworth's position would, if correct, result in a radical change to the way in which the relationship between a client and an investment firm has previously been understood. Thus far, the Court has proceeded on the basis that a client may have two concurrent claims in the administration of an investment firm: (i) a Client Money Entitlement against the Client Money Pool held by the firm as trustee under CASS7; and (ii) a Parallel Unsecured Claim against the firm's general estate. This assumption was judicially approved in *Re MF Global UK Ltd* [2014] 1 WLR 1558 at [1], where David Richards J explained:

> "*A financial firm, such as an investment bank, is required to segregate client money from its own funds and to hold it on trust for the clients. <u>The same transaction between a firm and a client may give rise to an obligation on the firm to hold client money for the client and to a personal claim on the contract</u>. The occurrence of certain events, including the firm going into liquidation or administration, will give rise to a distribution of the client money among the clients as beneficiaries and (in a liquidation or in an administration where permission to distribute is given) to a distribution of the firm's assets among its creditors, including its clients with personal claims*." (emphasis added)

<u>Wentworth's arguments</u>

12. Wentworth argues that it is conceptually incoherent for a proprietary beneficial interest to exist alongside a concurrent personal claim (W-PP/8.1):

> "*One cannot beneficially own property and, at the same time, be a creditor for the value of it. That is conceptually incoherent, and would be apt to permit double recovery.*"

[1] Assuming that the contractual debt in respect of the relevant ETD Trade was in LBI's favour.

13. This is wrong. There is nothing incoherent in the concept of a beneficial interest existing alongside a personal claim. A similar structure can be found in many examples across the financial markets, including the following:

(1) A hedge fund transfers a parcel of intermediated securities into the custody of its prime broker. The securities are held by the broker in an omnibus trust account, together with other securities of the same type belonging to other clients.

(2) Under the terms of the contract between the client and the broker, the client is beneficially entitled to a proportionate share of the securities held in the broker's omnibus trust account.

(3) In addition to this proprietary claim, the client also has a concurrent contractual claim for the delivery (upon reasonable request) of equivalent securities. Such securities may be sourced from the broker's house account.

14. This was precisely the position in the *RAB Market Cycles* case: see *Re Lehman Brothers International (Europe)* [2009] EWHC 2545 (Ch). Briggs J explained (at [56]-[58]) that the "Counterparty" had both a proprietary interest in an omnibus securities account and a personal right to the delivery of equivalent securities from the broker's house account:

> "*[56] There is in my judgment nothing incompatible with the recognition of a proprietary Counterparty interest in securities in the provisions whereby they may be held in omnibus fungible accounts with equivalent securities of other Counterparties ...*
>
> *[57] Nor do I regard the primary obligation of the Prime Broker under clause 7.1(b) of the Agreement, to deliver, upon reasonable request, equivalent securities to the Counterparty as pointing away from the recognition of a proprietary interest of the Counterparty in securities ... Upon delivery of an equivalent security to a requesting Counterparty (whether from LBIE's stocks as custodian or from its house account) the Counterparty's commercial desire to obtain property rather than cash or a debt in respect of its proprietary interest would be fully satisfied, and its proprietary interest in the fund into which its security had originally been transferred thereby discharged.*

> *[58] I asked Mr Peacock whether he could think of any reason why, if a client asked his solicitor for the return of money held on client account and was paid cash by the solicitor from his own resources, that would not be both a full discharge of the solicitor's duty as trustee to the client, and a discharge, pro tanto, of the client's proprietary interest in the client account fund. He could think of no reason why not, and nor can I.*"

15. In any event, Wentworth is wrong to characterise the Parallel Unsecured Claim as a claim "*for the value*" of property held by the firm as trustee (W-PP/8.1). The value of the Parallel Unsecured Claim is determined by the contract between the client and the firm. This may bear little relation to the amount of client money which the firm has segregated or which the firm is required to segregate by CASS7. Due to the constant fluctuation in the value of open positions, the total quantum of client money held by the firm will frequently diverge from the total value of open positions held by the firm's clients, even if the firm fully complies with its client money obligations at the end of every business day.[2] As David Richards J held in *Re MF Global UK Ltd* [2014] 1 WLR 1558 at [3], the Parallel Unsecured Claim must be valued independently of the Client Money Entitlement.

16. Further, there are clear rules governing the relationship between Client Money Entitlements and Parallel Unsecured Claims (developed by the Court in *Re MF Global UK Ltd* [2014] 1 WLR 1558) which prevent any possibility of double-recovery.

17. Wentworth attempts to argue that the existence of a Parallel Unsecured Claim would be inconsistent with the firm's fiduciary obligations to the client (W-PP/8.3). This assertion is wrong – there is no inconsistency – and Wentworth does not pursue the point at any length.

18. Wentworth states (W-PP/9.4):

> "*It is likewise incorrect to conceptualise the process of a Primary Pooling Event as terminating or expropriating the client's contractual rights, as [the Administrators] would have it. Its right is <u>always</u> as owner, not as creditor.*" (emphasis added)

[2] For the firm's daily obligation to segregate client money, see the following footnote.

19. This is a surprising proposition. It would entail that, when a client instructs a firm to open a derivatives position, the client does not (at any time) have an ordinary contractual claim against the firm for the value of the client's open position – even before the primary pooling event occurs. This cannot be correct:

(1) When a client opens a derivatives position, the firm does not automatically segregate cash equal to the precise value of the client's position at all times.

(2) Rather, the value of the client's position is constantly in flux. At regular intervals, the firm is required to segregate client money to cover its contractual exposure to the client.[3]

(3) The entire scheme of CASS7 therefore presupposes that the client has a contractual entitlement in respect of which client money is segregated. If a client did not have a contractual claim to be paid the value of an open position, then there would be no need for the firm to segregate anything in respect of that position.

(4) Accordingly, the client cannot be regarded as simply an "*owner*" and not additionally a "*creditor*". Indeed, Wentworth expressly acknowledges that "*beneficial interests in the Client Money Pool crystallise at the time of the primary pooling event*" (W-PP/19.1). On Wentworth's position, it is far from clear what rights a client has before the primary pooling event occurs.

20. The existence of a Parallel Unsecured Claim is inherent in the structure of CASS7. The very phrase "*client money entitlement*" is defined by reference to the phrase "*client equity balance*", which in turn is defined as "*the amount which a firm would*

[3] See the summary of the "*alternative approach*" under CASS7 in *Re LBIE* [2009] EWHC 3228 (Ch) at [7] (Briggs J): "*… client money is both received from and paid out to clients from the firm's house accounts, and internal reconciliations are conducted on every business day so as to top up, or as the case may be reduce, the amount held in segregated accounts by transfers from or to house accounts, so that the aggregate amount segregated is equivalent to the aggregate amount required to be segregated in respect of all qualifying clients*."

be <u>*liable*</u> *... to pay to a client ... if each of his open positions was liquidated*" (emphasis added). The reference to the firm's "*liability to pay [the] client*" is a clear reference to the Parallel Unsecured Claim.

21. At W-PP/9.6, Wentworth states that it cannot be possible to assign a Parallel Unsecured Claim separately from a Client Money Entitlement. This is irrelevant to Issue 5, which is concerned with the logically prior question of whether a Parallel Unsecured Claim exists. In the present application, the Court is not asked to consider whether a Parallel Unsecured Claim or Client Money Claim can be assigned. Neither is the Court asked to consider any issues relating to the Laurifer structure (to which Wentworth and Barclays allude at W-PP/9.6 and B-PP/36 respectively).

22. Some of Wentworth's arguments against the existence of Parallel Unsecured Claims are based on public policy. For example, Wentworth argues that clients should not be allowed to "*arbitrage*" between the Client Money Entitlement and the Parallel Unsecured Claim (W-PP/12.2). This appeal to public policy is misconceived as a matter of principle. The existence of a contractual claim is not determined by considerations of public policy. It is simply determined by the relationship between the client and the investment firm. In any event, there is no public policy against creditors seeking to maximize their returns in an insolvency. Just as a secured creditor can voluntarily surrender its security and prove as an unsecured creditor (see Rule 2.83(2) (*cf*. rule 14.19(2) of the Insolvency (England and Wales) Rules 2016)), a creditor with a Client Money Entitlement can waive that right and pursue its residual contractual Unsecured Claim, in both cases, recovering statutory interest on the proved debt in the event of a surplus.

23. There is nothing in MIFID or CASS7 which supports Wentworth's position. Wentworth makes vague appeals to the "*MIFID regime*" (W-PP/6-7), but does not cite any specific provisions which are inconsistent with the existence of Parallel Unsecured Claims. This is because there are no such provisions. Indeed, the overall scheme of the MIFID regime supports the existence of Parallel Unsecured Claims: see A-PP/35(1).

24. Wentworth criticises the Administrators for failing to justify their argument for the existence of Parallel Unsecured Claims, and states that the Administrators' approach "*begs the question*" (W-PP/10). The Administrators consider that they have provided ample arguments for the existence of Parallel Unsecured Claims in their original position paper and in this reply position paper.

ISSUE 6

To the extent that the answer to Issue 5 is "yes", on what basis is the Parallel Unsecured Claim to be valued?

25. Issue 6 is one of the Disputed Issues. The Administrators have adopted the following position on Issue 6 (see A-PP/41):

    (1) For the purposes of proof, the value of Barclays' Parallel Unsecured Claim falls to be estimated in accordance with Rule 2.81. The estimate made by the Administrators (from time to time) represents the provable amount of the Parallel Unsecured Claim.

    (2) In estimating the value of Barclays' Parallel Unsecured Claim under Rule 2.81, the amount of that claim falls to be reduced by:

        (a) The amount of any actual distributions from the Client Money Pool (regardless of whether such distributions are made before or after the date of the Barclays Proof); and

        (b) The amount of any distributions from the Client Money Pool which are likely to be made in the future.

    (3) If Barclays lawfully waives its Client Money Claim, then any prior distributions from the Client Money Pool, and the consequences of such distributions, will be undisturbed. A waiver has no effect on past distributions, which must continue to be taken into account when valuing Barclays' Unsecured Claim. However, future distributions from the Client Money Pool

(whether actual or anticipated) would not be taken into account when valuing the Unsecured Claim.

(4) The Client Money Claim is to be treated as Barclays' primary claim; the Parallel Unsecured Claim has a secondary status.

26. Wentworth's primary position is that Barclays does not have a Parallel Unsecured Claim, so that Issue 6 does not arise. If that is wrong, then Wentworth broadly concurs with the Administrators' position on Issue 6: see W-PP/14-15. However, Wentworth adds two points with which the Administrators disagree:

(1) Wentworth asserts that even if Barclays waives its Client Money Claim,[4] all actual and anticipated <u>future</u> distributions (after the date of waiver) must continue to be taken into account when valuing Barclays' Unsecured Claim: see W-PP/17.2. The Administrators consider that this proposition is wrong:

(a) If the Client Money Claim is lawfully waived, then that claim no longer exists. In those circumstances, there would be no justification for deducting any future distributions from the Client Money Pool. The logical consequence of waiving a claim is that no further distributions can be made in respect of that claim.

(b) If the Client Money Claim is waived by Barclays, then the Client Money Pool will be distributed to other claimants. Given that Barclays will not share in those distributions, it would be wrong to make any notional deduction from Barclays' Unsecured Claim.

(2) Wentworth seeks to invoke the doctrines of marshalling[5] and exoneration[6] in order to explain why Barclays must have recourse to the Client Money Pool before claiming anything from LBIE's general estate. The Administrators

[4] Wentworth contends that no such waiver is possible: see Issue 7 below. Accordingly, this point only arises if Wentworth is wrong on both Issue 5 and Issue 7.
[5] W-PP/15.4.
[6] W-PP/15.5.

consider that the doctrines of marshalling and exoneration have no application in the present case:

(a) The doctrine of marshalling is exclusively concerned with the enforcement of secured debts: see *Highbury Pension Fund Management Co v Zirfin Investments Ltd* [2014] Ch 359 at [16]-[18]. In *Re MF Global UK Ltd* [2014] 1 WLR 1558 (at [46] and [67]), David Richards J established that the Client Money Entitlement is not to be treated as a form of security, and did not consider attempts to draw analogies between the two concepts helpful. It follows that the doctrine of marshalling does not apply to the Client Money Entitlement.

(b) The doctrine of exoneration is exclusively concerned with the enforcement of guaranteed debts: see *Highbury v Zirfin* [2014] 1 All ER 674 at [19]. In *Re MF Global UK Ltd* [2014] 1 WLR 1558 (at [46] and [66]), David Richards J established that the Client Money Entitlement is not a form of guarantee, and did not consider attempts to draw analogies between the two concepts helpful. It follows that the doctrine of exoneration does not apply to the Client Money Entitlement.

27. Barclays' position is different from that of the Administrators and that of Wentworth. Barclays contends that the value of its Parallel Unsecured Claim should not be "*reduced automatically by the estimated value of the Client Money Claim, in circumstances where a creditor has made no election and retains the right to waive its Client Money Claim*" (B-PP/23). As to this:

(1) The Administrators accept that, once Barclays has duly waived its Client Money Entitlement, the Unsecured Claim can be valued without taking into account any future distributions from the Client Money Pool (whether actual or anticipated).

(2) However, until Barclays effects such a waiver, future distributions from the Client Money Pool (both actual and anticipated) must be taken into account

when valuing the Parallel Unsecured Claim. The default position is that, absent a waiver, Barclays retains its Client Money Entitlement. In order to prevent double-recovery from the Client Money Pool and the general estate, the expected return from the Client Money Pool must be deducted from the Parallel Unsecured Claim.

(3) Prior to the date when Barclays effects a waiver, the Administrators remain under a duty to distribute the assets of LBIE, and LBIE (as client money trustee) remains under a duty to distribute the Client Money Pool. That requires, for the purposes of proof, Barclays' expected return from the Client Money Pool to be automatically deducted from the Parallel Unsecured Claim.

(4) The Administrators do not accept Barclays' suggestion that they have misconstrued the ratio of *Re MF Global UK Ltd* [2014] 1 WLR 1558: see B-PP/21-23.

28. Barclays does not accept that its Client Money Entitlement is to be regarded as the primary claim, and contends that this approach is "*without support*" (B-PP/26). This is not accepted. The primary status of the Client Money Entitlement is inherent in the approach to valuation set out by David Richards J in *Re MF Global UK Ltd* [2014] 1 WLR 1558, which treats the Parallel Unsecured Claim as that which remains after distributions from the Client Money Pool are taken into account (as is the case for any contingent claim).

ISSUE 7

If Barclays has both a Client Money Entitlement and a Parallel Unsecured Claim, is Barclays entitled to elect to pursue the Parallel Unsecured Claim to the exclusion of the Client Money Entitlement?

29. This is one of the Disputed Issues. The Administrators consider that Barclays is entitled to elect to waive the Client Money Entitlement, so that it can exclusively pursue its Unsecured Claim: see A-PP/49-61. Barclays concurs with the Administrators' position: see B-PP/27-33.

30. Wentworth adopts a contrary position. Wentworth contends that:

> "*17.1 Either waiver is precluded altogether by the CASS regime; or*
> *17.2 Alternatively, waiver is permissible but actual and anticipated distributions from the Client Money Pool must still be taken into account in quantifying Barclays' claim, such that it cannot claim more from the general estate as a result of its waiver.*"

31. The "*alternative*" position is not understood. As noted above at paragraph 26(1), if the Client Money Claim is lawfully waived, then that claim no longer exists. In those circumstances, there would be no justification for deducting any future distributions from the Client Money Pool. The logical consequence of waiving a claim is that no further distributions can be made on that claim.

32. Accordingly, the Administrators focus on Wentworth's primary position that waiver is impossible as a matter of law.[7] The Administrators do not accept this proposition. As Wentworth acknowledges, a Client Money Entitlement is a proprietary interest in the Client Money Pool (W-PP/8). The proprietary interest belongs to the relevant client. There is no reason why a client should be unable to give up its own property.

33. Wentworth's arguments in relation to Issue 7 are developed in its position paper under Issue 7(1): see W-PP/17-27. On Wentworth's primary position, however, Issue 7(1) does not, in fact, arise (since Issue 7(1) is predicated on the assumption that waiver is possible).

Wentworth's arguments

34. Wentworth's main argument is that, if waiver were possible, there could be delays in the distribution of the Client Money Pool (W-PP/20). This argument is not persuasive. The possibility of a delay is not a good reason for the Court to conclude that it is impossible, as a matter of law, for Client Money Entitlements to be waived.

[7] This position is, of course, secondary to Wentworth's ultimate position (under Issue 5) that the Parallel Unsecured Claim does not exist at all.

35. Wentworth comments that "*[t]here would have to be a delay while it was determined who was waiving, and to what extent, and who was not*", and that "*there would then have to be one or more recalculations (depending on who waived and when)*" (W-PP/20.1-20.2). These alleged difficulties can be mitigated by making interim distributions from the Client Money Pool which need not be affected by any waivers. If a late waiver occurs, this would simply unlock more funds for distribution to clients who have not waived.

36. Initial distributions from the Client Money Pool can be made to clients on the basis that they are entitled to receive them if they have not waived their Client Money Entitlement. There is no obligation on the trustee of the Client Money Pool to postpone distributions to give clients further time to decide whether or not to waive their Client Money Entitlements. Further, unless and until a client does waive its Client Money Entitlement, the insolvency office holder will, for the purposes of proof, take into account actual and anticipated distributions from the Client Money Pool in estimating the value of the Parallel Unsecured Claim.

37. Wentworth emphasises that the CASS client money trust exists "*for the benefit of a class (namely the firm's clients as a whole)*": see W-PP/22.2. The Administrators agree: but it does not lead to the conclusion that waiver is impossible. All trusts exist for the benefit of the beneficiaries as a whole; yet an individual beneficiary is entitled to waive its beneficial interest: see *Re Paradise Motor Co* [1968] 1 WLR 1125 at 1141-1444. Waiver merely operates to increase the other beneficiaries' interest in the trust assets.

38. Wentworth suggests that waiver would not be in the public interest (W-PP/22.2-22.3), but struggles to identify precisely what public interest would be undermined by waiver. The complaint is not an argument against the possibility of waiver, but simply a description of the legal consequences that follow from waiver on the facts of this case.

39. Wentworth cites the case of *Graham v Ingelby* (1848) 1 Exch 651. However, far from supporting Wentworth's position, this case undermines it. As Alderson B explained (at 657), "*the advantage given by the statute was intended for the benefit of the party*

suing, and not for the public; and it is evident that a party who has a benefit given him by statute, may waive it if he thinks fit". It is fanciful to suggest that the Client Money Pool exists for the benefit of the public as a whole. The Client Money Pool exists for the benefit of the firm's clients. All clients benefit from the right of waiver, including non-waiving clients (who benefit from an increase in their proportionate share of the Client Money Pool if there would otherwise be a shortfall).

40. Wentworth also cites *National Westminster Bank Ltd. v Halesowen Presswork and Assemblies Ltd* [1972] AC 785 as authority for the proposition that it is impossible to contract out of the insolvency legislation (W-PP/22.1-22.2). However, the Court has subsequently clarified that it is possible for a party to waive its rights under the insolvency legislation by way of consensual subordination: see *Re Maxwell Communications Corp (No. 2)* [1994] 1 BCLC 1; and see also the judgment of the Supreme Court in *Re LBIE (Waterfall I)* [2017] UKSC 38 at [66]. This is analogous to the waiver of a Client Money Entitlement in all material respects.

41. Wentworth does not dispute that it would have been possible for LBI to enter into a title transfer collateral arrangement prior to LBIE's insolvency, so as to prevent any Client Money Entitlement from arising (W-PP/24). That being so, there is no logical reason why Barclays, as LBI's assignee, should be unable to waive its Client Money Entitlement at the present time: see A-PP/58-59.

42. In any event, the Client Money Pool was constituted upon the occurrence of the primary pooling event: see *Re LBIE* [2012] UKSC 6 at [42]. The critical question is whether Barclays can waive its beneficial interest in the Client Money Pool after the primary pooling event has occurred. The Administrators consider that the answer to this question is "yes". After a primary pooling event has occurred, the purpose of CASS7 (viz. to require firms to segregate money for the protection of clients) is complete. A continuing prohibition on waiver would not provide any protection or benefit at all to any of the firm's client money claimants. Wentworth has not identified how any client money claimant would benefit from the prohibition on waiver which it seeks to endorse.

43. True it is that the possibility of waiver would, in the circumstances of LBIE's administration, enable client money claimants to increase the amount of Statutory Interest to which they would otherwise be entitled. However:

(1) Waiver merely enables client money claimants to receive the same amount of Statutory Interest as general unsecured creditors.

(2) Given that client money claimants hold Parallel Unsecured Claims (which is the basic assumption underlying Issue 7), there is no reason why client money claimants should receive less Statutory Interest than other creditors.

(3) In any event, the policy of MIFID is to protect the firm's clients. MIFID is not concerned with the protection of other types of creditors (e.g. holders of subordinated debt, or other non-clients who are entitled to share in the surplus of the firm's estate). Accordingly, when determining whether waiver is possible, the predominant consideration should be the interests of client money claimants.

(4) It would be perverse if the client money protection conferred by CASS7 had a detrimental effect on the financial position of those entitled to such protection.

44. Wentworth's reference to "'*game theory' problems*" (at W-PP/20.3) is not understood. Finally, Wentworth's reference to the legal consequences of a future assignment of the Client Money Entitlement (at W-PP/27) is irrelevant to the present application.

45. Wentworth states (at W-PP/21.2.1) that "*the Client Money Pool and the general estate are subject to statutory trusts, and LBIE does not have the legal power to use property falling within either statutory trust other than for the relevant statutory purposes*". This is true, but irrelevant. A client's decision to waive its Client Money Entitlement plainly does not require LBIE to use the Client Money Pool for any improper purpose. On the contrary, its distribution continues to be governed by the CASS Rules.

46. Wentworth suggests that waiver would involve LBIE "*treat[ing] client money as its own*" (W-PP/21.1.2), and makes the suggestion that waiver would lead to LBIE unlawfully "*acting like a depositary institution*" (W-PP/21.1.3). This argument is misconceived for many reasons. For present purposes, it suffices to note that waiver does not result in any client money leaving the Client Money Pool and being returned to LBIE's ownership. The Client Money Entitlement is waived; but the Client Money Pool itself is unchanged, and falls to be applied in the same statutory order of priority as it did before the waiver.

ISSUE 7(1)

If the answer to Issue 7 is "yes":

(a) Is Barclays required to disclaim, surrender, abandon, assign or take any other step in relation to the Client Money Claim before the Parallel Unsecured Claim can be admitted by the Administrators; (b) If so, is Barclays entitled to disclaim, surrender, abandon, assign or take such other step in relation to the Client Money Claim?

47. The Administrators consider that Barclays is not required to disclaim, surrender, abandon, assign or take any other step in relation to its Client Money Claim before its Parallel Unsecured Claim can be admitted: see A-PP/62. Barclays concurs with the Administrators' position (B-PP/34-36).

48. On Wentworth's primary position, Issue 7(1) does not arise and therefore is not addressed directly.[8]

49. Accordingly, the Administrators invite the parties to adopt an agreed position on Issue 7(1) on the terms set out above. This is without prejudice to Issue 6, which will determine the correct approach to valuation.

[8] As noted above, Wentworth has addressed Issue 7(1) as part of Issue 7.

ISSUE 7(2)

If the answer to Issue 7 is "yes":

If the value of the Parallel Unsecured Claim is impacted by the Client Money Entitlement, prior to the Client Money Pool being distributed are the Administrators entitled and/or obliged (a) to admit the Parallel Unsecured Claim; and/or (b) to pay a dividend in respect of the Parallel Unsecured Claim? If so, in each case, to what extent should the Client Money Entitlement be taken into account when admitting or paying a dividend in respect of the Parallel Unsecured Claim?

50. As to the first question raised by Issue 7(2), the Administrators consider that they are entitled to admit the Parallel Unsecured Claim for dividend (and pay dividends on the admitted amount) prior to the Client Money Pool being distributed: see A-PP/66(1). Barclays concurs with this position (B-PP/38).

51. Assuming that waiver is possible, it appears that Wentworth does not dissent from the position formulated by the Administrators (although it considers the issue to be "*essentially procedural*"): see W-PP/28.

52. The second question raised by Issue 7(2) effectively replicates Issue 6. Accordingly, the Administrators invite the parties to adopt the following agreed position on Issue 7(2):

    (1) The answer to the first question raised by Issue 7(2) is that given by the Administrators at A-PP/66(1).

    (2) The answer to the second sentence raised by Issue 7(2) is determined by the answer to Issue 6.

ISSUE 7(3)

If the answer to Issue 7 is "yes":

If the Parallel Unsecured Claim should not be admitted until a particular time or event, what interim steps (if any) are the Administrators entitled and/or obliged to take to make a provision for the Parallel Unsecured Claim?

53. The Administrators consider that Issue 7(3) does not arise (because it is not the case that the Parallel Unsecured Claim should not be admitted until a particular time or event): see A-PP/69. Barclays concurs: see B-PP/41.

54. Assuming that waiver is possible, it appears that Wentworth does not dissent from the position formulated by the Administrators (although it considers the issue to be "*essentially procedural*"): see W-PP/28.

55. Accordingly, the Administrators invite the parties to adopt an agreed position that Issue 7(3) does not arise (because there is no particular time or event which must occur before the Parallel Unsecured Claim can or should be admitted).

ISSUE 7(4)

If the answer to Issue 7 is "yes":

If the Parallel Unsecured Claim may be admitted but no dividend(s) may be paid in relation thereto until a particular time or event, what interim steps (if any) are the Administrators entitled and/or obliged to take to make a provision for the Parallel Unsecured Claim?

56. The Administrators consider that Issue 7(4) does not arise (because it is not the case that dividends should be withheld on the Parallel Unsecured Claim until a particular time or event): see A-PP/70. Barclays concurs: see B-PP/41.

57. Assuming that waiver is possible, it appears that Wentworth does not dissent from the position formulated by the Administrators (although it considers the issue to be "*essentially procedural*"): see W-PP/28.

58. Accordingly, the Administrators invite the parties to adopt an agreed position that Issue 7(4) does not arise (because, once admitted, there is no particular time or event which must occur before dividends can be paid in respect of the Parallel Unsecured Claim).

ISSUE 8

If Barclays is not entitled to elect to pursue the Parallel Unsecured Claim to the exclusion of the Client Money Entitlement:

(1) Are the Administrators entitled and/or obliged to admit any Unsecured Claim prior to the Client Money Pool being distributed? If so, to what extent should the Client Money Entitlement be taken into account when admitting the Unsecured Claim?

(2) If any Unsecured Claim should not be admitted until a particular time or event, what interim steps (if any) are the Administrators entitled and/or obliged to take to provide for the Unsecured Claim?

59. The Administrators' primary position is that Issue 8 does not arise, since Barclays is entitled to elect to pursue the Parallel Unsecured Claim to the exclusion of its remaining Client Money Entitlement (if any, and assuming it waives its Client Money Claim prior to receiving any Client Money). If Issue 8 arises, the Administrators' position is as follows (A-PP/72):

(1) The Administrators are entitled to admit the Parallel Unsecured Claim for dividend (and pay dividends on the admitted amount) prior to the Client Money Pool being distributed;

(2) There is no particular time or event which must occur before any Unsecured Claim can be admitted for dividend; and

(3) As above, the Administrators consider that the valuation of the Parallel Unsecured Claim in these circumstances falls to be determined in accordance with Issue 6.

60. Barclays contends that Issue 8 does not arise: see B-PP/43. As such, Barclays makes no comment on Issue 8 at this stage (but reserves its rights to do so in future), other than to note that the decision in *Re MF Global UK Ltd (No 4)* [2014] 1 WLR 1558 (Ch) supports the view that there is no required order in which the Administrators must admit proofs or distribute the Client Money Pool: see B-PP/44.

61. Wentworth contends that, although Issue 8 arises, it is an "*essentially procedural*" question: see W-PP/29. Wentworth offers the following comment (W-PP/29.1):

> "*A circumstance in which a client has as a matter of principle a Parallel Unsecured Claim, but is not entitled to pursue it to the exclusion of its Client Money Entitlement, is functionally equivalent to a situation where a client has no Parallel Unsecured Claim but has a Shortfall Unsecured Claim*."

62. This is wrong. Even if the Client Money Entitlement cannot be waived, the Parallel Unsecured Claim would still exist. Moreover, a Parallel Unsecured Claim could have a value above that of the Client Money Entitlement (e.g. due to the effect of hindsight) although, for the purposes of proof, its estimated value would take into account actual and anticipated distributions from the Client Money Pool. Such a scenario would not be "*functionally equivalent to the situation where a client has no Parallel Unsecured Claim but has a Shortfall Unsecured Claim*".

63. The Administrators invite the parties to agree that the Administrators' position on Issue 8 is correct. This is without prejudice to Issue 6, which will determine the correct approach to valuation.

64. For the avoidance of doubt, the Administrators do not agree with Barclays' contention (at B-PP/45) that Issue 8 may require the Court to review the Administrators' treatment of other creditors. The basis for this contention is not understood. Issue 8 is a narrow and, as Wentworth puts it, essentially procedural point of law.

Part B

The effect of set-off on Barclays' claims

ISSUE 3

If Barclays has a Client Money Entitlement and a Parallel Unsecured Claim, and the Parallel Unsecured Claim is reduced by any set-off (whether under Rule 2.85 or otherwise), does the Client Money Entitlement fall to be reduced by the same (or any other) amount?

65. Issue 3 is one of the Disputed Issues. The Administrators contend that the answer to Issue 3 is "no": see A-PP/13-23. Wentworth contends that the answer to Issue 3 is "yes": see W-PP/38-41. Barclays states that, as a result of their position in respect of Issue 9, Issue 3 does not arise: see B-PP/135.

66. Wentworth argues that it would be unjust if a client could benefit from a set-off of its Parallel Unsecured Claim (so as to reduce the creditor's liabilities to LBIE) whilst simultaneously claiming the full amount of its Client Money Entitlement: see W-PP/39-40. As to this:

(1) The supposed injustice contemplated by Wentworth cannot arise. If a client has both a Parallel Unsecured Claim and a Client Money Entitlement (and has waived neither), then actual and anticipated distributions from the Client Money Pool fall to be deducted from the provable amount of the Parallel Unsecured Claim: see Issue 6 above. Accordingly, the client would only

benefit from a set-off of the Parallel Unsecured Claim (thereby reducing the client's liabilities to LBIE) to the extent that the value of the Parallel Unsecured Claim exceeds the quantum of actual and anticipated distributions from the Client Money Pool. It follows that there is no risk of the client being "*unjustly enriched*".[9]

(2) In any event, it cannot be unjust for a client to claim monies in the Client Money Pool which beneficially belong to the client itself. Nor is it unjust for a client to benefit from a mandatory set-off under the statutory insolvency scheme. Accordingly, there is no unjust enrichment, and no basis for any restitutionary claim.

(3) Wentworth is wrong to suggest that a Client Money Claim could be the subject of a "*legal set-off*" (W-PP/40). As Wentworth repeatedly emphasises, a Client Money Claim is a proprietary beneficial interest in the Client Money Pool. Proprietary claims cannot be subject to set-off: see *Re Pollitt* [1893] 1 KB 455.

67. The Administrators do not have anything to add to the arguments set out in A-PP/13-23, to which Wentworth has not responded in its position paper.

ISSUE 9

If Barclays has an Unsecured Claim (whether a Parallel Unsecured Claim, a Shortfall Unsecured Claim or any other Unsecured Claim):

(1) Is such Unsecured Claim subject to a mandatory set-off under Rule 2.85 against any sums owing by LBI to LBIE?

68. Issue 9(1) is one of the Disputed Issues. The Administrators consider that none of the Unsecured Claims held by Barclays is affected by or subject to any form of set-off

[9] It should be noted that Wentworth's argument potentially engages Issue 7(5). (Issue 7(5) asks whether a distribution from LBIE's general estate on a Parallel Unsecured Claim would operate to reduce the corresponding Client Money Entitlement.) Issue 7(5) has been stayed, and will not be considered by the Court at this stage.

under Rule 2.85: see A-PP/73-95. Barclays concurs with the Administrators' position: see B-PP/133. By contrast, Wentworth contends that any sums owing by LBI to LBIE (as at the date of administration) are subject to a mandatory set-off under Rule 2.85 against any Unsecured Claim assigned to Barclays: see W-PP/30-36.

69. The basic question for the Court to determine is whether set-off under Rule 2.85 takes effect on the date of the 2.95 Notice or retroactively on the date of the administration.

70. Wentworth asserts that "*the discharge or satisfaction of a claim by way of set-off operates retroactively, taking effect from the date of administration*" (W-PP/34.1). This assertion is inconsistent with the recent analysis of the Supreme Court in *Re LBIE (Waterfall I)* [2017] UKSC 38 at [25], where Lord Neuberger stated:

> "*Rule 2.85 provides for mutual credits and set-off of debts as at the date that the administrator gives notice that he proposes to make a distribution, and such a notice is provided for in rule 2.95. Rule 2.85(3) read together with rule 2.85(2) provides that, as at the date on which an administrator gives notice of his intention to make a distribution, there should be a set-off in respect of what is owing 'between the company and any [proving] creditor of the company' in respect of 'mutual dealings' between them.*" (emphasis added)

71. While it is right to acknowledge that the alleged retroactivity of set-off was not argued before the Supreme Court, Lord Neuberger's comments are clearly inconsistent with the position adopted by Wentworth in its position paper. Accordingly, the Administrators invite Wentworth to withdraw its position on Issue 9(1).

72. Wentworth makes a number of critical remarks about the Administrators' position, but these remarks are based on a misunderstanding of the issues.

73. For example, Wentworth states that the Administrators' position entails that "*LBI could, after the commencement of insolvency proceedings, by assignment improve the recovery in respect of its claim at the expense of other creditors*" (W-PP/34.4). As to this:

(1) The Administrators' position is that set-off does not take effect until the date of the 2.95 Notice.

(2) A logical consequence of this position is that, if a creditor assigns its claim between the date of administration and the date of the 2.95 Notice, the assignment may prevent a set-off from arising.

(3) There is nothing unfair in this result, which simply follows from the way in which the statutory scheme has been designed. Since the company may continue to trade between the date of administration and the date of the 2.95 Notice, the draftsman plainly contemplated that rights of set-off would not crystallise until the latter date.

74. Likewise, Wentworth effectively states that the Administrators' position would involve the "*resurrect[ion]*" of a claim which had previously been "*extinguished*" by way of set-off (W-PP/34.3). This is wrong. The Administrators have never suggested that LBI's claim was extinguished by set-off and subsequently resurrected upon its assignment to Barclays. Rather, the Administrators' position is that LBI's claim was never extinguished by set-off (because set-off does not take effect until the date of the 2.95 Notice). Accordingly, the claim continued to subsist at the time of the assignment.

75. The Administrators do not consider that Wentworth has provided a viable answer to the points regarding the LBI/LBIE Settlement at A-PP/91-95.

76. Wentworth's argument for retroactivity is based primarily on the Waterfall II Supplemental Issues Judgment. It should be noted that the alleged retroactivity of set-off was the subject of a sustained debate in the Court of Appeal during the hearing of the Waterfall II appeal. Patten LJ questioned why relevant authorities on the topic, including *Revenue and Customs Commissioners v Football League Ltd* [2012] Bus LR 1539, had not been drawn to the attention of David Richards J.[10] As counsel

[10] See the transcript of Day 5, Page 36, Lines 11 to 25. As to the significance of the *Football League* case, see A-PP/77-79.

explained during the hearing, the reason was that David Richards J's retroactivity analysis was his own, and was not tested in oral argument.

77. It is highly unlikely that the Court of Appeal will ever give judgment on this particular part of the Waterfall II appeal (since the underlying issue was predicated on the existence of currency conversion claims, which the Supreme Court has held not to exist).[11] To the extent that the Waterfall II Supplemental Issues Judgment supports the view that set-off takes effect retroactively on the date of administration, the Administrators will argue that the judgment is wrong and should not be followed.

(2) Is such Unsecured Claim subject to a mandatory set-off under Rule 2.85 against any sums owing by Barclays to LBIE?

78. The Administrators and Barclays agree that the answer to Issue 9(2) is "no": see A-PP/96-97 and B-PP/133. Wentworth's position is as follows (see W-PP/36):

> "*Wentworth is currently unaware of whether other sums are owed by Barclays to LBIE. If there are, then they are capable of being the subject matter of a set-off.*"

79. The Administrators hereby confirm that no sums were owing by Barclays to LBIE at the date of administration or the date of the 2.95 Notice. Accordingly, the Administrators invite the parties to adopt an agreed position that Issue 9(2) does not arise.

(3) Does LBIE have an equitable right to set off such Unsecured Claim against any sums owing by Barclays and/or LBI to LBIE?

80. Issue 9(3) is one of the Disputed Issues. The Administrators contend that LBIE does not have any rights of equitable set-off: see A-PP/98-105. Barclays concurs with the Administrators' position: see B-PP/133. By contrast, Wentworth asserts that LBIE has an equitable right to set off Barclays' Unsecured Claim(s) against any sums owing by LBI to LBIE: see W-PP/33.

[11] *Re LBIE (Waterfall I)* [2017] UKSC 38.

81. The Administrators do not consider that Wentworth has provided a viable answer to the points made in A-PP/98-105 and have nothing to add to the Administrators' original position paper on this Issue.

(4) Does LBIE have a common law right to set off such Unsecured Claim against any sums owing by Barclays and/or LBI to LBIE?

82. The Administrators and Barclays agree that the answer to Issue 9(4) is "no": see A-PP/106-109 and B-PP/133. Wentworth does not have an express position on Issue 9(4), but places no reliance on the doctrine of common law set-off. That being so, the Administrators invite the parties to adopt an agreed position that the answer to Issue 9(4) is "no".

Part C
Admission of the Barclays Proof

ISSUE 10

In what manner, and from what date, does the LBI Payment fall to be applied towards the discharge or reduction of:

(1) Barclays' Client Money Entitlement (if any);

(2) Barclays' Unsecured Claim(s) in respect of the ETD Trades (if any); and/or

(3) Barclays' other claims (if any)?

83. Issue 10 is one of the Disputed Issues. The Administrators' position is set out in A-PP/110-133. In summary:

(1) The Administrators' primary position is that the entire amount of the LBI Payment was applied towards the reduction of Barclays' Client Money Entitlement in respect of the ETD Trades by USD 777m with effect from the date of the LBI Payment. As a result, Barclays' Parallel Unsecured Claim was reduced in like amount.

(2) Alternatively, if Barclays had a Client Money Entitlement of less than USD 777m in respect of the ETD Trades, then the Administrators adopt the following analysis:

(a) The LBI Payment extinguished Barclays' Client Money Entitlement in respect of the ETD Trades (being an amount less than USD 777m), and thereby reduced Barclays' Parallel Unsecured Claim in like amount.

(b) Barclays' remaining Unsecured Claim in respect of the ETD Trades was further reduced up to the full amount of the LBI Payment, resulting in a total reduction of USD 777m from Barclays' Unsecured Claim in respect of the ETD Trades.

84. Wentworth concurs with the Administrators' position (assuming a Parallel Unsecured Claim exists): see W-PP/42-45.

85. Barclays adopts a contrary analysis. Barclays asserts that it is entitled to elect how the LBI Payment is to be allocated (as between its Client Money Entitlement and Parallel Unsecured Claim), and that no such election has been made at the present time: see B-PP/46-62.

86. The Administrators do not accept Barclays' arguments. The Administrators consider that Barclays has already chosen voluntarily to receive the LBI Payment in accordance with the terms of the June 2015 Order, the LBI/LBIE Settlement and the LBI/ Barclays Settlement, and that, as a matter of law, that receipt has reduced the Client Money Entitlement (and the Parallel Unsecured Claim).

87. If Barclays' position were correct, then it would follow that the LBI Payment has not yet discharged any of Barclays' claims. Such discharge would only take effect upon an election by Barclays at some uncertain time in the future. This analysis is inconsistent with the language of the June 2015 Order, which states:

> "*Barclays consents and agrees that <u>upon payment by the [trustee of LBI] of the $777,000,000</u>, (i) the maximum aggregate undischarged liability of [LBIE] and/or the trustee of the UK statutory trust of client money arising under*

CASS 7 in relation to LBIE (including the LBIE Client Money Trustee) to [Barclays], with respect to the Barclays LBIE ETD Claims shall automatically, unconditionally and irrevocably be reduced by $777,000,000 and (ii) Barclays hereby releases LBIE (including the LBIE Client Money Trustee) with respect to the Barclays LBIE ETD Claims in such amount." (emphasis added)

88. As the underlined words demonstrate, Barclays has already voluntarily chosen to receive the LBI Payment, thereby discharging (in part) its Client Money Entitlement. This "*reduction*" took place "*upon payment*", and was "*automatic*", "*unconditional*" and "*irrevocable*". Moreover, Barclays' rights against the "*LBIE Client Money Trustee*" were expressly "*included*" within the scope of the discharge. On this language, it is impossible to understand how Barclays could, at some indeterminate time in the future, make a unilateral election which operates to prevent the LBI Payment from discharging its Client Money Entitlement.

89. Barclays seeks to rely on the reference to "*the maximum aggregate undischarged liability of [LBIE] and/or the trustee of the UK statutory trust of client money*" to argue that "*no one specific liability of LBIE and/or the trustee was reduced*": see B-PP/53(b). However, in light of the underlined language set out above, this argument is unsustainable. The words "*and/or*" do not confer a right of appropriation on Barclays, but simply reflect the uncertainty (at the time of the settlement) as to whether Barclays had a Client Money Entitlement and/or an Unsecured Claim. To the extent that Barclays has a Client Money Entitlement, the draftsman plainly intended that it would be discharged to the extent of the LBI Payment.

90. Barclays intends to rely on expert evidence of New York law in order to establish that the Administrators' analysis "*violates ... well-established principles of contract law of the State of New York*": see B-PP/55. The Administrators note that the parties' experts are not competent to comment on the construction of specific documents, but merely to provide guidance on the principles of construction under New York law: see *King v Brandywise Reinsurance Co* [2005] 2 All ER (Comm) 1 at [68].

91. Barclays seeks to argue that the Administrators' construction of the June 2015 Order is inconsistent with their treatment of other creditors: see B-PP/59-62. However, the June 2015 Order is a bespoke arrangement which must be considered on its own

terms. Accordingly, Barclays' attempts to rely on the Administrators' treatment of other creditors is misplaced. The terms of the CDDs and CMSDs which the Administrators entered into with other creditors are irrelevant to the construction of the June 2015 Order and, in any case, the comparative treatment of other creditors is not relevant to the present Application. Barclays agreed with LBI to take the LBI Payment on the terms of the June 2015 Order. This was a voluntary choice by Barclays (based on sophisticated legal advice) which was intended to promote its own commercial interests.

ISSUE 11

Rule 2.72(3)(b)(ii) provides that a proof of debt must state "*the total amount of [the creditor's] claim as at the date on which the company entered administration, less any payments that have been made to [the creditor] after that date in respect of [the creditor's] claim …*" On the true construction of the latter provision, does the LBI Payment, or any part thereof, constitute a payment in respect of Barclays' claim within the scope of Rule 2.72(3)(b)(ii)?

92. Issue 11 is one of the Disputed Issues. In summary, the Administrators consider that any payment received by a creditor from a third party (not being a surety) towards the discharge of the debt must be deducted from the creditor's proof, regardless of the date when the payment was made: see A-PP/134-167.[12]

93. The Administrators and Wentworth are aligned on the answer to Issue 11. The Administrators concur with the further arguments advanced by Wentworth in W-PP/46-53.

94. Barclays adopts a contrary analysis: see B-PP/63-80. But it appears that Barclays' position is internally inconsistent:

[12] Payments by sureties may require a different treatment, in light of the Guarantee Cases. The Administrators consider that there is no need for the Court to determine which of the Guarantee Cases remain good law, since there is no relation of suretyship between Barclays and LBI. However, to the extent necessary, the Administrators will argue that some or all of the Guarantee Cases should not be followed: see A-PP/167.

(1) Barclays appears to accept that a proof must be reduced by the amount of any payments made by third parties "*in respect of [the creditor's] claim*" between the date of administration and the date of proof: see B-PP/67. This proposition follows from the plain language of Rule 2.72(3)(b)(ii), and should be uncontroversial.

(2) However, Barclays goes on to endorse a contradictory proposition (B-PP/77):

> "*It is also established law that where a creditor receives only part payment from a surety or a third party in respect of the debtor's liability, this sum should not be deducted by the creditor from the amount of his proof, regardless of the time at which the creditor received the payment (whether before or after bankruptcy or before or after proof)*." (emphasis added)

(3) Barclays makes no attempt to explain how the inconsistency in its position can be reconciled, or how the purportedly "*established*" rule quoted above is consistent with Rule 2.72(3)(b)(ii).

95. The Administrators do not understand whether, on Barclays' position, the LBI Payment would have fallen to be deducted from the Barclays Proof if it had been made (i) prior to the date of administration or (ii) after the date of administration but prior to the date of proof.

96. For the avoidance of doubt, the Administrators do not accept the arguments put forward by Barclays at B-PP/63-80. As the Administrators have explained, there is a fundamental distinction between a payment made by a surety and a payment made by a mere third party: see A-PP/163. The Administrators note that Barclays has not sought to provide a detailed response to this argument in its position paper.

97. The Administrators' position (viz. that any payment received by a creditor from a third party (other than a surety) towards the discharge of the debt must be deducted from the creditor's proof regardless of the date when the payment was made) is directly supported by the decision of the Privy Council in *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147. In that case, Lord Hoffmann held that a liquidator was right to reject a proof where the debt had been repaid after the proof was submitted.

98. Barclays attempts to distinguish *Wight v Eckhardt* on the basis that the relevant debt was fully repaid rather than partially repaid (as in the present case): see B-PP/79. However, this is a distinction without a difference. It appears that Barclays accepts, on the basis of *Wight v Eckhardt*, that a proof must be rejected if the debt is repaid in full after the proof is submitted. Yet if the debt is partly repaid by 99p in the £ after the proof is submitted, Barclays apparently considers that the proof should be admitted without any deduction for the partial repayment. This position is unsustainable.

99. In support of its position, Barclays seeks to rely on various passages from *Re Amalgamated Investment and Property Co Ltd* [1985] Ch 349: see B-PP/71-73. To the extent that those passages are inconsistent with the reasoning of Lord Hoffmann in *Wight v Eckhardt*, the Administrators will argue that they should not be followed: see A-PP/167.

100. Barclays also seeks to rely on considerations of "*public policy*": see B-PP/80. It is submitted that considerations of public policy are unlikely to provide any real assistance to the Court in resolving the complex questions of statutory interpretation and contractual construction which arise in the present case. In any event, the Administrators' position does not operate to discourage creditors from accepting payments from third parties. Accepting such a payment simply means that the creditor's proof must be reduced, just as a creditor's proof would be modified upon the realisation of security: see Rule 2.94. Barclays should not be allowed to reverse-engineer an entitlement to Statutory Interest by misapplying the law on the admission of proofs. Further, Barclays' own position gives rise to arbitrary results which would be contrary to public policy (e.g. that the impact of a third party payment on the amount of the creditor's proof, and the consequential effects on the creditor's entitlement to Statutory Interest, would depend on the precise timing of the relevant payment).

ISSUE 12

Are the Administrators entitled and/or obliged to admit the Barclays Proof for a reduced amount deducting an amount in respect of the LBI Payment (or any part thereof)?

101. Issue 12 is one of the Disputed Issues. The Administrators consider that the LBI Payment must be taken into account for the purposes of valuing and admitting the Barclays Proof. Wentworth concurs with the Administrators' position.

102. Barclays contends that the LBI Payment should not be taken into account for the purposes of valuing and admitting the Barclays Proof. Barclays makes a number of points in support of its position on Issue 12 (see B-PP/81-94), but most of these points arise *mutatis mutandis* under Issue 18 (and will be dealt with under that heading).

103. The Administrators do not consider that Issue 12 is the right place for Barclays to advance arguments in relation to estoppel, *Ex Parte James* and paragraph 74. The purpose of Issue 12 is to determine whether, under the general law, the LBI Payment falls to be deducted from the Barclays Proof. There are only two Issues which deal with estoppel, *Ex Parte James* and paragraph 74: Issue 7A (which has been stayed) and Issue 18.

104. In support of its position on Issue 12, Barclays denies that the primary purpose of admitting a proof is to pay dividends on the admitted amount. Barclays notes that a proof can be admitted to enable voting in creditors' meetings (B-PP/85). As to this:

(1) It is true that the amount for which a proof is admitted determines the creditor's voting rights at meetings.

(2) However, far from supporting Barclays' position, this merely demonstrates why Barclays' position cannot be correct. It would be absurd if a creditor could continue to exercise voting rights reflecting the full amount of its proof in circumstances where the creditor had received a payment of 99p in the £ from a third party after the proof was submitted. Yet this is what Barclays' position entails.

105. Barclays also notes that there are cases (such as *Re Sass* [1896] 2 QB 12) in which a creditor has been allowed to prove for the full amount of the debt without deducting a part-payment made by a surety: see B-PP/85. However, this doctrine has no application outside the special context of suretyship, where the creditor's proof represents both the principal debt and the surety's right of indemnity: see A-PP/163.

ISSUE 13

Does (i) the creation of the Dedicated Reserve; and/or (ii) the LBI Payment; and/or (iii) the Administrators' consent thereto; and/or (iv) any other action relating to the creation of the Dedicated Reserve and payment therefrom, itself constitute (a) an admission to proof; and/or (b) payment of a dividend by the Administrators of part of the Barclays Proof in an amount equal to such payment?

106. Issue 13 is one of the Disputed Issues. It was included in the application at Barclays' request. The Administrators consider that the Barclays Proof has never been admitted in part or in full at any time, and no dividend has ever been paid in respect of the Barclays Proof: see A-PP/169-180. Wentworth concurs with the Administrators' position.

107. In contrast, Barclays argues for the following proposition (B-PP/98):

> "*... in the event that [Barclays] elects to pursue its Unsecured Claim, the Court should deem the Administrators' actions as constituting an admission of at least the amount of the LBI Payment.*"

108. This proposition is obscure in a number of respects:

(1) Either the Administrators have admitted the Barclays Proof (up to the amount of the LBI Payment) or they have not. There is no third option.

(2) For the reasons set out in A-PP/169-180, the Administrators have not admitted any part of the Barclays Proof at the present time.

(3) Barclays appears to accept that the Administrators have not actually admitted any part of the Barclays Proof. However, Barclays suggests that the Court should "*deem*" that the Barclays Proof has been admitted up to the amount of the LBI Payment.

(4) It is wholly unclear what "*deeming*" means in this context, or from where the Court derives its power to "*deem*" that a proof has been admitted. The question of whether a proof has been admitted is a matter of fact. The Court may direct the Administrators to admit a particular proof for a particular sum, but this is very different from deeming that a proof has been admitted.

(5) Barclays states that the Administrators' "*actions*" should be deemed to "*constitute*" an admission of the Barclays Proof. However, Barclays fails properly to particularise the actions of the Administrators which should be so deemed.

(6) Moreover, Barclays appears to suggest that the Court should only "*deem*" that the Barclays Proof has been admitted "*in the event that Barclays elects to pursue its Unsecured Claim*". It is apparently suggested that the Court should retrospectively deem that the Barclays Proof has been admitted if, and only if, Barclays decides (at some uncertain point in the future) to elect to pursue its Unsecured Claim.

(7) No authority is cited in support of this approach. Barclays' argument on Issue 13 is developed within the space of a single paragraph.

ISSUE 14

If the Barclays Proof should be admitted without deducting an amount in respect of the LBI Payment (or any part thereof), are the Administrators entitled and/or obliged to give credit for the Sterling Equivalent of the LBI Payment (or any part thereof) when paying dividends in respect of the Barclays Proof?

109. The Administrators consider that Issue 14 does not arise (given that the LBI Payment should be deducted from the Barclays Proof): see A-PP/181. Wentworth concurs with the Administrators' position: see W-PP/58.

110. However, all of the parties agree that, regardless of the amount for which the Barclays Proof is ultimately admitted, Barclays is not entitled to recover more than 100p in the £ (taking into account the LBI Payment and any dividends received from the general estate of LBIE).

111. Accordingly, the Administrators invite the parties to adopt an agreed position on Issue 14 on the terms set out above.

112. Without prejudice to the foregoing, the Administrators consider that the burden falls on Barclays to explain how it is possible, as a matter of law, for an office-holder to pay dividends on a sum other than the amount admitted for dividend: see A-PP/181-190. This is necessary in order for Barclays to be correct on Issues 11 and 12.

Part D
Barclays' claim to Statutory Interest

ISSUE 17

On the true construction of Rule 2.88(7), if the Barclays Proof should be admitted for a reduced amount by deducting an amount in respect of the LBI Payment (or any part thereof), is the debt on which Statutory Interest is payable: (i) the amount admitted to proof; or (ii) the amount that would have been admitted to proof but for such deduction?

113. Issue 17 is one of the Disputed Issues. It arises if the Administrators are correct on Issues 11 and 12, such that the LBI Payment should be deducted from the Barclays Proof. In those circumstances, Issue 17 asks whether Statutory Interest is capable of being paid on some amount other than the amount admitted for dividend. This would enable Barclays to receive Statutory Interest on the amount of the LBI Payment.

114. It is common ground that the answer to Issue 17 depends on the principles of statutory construction as applied to Rule 2.88(7).

115. The Administrators consider that Statutory Interest is payable only on the amount of the Barclays Proof which is (i) admitted for dividend and (ii) paid in the administration of LBIE by distributions from the general estate. Accordingly, Barclays cannot receive Statutory Interest on the amount of the LBI Payment. Wentworth concurs with the Administrators' position.

116. Barclays adopts a different analysis. According to Barclays, Statutory Interest is payable on "*debts eligible for and submitted for proof in relation to which payment has been received*" (including debts paid, in part or in full, by third parties): see B-PP/103.

117. Barclays does not explain the meaning of the words "*eligible for proof*". On one natural interpretation, a debt is "*eligible for proof*" if the debt is admitted for dividend. However, this cannot be the correct interpretation of Barclays' analysis, since it would mean that Barclays' position is no different from the Administrators' position.

118. Rather, Barclays contends that Statutory Interest is payable on any sum submitted for proof for which payment has been received during the administration (whether from LBIE's general estate or from third parties such as LBI), even if part of the proof is rejected by the Administrators in due course.

<u>Difficulties for Barclays' analysis</u>

119. Barclays' construction of Rule 2.88(7) fails, in some scenarios, to calculate the correct amount of Statutory Interest.

120. By way of example, assume that a creditor submits a proof for £1,000. Upon investigation, the Administrators reach the conclusion that only £200 of the claim should be admitted for dividend. This could be for any number of reasons – e.g. there may be a dispute as to the terms of the underlying contract; or 80% of the claim may

rank as an expense of the administration; or 80% of the claim may rank as a non-provable liability. Whatever the explanation, it is clear that the creditor should only receive Statutory Interest on the principal amount of £200 rather than the original face value of the proof.

121. It is possible that the creditor could subsequently recover the remaining £800 from a third party (e.g. a guarantor or a co-obligor), who may be persuaded that the creditor is in fact owed the full amount of £1,000. Clearly, however, this would not enable the creditor to obtain Statutory Interest on the full face value of the proof. If the Administrators determine that the creditor's proof is excessive, interest cannot be paid on the rejected part of the proof.

122. Barclays' analysis runs into insuperable difficulties on this point. It is inherent in Barclays' position that Statutory Interest can be paid on the full face value of a proof which is partly rejected. Barclays seeks to mitigate this problem by restricting Statutory Interest to proofs which are actually paid: See B-PP/106(g):

> "*... there is no risk of unmeritorious proofs receiving Statutory Interest, since payments would not be made on unjustifiable or questionable proofs, and accordingly no Statutory Interest would become payable.*"

123. This analysis is unable to account for the example described above (where the creditor proves for £1,000, the Administrators admit the proof for only £200, and the creditor subsequently recovers the balance of £800 from a third party who is persuaded that the creditor is owed the full amount of £1,000). In that example, Barclays' analysis would award Statutory Interest on the principal sum of £1,000 rather than £200. This result is plainly wrong.[13]

124. The basic problem is that Barclays' analysis permits Statutory Interest on proofs paid by third parties (see B-PP/108), regardless of the amount admitted for dividend by the Administrators. This means that third parties can effectively dictate the amount of

[13] The Administrators recognise that the example described in this paragraph is different, in various respects, from the facts of the present case. However, the example demonstrates the difficulties that would arise if Barclays' analysis of Rule 2.88(7) were correct.

Statutory Interest which a creditor is entitled to receive, by choosing to pay claims which the Administrators have rejected.

125. By contrast, the Administrators' position provides a straightforward way of calculating Statutory Interest on excessive proofs. On the Administrators' analysis, Statutory Interest is payable only on the amount of the proof which is admitted for dividend and paid in the administration. No Statutory Interest is payable on sums which are submitted for proof but which are rejected for dividend.

126. The Administrators' analysis is supported by the judgment in *Waterfall IIA* (see *Re LBIE* [2016] Bus LR 17 at [204]-[208]), where David Richards J expressly stated that the reference to "*the debts proved*" in Rule 2.88(7) "*can only be, in my view, a reference to the debts <u>as admitted to proof</u>*" (emphasis added). The Administrators do not consider that *Waterfall IIA* can be distinguished on the grounds suggested by Barclays or at all.[14]

127. The Administrators concur with Wentworth's comments on the purpose of Rule 2.88(7) in W-PP/61.

ISSUE 18

If the Administrators admit the Barclays Proof for a reduced amount by deducting an amount in respect of the LBI Payment (or any part thereof):

(1) Should the Administrators be directed under the rule in *Re Condon; ex p. James* (1873-74) LR 9 Ch App 609; and/or

(2) Should the Administrators be directed under paragraph 74 of Schedule B1; and/or

(3) Are the Administrators estopped from refusing to pay Statutory Interest on some amount other than the sum admitted to proof? If so, how should such amount be calculated, and from what date should Statutory Interest be paid thereon?

[14] For Barclays' attempt to distinguish *Waterfall IIA*, see B-PP/107.

128. Issue 18 is one of the Disputed Issues. The Administrators consider that the Court has no jurisdiction to order them to pay Statutory Interest on any amount other than the sum admitted for dividend in respect of the Barclays Proof. Neither the rule in *Ex parte James*, paragraph 74 of Schedule B1 nor any concept of estoppel confers jurisdiction on the Court to modify the statutory scheme for the payment of Statutory Interest. Even if the Court had such a power, there would be no basis for exercising it in the present case: see A-PP/222-238. Wentworth concurs with the Administrators' position: see W-PP/64.

129. By contrast, Barclays asserts that the Court has jurisdiction, and the tests are satisfied, to direct the Administrators under the rule in *Ex parte James* and/or paragraph 74 of Schedule B1 to pay Statutory Interest on the full value of Barclays' claim against LBIE: see B-PP/114. Alternatively, Barclays contends that the Administrators are estopped from refusing to pay Statutory Interest on the full Barclays Proof: see B-PP/115-123.

Jurisdiction

130. The Administrators rely, *inter alia*, on the statement of Lord Neuberger in *Re Nortel GmbH* [2014] AC 209 at [123] that "*none of [the authorities] begins to justify the contention that an administrator can be ordered to change the ranking of a particular debt simply because the statutory ranking appears unattractive … the Court cannot sanction a course which would be outside an administrator's statutory powers*". It is assumed, for the purposes of Issue 18, that no Statutory Interest is payable to Barclays on the amount of the LBI Payment under Rule 2.88(7). The Administrators consider that they have no power to pay Statutory Interest in circumstances where none is due. Accordingly, applying *Nortel*, the Court does not have jurisdiction to direct the Administrators to pay Statutory Interest on the amount of the LBI Payment.

131. Barclays responds to this argument in B-PP/116, but its response is not understood. Barclays seeks to distinguish between "*variation of the size of debts within each tier of the statutory ranking*" (which is said to be permissible) and "*alteration of the order of that ranking*" (which is not permissible). This distinction is artificial and should be rejected. The relevant test, applying *Nortel*, is whether the Court is being asked to

sanction a course of action which would otherwise be outside the Administrators' statutory powers. This is precisely what Barclays is asking the Court to do, since the Administrators do not have the power to pay Statutory Interest except in accordance with Rule 2.88(7).

132. If the Court directs the Administrators to pay more Statutory Interest than that which is actually due, this would involve a fundamental modification to the statutory scheme. It would be comparable to the Court directing the Administrators to treat a particular creditor as if it had a larger preferential or expense claim than it actually has. Lord Neuberger clearly did not envisage that it would be permissible for the Court to give such a direction.

133. Barclays seeks to rely on the decision in *Waterfall IIB* (*Re LBIE* [2015] EWHC 2270 (Ch) at [171]-[189]) where David Richards J held, *obiter*, that the Administrators should be directed not to enforce certain contractual releases of currency conversion claims: see B-PP/116. Barclays' reliance on *Waterfall IIB* is misplaced:

(1) Even if the existence of currency conversion claims had been upheld by the Supreme Court, the premise of the questions asked of David Richards J in Waterfall IIB and of the Court in this case are fundamentally different. Whereas David Richards J proceeded on the basis that the Administrators had the power not to enforce contractual releases of such claims,[15] here Barclays seeks to compel the Administrators to take a step they have no power to take, namely to pay Statutory Interest on a sum greater than that admitted to proof.

(2) Following the decision of the Supreme Court in *Re LBIE (Waterfall I)* [2017] UKSC 38, it is clear that currency conversion claims do not exist. This means that all of the relevant reasoning in *Waterfall IIB* was predicated on a false assumption.

[15] It should be noted that, during the hearing of the appeal in *Waterfall IIB*, the Court of Appeal questioned whether David Richards J was correct to assume that the Administrators had the power not to enforce valid contractual releases. See the remarks of Briggs LJ at Day 6, Pages 57-58.

134. The Administrators do not agree with Barclays' assertion that "*a creditor's right to Statutory Interest cannot be removed without a clear intention by the creditor to waive such a right*" (B-PP/120). The present case is not concerned with a "*waiver*" of Statutory Interest (in contrast to *Waterfall IIB*, which was concerned with the contractual release of currency conversion claims). The Administrators have never suggested that Barclays "*waived*" its right to Statutory Interest. Rather, the Administrators consider that the Barclays Proof should be admitted for a reduced amount deducting the LBI Payment, and that Statutory Interest should be paid on the admitted amount only. The resolution of this dispute depends on the construction of Rule 2.88(7), and not on the scope of a contractual waiver or release. The intentions of Barclays in accepting the LBI Payment are irrelevant to the construction of Rule 2.88(7).

Discretionary factors

135. Barclays complains that it would be "*unfair*" if Statutory Interest were not paid on the amount of the LBI Payment (B-PP/117). It is not accepted that there is any unfairness: see A-PP/228. Further, the alleged "*unfairness*" results from the voluntary actions of Barclays and the subsequent effect of the statutory scheme rather than the conduct of the Administrators. If the Rules prevent the recovery of Statutory Interest in circumstances where a creditor has accepted a third party payment, this outcome cannot be circumvented by arguments based on *Ex Parte James*, estoppel or paragraph 74. Discretionary doctrines cannot be used to undermine the intention of Parliament.

136. In its position paper, Barclays makes a number of factual assertions about the conduct of the Administrators: see e.g. B-PP/119. The Administrators will endeavour to produce a statement of agreed facts with the Respondents. To the extent that the facts cannot be agreed prior to that deadline, the Administrators reserve the right to adduce evidence in response to what is said in B-PP/119.

137. The Administrators note that, although Barclays purports to rely on estoppel as an alternative fall-back position (B-PP/121), no attempt is made to particularise how any estoppel might arise, or even to identify the relevant form of estoppel.

<u>The June 2015 Order</u>

138. Barclays asserts that, by virtue of the June 2015 Order, "*the SDNY Bankruptcy Court has already ruled that the LBI/Barclays Settlement has no effect on Barclays' right to claim Statutory Interest from LBIE*": see B-PP/122-123. Accordingly, "*whether by application of estoppel, res judicata or the rule in Henderson v Henderson (1843) 3 Hare 100, the Administrators should be precluded from re-litigating a point already decided in a foreign proceeding in which they participated*". As to this:

(1) The SDNY Bankruptcy Court plainly did not make any determination as to the effect of Rule 2.88(7). The suggestion that the Administrators are seeking to "*re-litigate a point already decided in a foreign proceeding*" is absurd.

(2) The SDNY Bankruptcy Court simply sanctioned a consent order which states, "*for the avoidance of doubt*", that Barclays has not "*waived*" or "*released*" its claim to Statutory Interest. This provision does not enable Barclays to receive Statutory Interest which is not due. The purpose of the provision is to ensure that the Barclays' claim for Statutory Interest is not affected by the settlement <u>save to the extent that such effects follow from the mandatory rules of insolvency law</u>: see A-PP/219. The Administrators do not suggest that Barclays has "*waived*" or "*released*" any entitlement to Statutory Interest in respect of the LBI Payment. Rather, as a result of Barclays' voluntary decision to accept the LBI Payment, such an entitlement simply does not arise on the true construction of the Rules.

(3) In any event, the SDNY Bankruptcy Court is not competent (as a matter of the private international law of England) to make any determination as to the effect of Rule 2.88(7), being a provision of the English statutory scheme. To the extent that the SDNY Bankruptcy Court has made such a determination, it is not capable of giving rise to any form of estoppel, *res judicata* or abuse of process.

ISSUE 19

If the Barclays Proof should be admitted without deducting an amount in respect of the LBI Payment (or any part thereof), on the true construction of Rule 2.88(7), in calculating the principal sum on which Statutory Interest is payable in respect of the Barclays Proof, should such principal sum be reduced by the Sterling Equivalent of the LBI Payment from the date when Barclays received the LBI Payment (or any other date)?

139. Barclays contends that Statutory Interest is payable on the amount equivalent to the LBI Payment from the date of the Administration to the date that payment was made (i.e. 2 July 2015), and on the outstanding balance of the Barclays Proof from the date of the Administration to the date of payment: see B-PP/125.

140. The Administrators and Wentworth consider that Issue 19 does not arise (on the basis that the LBI Payment should be deducted from the Barclays Proof). However, to the extent that Issue 19 does arise, the Administrators concur with Barclays' analysis. Wentworth does not address Issue 19 directly.

141. Accordingly, the Administrators invite the parties to adopt an agreed position on Issue 19 on the terms set out above.

Part E
Currency issues

ISSUE 16

If Barclays has an Unsecured Claim in respect of the ETD Trades, in what currency (or currencies) is such Unsecured Claim denominated (prior to any conversion under Rule 2.86)?

142. Issue 16 is one of the Disputed Issues. The Administrators consider that Barclays' Unsecured Claim in respect of the ETD Trades is denominated in USD (prior to

conversion under Rule 2.86). Barclays concurs with the Administrators' position. Wentworth states that it has insufficient information to take a position on Issue 16.

143. In due course, the Administrators will adduce further evidence of fact in support of their position.

ISSUE 15

In relation to Issues 10 to 14 and Issue 19, how is the amount in respect of the LBI Payment to be calculated? In particular, if it is the Sterling Equivalent that is to be taken into account, should the Sterling Equivalent of the LBI Payment be calculated based on the exchange rate prevailing at:

(1) The Time of Administration;

(2) The time when Barclays received the LBI Payment; or

(3) Some other time?

144. Issue 15 is one of the Disputed Issues. The formula proposed by the Administrators is set out in A-PP/191-202. The formula proposed by Barclays is set out in B-PP/128-131. Although these formulae are different, they give the same result if Barclays' Unsecured Claim is denominated in USD. Wentworth states that it has insufficient information to take a position on Issue 15.

145. Since Issue 15 is a question of law rather than a question of fact, it is not understood why Wentworth purports to have insufficient information to take a position. That aside, the Administrators have nothing to add to their original position paper on this Issue.

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30 JUNE 2017

SOUTH SQUARE