

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

No. 7942 of 2008

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE)
(IN ADMINISTRATION)
AND IN THE MATTER OF THE INSOLVENCY ACT 1986

B E T W E E N

- (1) ANTONY 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 ISSUE 1(a)
SENIOR CREDITOR GROUP'S FURTHER SUBMISSIONS

A: The further questions in context

1. Supplemental Issue 1(a) asks: “*Whether and in what circumstances the words “the rate applicable to the debt apart from the administration” in rule 2.88(9) of the Rules include, in the case of a provable debt that is a close out sum under a contract, a contractual rate of interest that began to accrue only after the close-out sum became due and payable due to action taken by the creditor after the Date of Administration.*”
2. Supplemental Issue 1(a) is therefore concerned with a case in which a creditor is entitled to:
 - (1) a close-out sum in accordance with the terms of a contract which existed as at the date of administration; and
 - (2) contractual interest on that close out sum (in the case of ISDA agreements, usually at the Default Rate) in accordance with the terms of that existing contract.
3. The issue arises because the right to the close-out sum, although arising out of an existing obligation, is contingent, because it only becomes due if and when the Early Termination Date occurs, and because interest on the close-out sum is not payable pursuant to the contract until the close-out determination has been served.
4. York contends that, in such circumstances and in light of the Judge’s analysis of Issue 4 (and in particular the reference in paragraph 181 “*the rights of the creditor as at the commencement of the administration*”), the contractual rate of interest can never be the applicable rate for the purposes of Rule 2.88. The SGC disagrees. The SCG refer to their existing written submissions in respect of Supplemental Issue 1(a) and do not repeat them here.
5. As noted below, certain questions as to the period for which such interest is payable, and how it is calculated, are to be addressed by David Richards LJ in the context of Supplemental 1(c) and in respect of which the parties have already made submissions.

6. The further questions raised by the Court in its recent e-mail obviously need to be approached taking into account the general structure and purpose of Rule 2.88 and the Court's existing rulings on its interpretation.
7. In this respect the Court will recall that:
 - (1) Statutory interest under Rule 2.88 is payable in respect of proved debts rather than in respect of the underlying contractual or other obligation (Rule 2.88(7)).
 - (2) It is payable over a defined period, namely the period for which the proved debts have been outstanding since the relevant date (Rule 2.88(7)).
 - (3) The rate of interest payable is whichever is the greater of the rate specified in Section 17 of the Judgments Act 1838 as at the date of administration and the rate applicable to the debt apart from the administration (Rule 2.88(9)).
8. Where a proved debt was presently due and payable as at the date of administration and is subject to a fixed contractual rate (of, say, 15%) the application of Rule 2.88(7) is straightforward. In such a case the rate applicable to the debt apart from the administration is 15%, being the greater of the two potentially applicable rates.
9. The approach to determining the relevant rate under Rule 2.88(9) where the contractual rate of interest is floating rather than fixed was determined by David Richards J (as he then was) as part of *Waterfall ILA* (see Issue 5 and the related declaration).
 - (1) Issue 5 of the *Waterfall ILA* proceedings included the question as to “*how the total amount of interest is calculated where the “rate applicable to the debt apart from the administration” varies from time to time?*”.
 - (2) It was common ground between the parties before David Richards J that this aspect of Issue 5 was answered by conducting the same comparative exercise required where there is a fixed rate. Thus, where the “*rate applicable to the debt apart from the administration*” varies from time to time, it is necessary

to calculate the total amount of interest the creditor would be entitled to under the rate applicable to the debt apart from the administration as it varies from time to time with the total amount of interest the creditor would be entitled to under the Judgments Act rate, and to pay the greater of the two amounts.

- (3) For the purpose of assessing whichever is the greater of the two rates, David Richards J held that a “*comparison is to be made between the total amounts of interest that would be payable under rule 2.88(7) based on each method of calculation, rather than between only the numerical rates themselves*” (*Waterfall IIA* at [28]).
10. The calculation of the rate applicable to the debt apart from the administration therefore takes into account a variable rate. Thus if, subsequent to the date of administration, the variable rate increases from, say, 10% to 15%, for part of the relevant period, the rate of 15% is taken into account, despite the fact that the creditor was not entitled to receive interest at 15% at the date of administration or that the increase to 15% may in one sense have been contingent (for example, depending on movements in the Bank of England base rate). If this were not the case, Rule 2.88(9) would be deprived of much of its purpose, since it will very frequently be the case that interest rate provisions in a commercial context will provide for payment of a floating rate.
11. The application of Rule 2.88 to cases involving contingent or future debts is more complicated and, as set out below, questions as to how in such circumstances the rate is to be calculated and the period for which it is to be applied are to be decided by David Richards LJ as part of Supplemental Issue 1(c) (see further below).
12. However, for the purposes of Supplemental Issue 1(a), it is plain that a contractual rate of interest is capable of being the rate applicable to the debt apart from the administration, regardless of the fact that the underlying debt may have been a contingent or future debt as at the date of administration. Put another way, what matters is whether the claim to interest is pursuant to rights which the creditor had at the date of commencement, regardless of whether those rights were present, future or contingent, and not whether the relevant rate of interest had itself vested or was “*accruing*” as at that date.

13. Contingent and future debts were dealt with by David Richards J in the context of Issues 6 to 8 of *Waterfall IIA*. In that context, he held that interest was payable on such debts in accordance with Rule 2.88(7) from the date that the company entered administration and not from the date (if any) when such debts fell due for payment in accordance with its terms; see *Waterfall IIA* at [225]. If, as David Richards J held in respect of Issues 6-8, Statutory Interest is payable in respect of an admitted provable debt which was a contingent debt as at the date of administration from the date of administration, the contractual entitlement to interest on that contingent debt must be capable of being the rate applicable to the debt apart from the administration.

14. This is consistent with the nature and purpose of Rule 2.88 and with policy:
 - (1) Rule 2.88 provides compensation for the delay since the commencement of the administration in payment of a creditor's admitted debt at the higher of the Judgments Act rate and the rate applicable to the debt apart from the administration for the period for which the debt was outstanding.
 - (2) Contingent debts are ascertained or estimated in accordance with the legislation, and admitted to proof on that basis (see *Waterfall IIA* at [206]-[208] and [212]). Having obtained a current estimated value of the future or contingent debt, those debts are treated as having been outstanding in their estimated as from that date and statutory interest is payable on them accordingly *pari passu* with all other proved debts.
 - (3) There is no reason why, against that background, the contractual rate to which the creditor is entitled is not capable of being "*the rate applicable to the debt apart from the administration*".
 - (4) It cannot be right, for example, that a creditor ceases to have any entitlement to interest at a contractual rate of say 15%, merely because his underlying claim only became due and payable the day after, rather than the day before, the date of administration.

- (5) There is no reason why, in the event of a surplus, the administration regime should enable a debtor to avoid paying default interest, merely because interest at that rate only became due and payable after the date of administration. Such a conclusion would merely cause a wholly unnecessary injustice, unsupported by any need to fulfil any policy requirement.
- (6) Nor is there any reason why, given the determination in respect of Issue 5, a creditor who is entitled to interest at a floating rate, cannot be entitled to such interest on such a proved debt in accordance with Rule 2.88(9).
15. This situation is to be distinguished from that considered by David Richards J in relation to Issue 4 where he held that Rule 2.88(9) does not permit a creditor to claim interest pursuant to a foreign judgment at the foreign judgment act rate where the underlying judgment did not exist as at the date of administration. It was in this context that the reference to “*the rights of the creditor as at the commencement of the administration*” was made in paragraph 181 of the *Waterfall IIA* judgment.
16. The conclusions of David Richards J have, however, given rise to further questions as to how in such circumstances the rate is to be calculated and the period for which it is to apply. Thus, further to the judgment in *Waterfall IIA*, David Richards LJ is to respond to Supplemental Issue (1)(c). This 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 purposes of rule 2.88(9), should Statutory Interest be calculated by assessing the greater of the “rate applicable” and Judgments Act 1838 rate separately for the periods prior to and post the commencement of contractual interest or should such assessment be performed taking the periods together.”

17. The question of how a contractual rate is to be calculated and the period for which it should apply, where the underlying debt was a contingent debt which only became due and payable after the date of administration, is therefore something to

be addressed by David Richards LJ in the context of Issue 1(c) and is an issue in respect of which the parties have already made submissions to him. In that context the SCG contends that, given that the proved debt in respect of a contingent or future debt will have been discounted in accordance with the rules, it must necessarily carry interest at the contractual rate from the date of administration.

B: The further questions posed by the Court

18. In light of the analysis above, the Senior Creditor Group respond to the questions raised by the Court as follows.

1. 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.

- (1) Rule 2.88(9) does not use the word “*accrue*” or “*accrued*”. The Court is concerned with the rate applicable to the debt apart from the administration.
- (2) David Richards J did not draw any distinction in the context of Issue 4 (which forms the basis of Supplemental Issue 1(a)) between existing accrued rights on the one hand, and existing contingent or future rights on the other. He does not use the phrase “*accrue*” or “*accrued*” in paragraphs 171-183 of his Judgment when addressing Issue 4. Nor did he hold that only existing accrued rights are sufficient.
- (3) The decision of the Supreme Court in *Tael One Partners Ltd v Morgan Stanley & Co International Plc* [2015] UKSC 12 (“**Tael**”) is a decision concerning the contractual interpretation of the word accrue in a particular context. Whether or not a right to interest can be said to have accrued (as at the date of administration or at a later date) is not the test for identifying the applicable rate (and also begs the question of what is meant by accrued in this instance).

- (4) In addition, not all events can properly be described as “*contingencies to which the contractual entitlement is subject*”. For example, moves in the LIBOR rate although contingent are not a contingency affecting the entitlement to contractual interest, but rather are a fact by reference to which the amount of interest payable is calculated (see further the response to Question 3 below). In many cases the same will be equally true of an entitlement to the Default Rate.

2. *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.*

- (1) See analysis above.
- (2) Rule 2.88 requires the identification of the applicable rate apart from the administration. There is no additional requirement that 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*”, and the language of Rule 2.88 ought not to be interpreted in a manner that imposes such an additional requirement. Such a requirement would inevitably be artificial, and potentially unworkable. It is unclear, for example, how this could apply to time-based contingencies (such as where interest becomes due if payment has not been made seven days after it becomes payable). However, if a rate *would* have been payable had all the relevant contingencies been fulfilled at the date of administration, then that would clearly be a rate falling with Rule 2.88.
- (3) The Default Rate will be applicable to any early termination amount payable under the Master Agreements as from the point at which the close out sum falls due. The relevant contingency relates to whether (and if so when) the early termination amount becomes payable. However, the right to interest at the Default Rate is not itself contingent on anything other than the early

termination amount becoming payable: see paragraphs 8, 9 and 24 of the SCG Submissions¹.

- (4) To the extent that it is necessary that the rate be “*available*” as at the date of administration, the Default Rate should be regarded as a rate that was available as at the date of administration (with the question of how such interest is to be calculated and for what period to be determined as part of Supplemental Issue 1(c)).

3. 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.

- (1) The rate applicable to the debt apart from the administration may be a floating rate or variable rate: see above.

4. Any other points that arise in consequence or which the parties wish to emphasise

- (1) None that are not already addressed above.

ROBIN DICKER QC

RICHARD FISHER

23 June 2016

South Square

Gray's Inn

¹ As set out in those paragraphs, interest may be payable at the Termination Rate for the period prior to delivery of the calculation statement rather than the Default Rate for the purpose of the 1992 Master Agreement.

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WATERFALL II DIRECTIONS APPLICATION

SUPPLEMENTAL ISSUE 1(a)
SENIOR CREDITOR GROUP'S FURTHER
SUBMISSIONS

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