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) 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

SENIOR CREDITOR GROUP'S SUPPLEMENTAL SUBMISSIONS ON THE GERMAN MASTER AGREEMENT

A. INTRODUCTION

1. These supplemental submissions are filed on behalf of Burlington Loan Management Limited, CVI GVF (Lux) Master S.a.r.l, and Hutchinson Investors, LLC (collectively, the "Senior Creditor Group") in connection with Issue 20.

2. Issue 20 concerns the entitlement, under German law, to compensation for delayed payment of sums owed by LBIE following automatic termination of the German Master Agreement for Financial Derivative Transactions (the "GMA"). It asks whether such an entitlement exists and, if so, whether any such entitlement can constitute a "*rate applicable to the debt*" for the purpose of Rule 2.88(9).

3. At trial, both the Senior Creditor Group and Wentworth proceeded on the basis that the calculation of the close-out amount owed by LBIE following automatic termination of the GMA is governed by sections 8 – 9 of the GMA. On 22 June 2016, Wentworth wrote to the Court drawing its attention to a decision of the German Federal Court dated 9 June 2016 (the "BGH Decision" [**Supp/1**]). The BGH held that the GMA is invalid to the extent that the calculation method for the close-out amount envisaged by it contradicts section 104(3) of the German Insolvency Code ("InsO") ([56] BGH Decision). As a consequence, the calculation of the close-out amount following automatic termination of the GMA is governed by section 104(3) InsO and not by section 8 of the GMA.

4. The BGH Decision is of limited relevance to the matters raised by Issue 20 of these proceedings for the reasons set out in these supplemental submissions. In summary:

   (1) The BGH Decision concerns the methodology for calculating the close-out amount following automatic termination of the GMA. It does not concern, or address, creditors' entitlement to compensation for late payment of the close-out amount or any other matter relevant to Issue 20.

(2) Irrespective of whether the close-out amount owed following automatic termination of the GMA is calculated pursuant to sections 8 – 9 GMA or pursuant to section 104(3) InsO, the same principles of German law apply to the issue of whether GMA creditors are entitled to compensation for late payment of such sum.

(3) The only point of potential relevance of the BGH Decision identified by Wentworth is based on Dr Fischer's apparent view that an amount owed under section 104(3) InsO falls due at some point *after* the commencement of LBIE's administration. However, even if Dr Fischer's evidence on this point (which was not the subject of cross-examination for the reasons given below) were correct, the position is still that a "default" on the part of LBIE occurred under section 286 of the German Civil Code ("BGB") as soon as the close-out amount fell due. At the same time, GMA creditors became entitled to claim compensation for late payment as "further damages" under sections 280, 286 and 288 BGB.

(4) The BGH Decision has no impact on whether a "further damages" claim constitutes part of the "*rate applicable to the debt*" in the sense required by Rule 2.88(9). An entitlement to damages arising under the BGB applies to the debt proved (i.e. the close-out amount whether calculated under section 104(3) InsO or sections 8 – 9 of the GMA), is (for the reasons given below) part of a creditor's rights as against LBIE at the commencement of the administration and, where expressed as a rate, constitutes "*part of the rate applicable to the debt apart from the administration*" within the meaning of Rule 2.88(9).

B. BACKGROUND

5. The Court will recall that the basic issue raised by Issue 20 is whether LBIE could be liable to pay interest, by way of a claim for "further damage" under section 288 BGB, on a sum payable by LBIE following termination of the GMA.

6. There is considerable common ground as regards the pre-requisites to any such claim as a matter of German law. In particular (as set out at [5] of the Senior Creditor Group's written closing submissions **[3/15]**):

(1) Sections 247, 280 and 286 BGB permit a creditor to claim compensation by way of damages for late payment of a debt. Such compensation can be expressed as a rate which "*will be applied to the amount for which the debtor is in default"* (Fischer 1 [85]-[88] [**4/8**]; Mülbert 3 [45] [**4/11**]).

(2) A party can only claim damages for late payment of a debt if the debtor has "defaulted" in its payment obligations towards the creditor within the meaning of section 286 BGB.

(3) Section 286 BGB provides that a "default" can be triggered by (among other things):

(a) The giving of a "warning notice" from the creditor to the debtor requesting performance; or

(b) Where the debtor "*seriously and definitively refuses performance"*.

(4) A "default" cannot take place unless and until the relevant payment obligation has fallen due. However, a serious and definitive refusal to perform can occur before, when or after the relevant claim falls due. If a serious and definitive refusal occurs before the claim becomes due, a default will occur as soon as the relevant claim falls due: (see [82(5)] of the Senior Creditor Group's written closing submissions [**3/15**]).

C. THE PARTIES' POSITIONS AT THE NOVEMBER HEARING

7. The Senior Creditor Group's position at the hearing in November was (as set out at [8]–[12] of its skeleton argument [**3/9**]) that under German law:

(1) LBIE's application for an administration order caused an automatic termination of the GMA and all underlying transactions.

(2) As a consequence, LBIE was liable to pay a sum calculated pursuant to sections 7 – 9 of the GMA (the "Single Compensation Claim").

(3) The Senior Creditor Group contended that, on the true construction of the GMA (in accordance with section 271 BGB), the Single Compensation Claim became immediately due upon the occurrence of the automatic termination.

(4) The particular facts and circumstances of LBIE's administration application also constituted a "default" by virtue of a serious and definitive refusal to perform within the meaning of section 286 BGB.

(5) As a consequence, upon the commencement of LBIE's administration GMA creditors were entitled to claim compensation by way of damages for late payment of a debt under sections 280, 286 and 288(4) BGB. Such damages may, where appropriate, be expressed as a rate accruing on the amount of the unpaid debt.

(6) Alternatively, proofs of debt filed by GMA creditors in respect of their claims under the GMA constituted "warning notices" within the meaning of section 286(1) BGB and gave rise to a default on the part of LBIE.

(7) There is no principle of German law which prevents a default from occurring following the commencement of an English administration.

(8) Irrespective of whether the default occurs before or after the commencement of LBIE's administration, the entitlement to damages arising under the BGB (i) applies to the debt proved (i.e. the close-out amount), (ii) is part of a creditor's rights as against LBIE at the commencement of the administration and (iii) therefore constitutes part of the "*rate applicable to the debt apart from the administration"* within the meaning of Rule 2.88(9) (see, further, [22] – [23] Senior Creditor Group's skeleton argument [**3/9**]).

8. At the November hearing, Wentworth accepted that LBIE's application for an administration order caused an automatic termination of the GMA and all underlying transactions. It also accepted that, as a consequence, LBIE was liable to pay a sum calculated pursuant to sections 7 – 9 of the GMA[1]. However, Wentworth contended that:

(1) The Single Compensation Sum calculated under sections 7 – 9 of the GMA became due not immediately upon the occurrence of automatic termination, but only upon the calculation of that amount following termination of the GMA,: Wentworth's skeleton argument [28] **[3/10]**.

(2) No serious and definitive refusal to perform the GMA can be inferred from the fact or grounds of LBIE's administration application or order: Wentworth's skeleton argument [65]; [103].

(3) As matter of German law, no default can occur following the commencement of an English administration: Wentworth's skeleton argument [61].

(4) In any event, a claim for "further damage" under section 288(4) BGB does not constitute a "*rate applicable to the debt apart from the administration"* within the meaning of Rule 2.88(9): Wentworth's skeleton argument [119] – [133].

D. NO RELIANCE ON SECTION 104(3) INSO AT THE NOVEMBER HEARING

9. Prior to its letter of 22 June 2016 Wentworth did not advance any case based on section 104(3) InsO.

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[1] See, for example: [28] of Wentworth's skeleton argument [**3/10**] ("*The key provisions for the purpose of Issues 20 and 21 are clauses 7 to 9 GMA"*); [33] Wentworth's skeleton argument ("*Clauses 8 and 9 make provision for the calculation and payment of a close-out amount in respect of damages flowing from the termination of the GMA"*) [**3/10**]; [25(1)] of Wentworth's written closing submissions [**3/16**].

10. It is true that, in some of his reports, Dr Fischer expressed a view going beyond that of the BGH, namely that sections 7 – 9 of the GMA were unenforceable generally (that is, not only to the extent of any contradiction with section 104(3) InsO) and that claims of GMA creditors fell to be calculated pursuant to section 104(3) InsO. However, that formed no part of the case advanced by Wentworth.

11. In this regard, following service of Dr Fischer's first report (which expressed the view that sections 7 – 9 of the GMA were unenforceable) the Senior Creditor Group entered into lengthy correspondence with Wentworth asking it to clarify what reliance (if any) it sought to place on the provisions of the German Insolvency Code as it could have impacted upon the Senior Creditor Group's choice of expert (see Freshfields' letter of 23 July 2015 [**7/2/180**]).

12. That (and other) correspondence culminated in the Joint Administrators suggesting that revised position papers should be filed ([**7/2/212**]).

13. Wentworth provided its revised position paper on 11 September 2015 [**1/10**]. It placed no reliance on section 104(3) InsO and proceeded on the basis that sections 7 – 9 of the GMA were valid and enforceable. On 23 September 2015, the Senior Creditor Group therefore wrote to Wentworth suggesting that restated expert reports should be provided since the reports provided to date referred to matters which appeared to be irrelevant to the application: "*for example, Judge Fischer's original report deals with the effects of German insolvency law…which were not referred to in Wentworth's original or revised position papers and which do not appear now to be relied on"* ([**7/2/292**]). In the correspondence that followed, Wentworth did not seek to suggest that the Senior Creditor Group's conclusion was incorrect or that it relied on section 104 InsO. Nor did Wentworth seek to advance a case based on section 104 InsO at the November hearing.

14. Against that background, Wentworth's criticism of the fact that Professor Mülbert did not consider section 104 InsO in his reports (see, for example, paras 6 – 8 of Wentworth's letter of 22 June 2016) is unfair and unwarranted.

E. THE BGH DECISION

15. In the BGH Decision, the BGH held (contrary to the position taken by both the Senior Creditor Group and Wentworth at the November hearing) that the GMA is invalid to the extent that the calculation method envisaged by it deviates from section 104(3) InsO ([56] BGH Decision). As a consequence the calculation of the close-out amount payable following automatic termination of the GMA is governed by section 104(3) InsO and not by section 8 of the GMA.

16. The BGH Decision does not assist this court in resolving the matters raised by Issue 20. This is because, irrespective of whether the close-out amount owed following automatic termination of the GMA is calculated pursuant to sections 8 – 9 of the GMA or pursuant to section 104(3) InsO, the same principles of German law apply to the issue of whether GMA creditors are entitled to compensation for late payment of such amount.

17. In particular:

    (1) The BGH Decision does not address, and has no impact on, the agreed position of the parties that LBIE's application for an administration order caused an automatic termination of the GMA and all underlying transactions.

    (2) The BGH Decision does not address, and has no impact on, the question of whether (as the Senior Creditor Group contends) the particular facts and circumstances of LBIE's administration constituted a "serious and definitive refusal" to perform within the meaning of section 286 BGB. The Senior Creditor Group's position in this regard is as set out at [81] – [93] of its written closing submissions [**3/15**].

    (3) The BGH Decision does not address, and has no impact on, the agreed position of the parties' experts that a serious and definitive refusal to perform can occur prior to, as well as at the same time as or after, the obligation in question fell due (see [82(5)] of the Senior Creditor Group's written closing submissions [**3/15**] and Judge Fischer's evidence in cross-examination (day 7 p.105 line 22 – p.106 line 13) [**8/10**]). Nor does it address, or have any impact on, the agreed position that where a serious

and definitive refusal occurs *before* the claim becomes due, a default will occur as soon as it falls due (see [82(5)] of the Senior Creditor Group's written closing submissions[**3/15**]).

(4) The BGH Decision does not address, and has no impact upon, whether (as the Senior Creditor Group contends) proofs of debt filed by GMA creditors in respect of claims under the GMA constitute "warning notices" within the meaning of section 286(1) BGB and gave rise, in each case, to a default on the part of LBIE in respect of the relevant close-out amount.

(5) The BGH Decision does not address, and has no impact upon, whether (as the Senior Creditor Group contends) a default can occur after the commencement of English insolvency proceedings. The Senior Creditor Group's position in this regard is as set out at [110] – [111] of its written closing submissions [**3/15**]. Nor does it address, or have any impact on, the more general question of whether claims for further damage under section 280, 286 and 288(4) BGB can be made by a counterparty following the commencement of LBIE's administration.

(6) Although the BGH stated that the *contractual* provision for interest under section 3(4) of the GMA would be invalid if it deviated from section 104(2)(3) InsO, it also held that damages due to default, delay or for other reasons generally can be incurred following the termination of the GMA (BGH Decision [71][84]). The BGH did not address the entitlement for interest under *statute*, in particular it made no comment about the validity of a claim for "further damages" pursuant to section 288(4) BGTB. Given the Senior Creditor Group asserts its entitlement to "further damages" pursuant to *statute*, the BGH Decision does not assist this court in determining such entitlement.

18. The only point of alleged relevance now identified by Wentworth is based on Dr. Fischer's view that "*the claim* [under section 104(3) InsO] *only comes into existence as a consequence of the opening of insolvency proceedings, and matures a few days later, after the computation as provided there is complete"* (see [81] Fischer 1 [**4/8**]). According to

Wentworth this is somehow determinative of Issue 20 since (so it is said) "*there can be no claim for further damage under section 288(4) as there was no defaulted payment obligation in respect of the proved debt under the GMA prior to the opening of LBIE's insolvency proceedings"* (see, e.g. para. 9 of Wentworth's letter of 22 June 2016 [**Supp/3**] and Wentworth's letter of 15 July 2016 [**Supp/16**]).

19. Since Wentworth placed no reliance on section 104(3) InsO at trial, the Senior Creditor Group did not seek to address the question of *when* a close-out amount under section 104(3) InsO becomes due in their expert evidence or in cross-examination.

20. But, even if a close-out amount under section 104(3) InsO becomes due only after the commencement of LBIE's administration, Wentworth is wrong to suggest that this is determinative of Issue 20. In fact, the Senior Creditor Group's case on Issue 20 remains largely unchanged since:

    (1) The parties' experts agreed that a serious and definitive refusal to perform can occur *before* the relevant claim falls due, with the consequence that default will occur immediately upon the claim falling due (see Judge Fischer's evidence in cross-examination (day 7 p.105 line 22 – p.106 line 13 [**8/10**]).

    (2) If (as the Senior Creditor Group contends) the facts and circumstances of LBIE's administration application constituted a serious and definitive refusal to perform, a default occurred as soon as any close-out amount fell due (whether determined under the GMA or in accordance with section 104(3) InsO).

    (3) If (contrary to the Senior Creditor Group's primary position) the facts and circumstances of LBIE's administration application did not constitute a serious and definitive refusal to perform then, in any case, proofs of debt filed by GMA creditors in respect of claims under the GMA constituted "warning notices" within the meaning of section 286(1) BGB and gave rise, in each case, to a default on the part of LBIE in respect of the relevant close-out amount.

(4) In either case, a default is capable of occurring after the commencement of an English administration. In this regard, Dr Fischer accepted that, although no default can occur following the commencement of *German* insolvency proceedings, that is a consequence of the particularities of German insolvency law (see [110] of the Senior Creditor Group's written closing submissions [**3/15**]). Dr Fischer also accepted that "*if there are material differences on those points between German and English insolvency law, a different assessment of the problem of default [during the course of insolvency] may be required*" (Further Report [12] [**4/16**]). Such material differences exist for the reasons identified at [111] of the Senior Creditor Group's written closing submissions [**3/15**].

(5) As set out at [24] – [26] of the Senior Creditor Group's skeleton argument [**3/9**], even where a default occurs after the commencement of LBIE's administration a further damages claim under sections 280, 286 and 288(4) BGB can, where expressed as a rate, constitute a "*rate applicable to the debt"* for the purposes of Rule 2.88(9):

(a) It is common ground that a claim for further damages permitted by 288(4) BGB crystallises on the date of default and can, where appropriate, be expressed as a percentage rate of interest accruing on the unpaid amount for the period of default (Fischer 1 [85]-[89] [**4/8**]; Mülbert 3 [38(b)(i) and (ii)] [45] [**4/11**]).

(b) LBIE's serious and definitive refusal to perform its obligations taken in conjunction with the rights granted to all creditors under section 288(4) BGB meant that, as at the commencement of LBIE's administration:

(i) All GMA creditors were entitled to payment of a close-out amount calculated in accordance with section 104(3) InsO; and

(ii) All GMA creditors were entitled to make a further damages claim in respect of the close-out amount.

(c) The fact that the further damages claim did not start accruing on unpaid close-out amounts until after they fell due does not prevent it, when expressed as a percentage rate of interest, from being a "rate applicable to the debt" for the purposes of Rule 2.88(9). The situation is in substance no different from one in which a future creditor has contracted for interest to be payable as soon as the debt falls due for payment. In Waterfall IIA, David Richards J held (at [225]) that such a right to interest is a "rate applicable to the debt" for the purposes of Rule 2.88(9) [**6/3/200**].

Conclusion

21. The BGH Decision relates specifically to the methodology for calculating the close-out amount following automatic termination of the GMA and not to the determination of any entitlement to further damages as compensation for delayed payment of the close-out amount, which is the central issue in Issue 20. In those circumstances, for the reasons set out above, the BGH Decision does not assist this Court in determining the parties' entitlement to "further damages" for the purposes of Part C of the Waterfall II application.

ROBIN DICKER QC

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21 July 2016

South Square

Gray's Inn

No.7942 of 2008

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CHANCERY DIVISION
COMPANIES COURT

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

WATERFALL II DIRECTIONS APPLICATION

SENIOR CREDITOR GROUP'S SUPPLEMENTAL GERMAN LAW SUBMISSIONS

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