Waterfall II Application

No 7942 of 2008

IN THE HIGH COURT OF JUSTICE

CHANCERY DIVISION

COMPANIES COURT

The Honourable Mr Justice Hildyard

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

(1) ANTHONY VICTOR LOMAS

(2) STEVEN ANTHONY PEARSON

(3) PAUL DAVID COPLEY

(4) RUSSELL DOWNS

(5) GUY JULIAN PARR

(as the joint administrators of the above named company)

Applicants

- AND -

(1) BURLINGTON LOAN MANAGEMENT LIMITED

(2) CVI GVF (LUX) MASTER S.À R.L

(3) HUTCHINSON INVESTORS LLC

(4) WENTWORTH SONS SUB-DEBT S.À R.L

(5) YORK GLOBAL FINANCE BDH, LLC

(6) GOLDMAN SACHS INTERNATIONAL

Respondents

SPEAKING NOTE: CLOSING SUBMISSIONS ON BEHALF OF THE FOURTH RESPONDENT

INTRODUCTORY COMMENTS

1. The SCG faces very serious obstacles in its attempt to establish that a claim for *further damage* under section 288(4) BGB is a rate applicable to the proved debts under the GMA which is relevant for the purpose of rule 2.88(9).

2. Issues 20(1) and 20(2) are focused on the claim of the original counterparty.

3. Issue 21 is focused primarily on the claim of an assignee, but also raises issues in relation to the assessment of damages.

Issues 20(1) and 20(2)

4. The SCG needs to satisfy the Court of three key points in order for a claim for *further damage* under section 288(4) to have any relevance to the entitlement to statutory interest under rule 2.88(9).

5. First, the SCG needs to establish that the counterparties to the GMA are able to assert a claim for *further damage* under section 288(4) BGB against LBIE. In this regard:

    (1) It is clear from the expert evidence that there are very considerable obstacles for the SCG to overcome including, in particular, the requirement to establish that a "*default*" has occurred within the meaning of section 286 BGB in respect of the compensation claim payable under the GMA.

    (2) The experts agree that a default under section 286 BGB is required in order for a claim for *further damage* under section 288(4) to "exist": JS/para 19 [4/13].

    (3) The SCG is unable to establish a "*default*" within the meaning of section 286 BGB.

6. Secondly, even if the SCG can establish a "default" within section 286 BGB, it must still establish that any claim for further damage, if expressed as a "*rate*", is a "*rate*" applicable to the debt proved at the commencement of the administration by reason of the rights of the creditor as at that date.

7. A *further damage* claim under section 288(4) BGB is a claim for actual damage which must be pleaded and proved and which is ultimately to be assessed by the trial Judge in the exercise of his or her judicial discretion before any "*rate*" can be pronounced. Accordingly, it is **not** a rate applicable to the debt apart from the administration under rule 2.88(9), as that phrased was explained by David Richards J in *Waterfall IIA*.

8. Thirdly, even if the SCG is able to establish that the counterparties to the GMA can assert a claim for *further damage* under section 288(4) against LBIE, the SCG still needs to demonstrate that such a claim is to be characterised as giving rise to an interest rate applicable to the proved debt.

    (1) It is clear from the expert evidence and the written submissions that, in contrast to section 288(1) BGB which does make provision for an interest rate, section 288(4) BGB does not make provision for an interest rate.

    (2) Instead, section 288(4) BGB provides a statutory basis for a claim for damages.

    (3) Section 288(4) BGB goes no further than providing that where the obligor is in default of a payment obligation within the meaning of section 286 BGB, the obligee is not limited to the recovery of the default interest rate of roughly 5% found at section 288(1), but can assert a claim for *further damage*.

    (4) Any damages claim awarded, even if it is to be expressed as a "rate", is determined by reference to the principal sum of any amount borrowed to close the funding gap or an amount which might have been invested had the debt been paid on time. Each amount may be in a different amount, for a different tenor or indeed a different currency to the unpaid debt.

9. Wentworth contends that the SCG fails to overcome each of the obstacles in its way, although it is sufficient for Wentworth's purposes if the SCG fails to clear any one of these obstacles.

Issues 21(i) and 21(ii)

10. These issues concern the SCG's attempt to establish that an assignee of the compensation claim due from LBIE under clauses 7-9 GMA is entitled to assert a greater claim to *further damage* than the original counterparty.

11. There are two key obstacles that should be noted at the outset of Wentworth's closing submissions.

12. First, the assignment of the GMA claim has taken place after the commencement of the administration.

13. Professor Mulbert accepts that an assignee can assert a claim for its *further damage* only by reference to the period following the assignment and that any claim for *further damage* prior to the assignment is for the damage suffered by the assignor: JS/paras 29 [4/13]. As set out below, he accepts that the claim of the assignee for further damage does not materialise prior to actual damage sustained post-assignment.

14. This means that an assignee's claim for *further damage* cannot satisfy the requirement of rule 2.88(9) that the rate is a rate applicable to the proved debt at the commencement of the administration.

15. Secondly, and in any event, it is a general principle of the German law of obligations that the debtor's position should not be prejudiced by reason of the assignment of a claim against it.

16. It follows that the assignee is limited to the *further damage* claim that the original counterparty could have asserted against LBIE.

ISSUE 20(1)

17. Issue 20(1) poses the following question:

> *Whether and in what circumstances, following LBIE's administration, a creditor would be entitled to make a "damages interest claim" within the meaning of section 288(4) of the German Civil Code (BGB) on any sum which is payable pursuant to clauses 7 to 9 of the German Master Agreement?*

18. Wentworth contends that the answer to Issue 20(1) is that a creditor is not entitled, following LBIE's administration, to make a claim for *further damage* under section 288(4) BGB on any sum which is due under clauses 7 to 9 GMA.

19. It is common ground that the SCG needs to overcome the considerable hurdle of establishing that LBIE was in "default" of its payment obligations under the GMA within the meaning of s286 BGB in order have any prospect of making a claim for *further damage* under section 288(4) BGB: JS/para 19 [4/13].

20. If the SCG cannot do so, then its attempt to rely on a *further damage* claim in LBIE's administration comes crashing down at the first hurdle without the need to consider Issues 20(2) and Issues 21(i)-(iii).

21. Wentworth contends that the SCG is unable to establish a "default" within the meaning of section 286.

22. It is convenient to start with an overview which identifies the issues of German law relevant to Issue 20(1) that are common ground between the parties and those which are disputed.

23. The following key issues of German law are agreed by the experts:

    (1) No claim for *further damage* may be brought by a creditor of LBIE unless it can establish that LBIE was in "default" within the meaning of section 286 BGB: JS/para 19 [4/13].

(2) A default cannot arise under section 286 prior to the time at which the performance of the payment obligation has fallen due: see Fischer 1/63-64; [4/8] Mulbert 3/29(ii) [4/11].

(3) Where an obligee was not in default prior to the opening of German insolvency proceedings, a default cannot be established as against the insolvent estate following the commencement of the German insolvency proceedings: JS/para 21 [4/13].

(4) A claim for *further damage* under section 288(4) - or indeed a claim for default interest under section 288(1) - cannot be made in a German insolvency proceeding unless there had been a defaulted payment obligation in respect of the proved debt prior to the opening of the insolvency proceedings.

(5) A warning notice – the normal means of triggering a default under section 286 - cannot be served against an obligee so as to trigger a default by the obligee's estate after it has entered into German insolvency proceedings: JS/para 21 [4/13].

(6) The formal requirements for a warning notice under section 286(1) require that the obligor must receive a clear, definitive demand from the obligee for payment of an amount that is due: JS/para 22 [4/13].

(7) The filing of a proof of debt in a German insolvency proceeding does not establish a default: JS/para 23 [4/13].

(8) A warning notice cannot be served once the debt has been repaid: JS/25 [4/13]. The debts have been repaid by LBIE in the present case, so a warning notice can no longer be served.

24. The agreed position in respect of the above issues was confirmed by Professor Mulbert at the beginning of his cross-examination: see Day 6/Page 8/Line 22 to Page 11/Line 8.

25. The following key issues of German law relevant to Issue 20(1) are in dispute:

(1) The time at which the performance of the payment obligation under clauses 7 to 9 of the GMA becomes due.

Wentworth contends that the interpretation of clauses 7 to 9 GMA, according to the agreed principles of German law, is that the close-out amount did not become due until after LBIE's administration.

The SCG seeks to apply section 271(1) BGB and invoke a loose analogy with the ISDA Master Agreement in support of its case that the compensation claim becomes payable immediately on the automatic termination of the GMA.

(2) Whether the filing of a proof of debt in LBIE's administration constitutes an effective warning notice for the purpose of section 286(1).

The SCG contends that it does despite the common ground that the filing of a proof of debt in a German insolvency proceeding does not constitute a warning notice for the purpose of section 286(1): JS/para 23 [4/13].

Wentworth rejects this contention. The purpose of a proof – in both a German insolvency and an English administration - is not to demand performance of a payment obligation. Rather, the purpose of a proof is to file a claim to be dealt with by the insolvency officeholder in accordance with the statutory scheme governing the distribution of the assets of the insolvent estate.

It is about participation in the collective proceeding according to the rules of that proceeding. Professor Mulbert accepted this, on two occasions: Day 6/Page 75/Lines 2 to 7; Day 6/Page 82/Lines 17-20. This is how the courts have characterised the filing of a proof of debt in an English insolvency proceeding.

(3) Whether any of the exceptions to the requirement for the service of a warning notice set out at section 286(2) apply in the present case.

The SCG contends that section 286(2)(iii) is engaged in the present case by reason of the filing of the administration application by LBIE's directors.

This provision dispenses with the need to serve a warning notice – but not the requirement for the payment obligation to have fallen due – in circumstances where the obligor "*seriously and definitively refuses performance*".

Wentworth contends that there is no basis to characterise the filing of an administration application as a serious and definitive refusal by LBIE to perform its obligations under the GMA.

26. These disputed issues of German law will drive the Court's answer to Issue 20(1).

WHEN DOES THE CLOSE-OUT AMOUNT BECOME DUE?

Introduction

27. There are three topics for consideration:

    (1) The principles of German law which govern the interpretation of the GMA;

    (2) The meaning and effect of section 271(1) BGB;

    (3) The application of the principles of interpretation and section 271(1) BGB to the compensation claim created by Clauses 7 to 9 of the GMA so as to determine when that claim becomes due.

Principles of interpretation

28. The GMA can be found at [Core/9]

29. The GMA is governed by German law – see clause 11(2).

30. As a result, the meaning of the GMA is to be determined by the application of German principles of contractual interpretation.

31. The experts are agreed on the relevant principles: JS/para 3 [4/13]. In particular:

    (1) The experts agree that the interpretation exercise requires the Court to ascertain the objective intention of the parties.

    (2) The experts agree that the starting point and primary source for interpretation is the wording of the contract.

    (3) The experts agree that the wording is particularly important when interpreting general business terms.

    (4) There is no suggestion that there is any relevant custom or usage that impacts on the interpretation of the GMA.

(5) In addition, there is no particular purpose identified by the experts which is said to impact on an ordinary meaning of the words of the GMA.

(6) The key references are:

(a) JS/para 3 [4/13];

(b) Professor Mulbert at Day 6/Page 13/Line 6 – Page 14/Line 23; and

(c) The decision of the BGH at [AUTHS 1/30], para 14A.

Section 271(1) BGB

32. Section 271(1) BGB provides as follows:

> "*Where no time for performance has been specified or is evident from the circumstances, the obligee may demand performance immediately, and the obligor may effect it immediately.*"

33. The experts agree that section 271(1) is gap-filling rule under which a claim becomes immediately due only where (1) no due date can be inferred from an express or implied agreement; (2) no due date can be inferred from the circumstances, including having regard to the nature of the contractual obligation.

34. The evidence on section 271(1) may be summarised as follows:

(1) The time of performance in section 271(1) is the time from which the creditor is able to demand payment of a debt:

(a) Professor Mulbert accepted this proposition at Day 6/Page 16/Lines 4-10; and

(b) It is made clear by the BGH in the decision at [AUTHS 1/26/para 16].

(2) Section 271(1) is a gap-filling provision that only has any relevance where the time for performance is not apparent from the terms of the contract or the surrounding circumstances:

(a) Fischer 3/35-36 [4/12]; and

(b) Professor Mulbert at Day 6/Page 20/Line 6 - Page 21/Line 17.

(3) The surrounding circumstances include a consideration of the nature of the contractual obligation:

(a) Judge Gruneberg in Palandt at [AUTHS 1/48/A/para 9].

(4) The commentators are consistent in saying that performance does not fall due for a monetary obligation until the debtor knows how much it has to pay:

(a) Judge Gruneberg in Palandt at [AUTHS 1/48/A/para 9]

(b) Ernst at [AUTHS 1/45A] and [AUTHS 1/45B]

(5) Professor Mulbert confirmed, in response to a question by the Judge, that a debt falling due before the debtor knew the amount he had to pay made life "*quite difficult*" for the debtor. He said that his was tolerable because under German law nothing happened simply because performance was due, i.e. a warning notice or an exception under section 286(2) BGB would have to be satisfied to trigger a default: see Day 6/Page 40/Line 19 to Page 41/Line 25.

(6) Professor Mulbert's answer in this respect does not account for the consequences which do in fact happen upon a claim becoming due:

(a) The SCG's case necessarily involves a party being liable to be served with a warning notice (and hence put in default) even before the amount owed is calculated. It is entirely unclear why the parties to the GMA should have wished to be so exposed before either knew who was to pay what.

(b) The prospect of a default before it is known who should pay and the amount of the payment is likely to create problems in a number of contexts. Examples include the relevant limitation period, a right of a creditor to appropriate property of the debtor, a right to liquidate claims by way of set-off.

35. It is, therefore, true to say that the SCG's construction of section 271(1) and the GMA would make life "*quite difficult*" for the parties who would not know what to pay or indeed who was to pay before the completion of the calculation under clauses 8 and 9 GMA.

36. These difficulties were considered by the BGH in its 1991 decision on a landlord's entitlement to heating costs which was self-evidently not a deposit case [AUTHS 5/3]. Professor Mulbert provided the following confirmations in relation to this case:

(1) Day 7/Page 18/Line 9: he confirmed that there was no agreed due date in this case.

(2) Day 7/Page 18/Line 14: he agreed that a verifiable bill was required to make the sum due.

(3) Day 7/Page 18/Line 23: he agreed that BGH reasoned that "*Because the tenant cannot ascertain and therefore cannot pay the amount owed without a bill.*"

(4) Day 7/Page 19/Line 11: he agreed that tenant also benefit from this construction as regards rebates following the calculation to be performed, i.e. it is a two way provision.

37. This decision of the BGH cannot be distinguished as a landlord deposit case.

38. The case is general in its reasoning. Professor Mulbert sought, at first, to distinguish the reasoning of the BGH, but was forced to acknowledge he had misread the BGH's judgment: see Day 7/Page 20/Lines 15 to 21/8. In the paragraph that Professor Mulbert picked upon, the BGH was in fact making clear just how general its reasoning was, distinguishing as irrelevant all potentially applicable statutory provisions.

39. As the Judge put it at Day 7/Page 22/Lines 3-17:

> "*[T]here seem to be certain circumstances, both generally and in the landlord and tenant context, where the obligation to pay arises in accordance with a set procedure, or some set rule. In those circumstances, the obligation to pay is not subject to any precondition of an invoice but in the particular circumstances of this case, those automatic payment provisions were not applicable and the obligation to pay was preconditioned on the supply of an invoice, or bill.*"

40. There are only two cases that Professor Mulbert relies upon in support of his argument that section 271(1) operates to make the single compensation claim under clauses 7 to 9 GMA fall due immediately. It became clear during cross-examination that these cases do not, on proper analysis, provide any support for his argument.

41. They are both cases in which the debtor was in breach – in the tort case by reason of crashing into another car – in the loan case by reason of the breach of contract entitling the bank to cancel the loan.

42. They are not cases which arose in the context of a termination for a reason other than breach.

43. The road traffic accident case is at [AUTHS 1/29A]. Professor Mulbert accepted the following points during cross-examination (Day 6/Page 48/Line 20-Page 54/Line 19):

(1) The question for the Court was when the damage to the legally protected interest occurred. It was clear that this occurred when the accident took place.

(2) A breach of duty gives rise to an immediate claim and is different to a termination of a contract for reasons other than breach.

(3) The case speaks of a claim becoming due when the injured party has the information needed to assert his claims.

(4) The Court did not even find that the claim for the repairs was due from the date of the accident. The finding was that it was due at the latest from a date around two months after the accident once the amount of the claim became fixed.

44. The loan pre-payment case is at [AUTHS 1/39]. Professor Mulbert accepted the following points during cross-examination (Day 6/Page 54/Line 20-Page 60/Line 22):

    (1) The termination of the loan by the lender was due to a breach of contract by the borrower. It is a case of termination for breach unlike the claims against LBIE under the GMA.

    (2) Where there is a breach of contract there is an immediate right to assert a damages claim.

    (3) The case did not even contain any dispute or reasoning as to when the damages claim of the bank fell due for payment.

45. In short, Judge Fischer is correct to conclude that the two cases are irrelevant to the construction of clauses 7-9 GMA: see Fischer 4/8-9 [1/16].

46. Accordingly, the only general guidance as may assist the Court is the BGH case on section 271(1) concerning the landlord's claim for heating costs [AUTHS 5/3]. It is a case that does not concern a breach of duty, whether in contract or tort. It supports the construction advanced by Wentworth.

Application of principles to clauses 7-9 GMA

<u>SCG's case</u>

47. Before turning to Wentworth's case it is useful to state the key difference between Wentworth's case and that of the SCG.

48. The SCG – as highlighted from its cross-examination of Judge Fischer – attempts to focus on an analogy with the general law of damages under the BGB.

49. It this respect it relies on these particular matters:

    (1) It points out that clause 7(1) GMA permits termination for material reason including non-payment.

(2) It says that clause 7(1) of the GMA must do so in order to conform to sections 305, 307 and 314 BGB, i.e. which would treat the GMA as "standard business terms" and therefore subject to a test of "reasonableness" as regards "contents" [AUTHS 2/83/P, Q and R]. The GMA has therefore to permit termination for non-performance to be compatible with the GMA.

(3) It then relies on Professor Mulbert's citation of two general damages case to supports its view of immediate termination: a physical damage case under the law of tort in the context of a road traffic accident, and a breach of contract case concerning a loan contract breached by the borrower and cancelled by the bank.

50. The SCG's big picture point in relying on these three matters is to say: the general law of damages awards damages from the moment of the breach and therefore clause 7(1) GMA must be similarly construed.

51. It is then said that as the calculation provisions are the same for clause 7(1) as for clause 7(2) that an immediately due claim must also follow in the event of automatic termination for insolvency.

52. The essential premise for this argument is wrong. There is no analogy to be had with the general law of damages:

(1) The fact that the GMA must permit termination for breach to comply with the BGB does not mean that any compensation claim should fall due immediately. All sections 305, 307 and 314 do is to require standard terms to include a right to terminate for breach. It is a protective provision (primarily aimed at consumer protection). This should not inform how the close-out provisions are to be construed, especially when they so obviously diverge from a damages calculation for breach of contract.

(2) Just as the ISDA Master Agreement cases in this country and the US have rejected over-reliance upon the general law of damages in construing a close-out netting provision, so too should this Court in construing the GMA under German law. This is because the GMA provides for a 'two-way' close-out. This is in

sharp contrast to the general law of damages under the BGB which permits only the innocent party to claim damages for breach: see sections 280 and 286 BGB as regards damages for delay. There are parallel provisions for damages for non-performance. In either case, there is a claim by the innocent party only. Any construction of the 'two-way' close-out provisions by reference and as limited by the general law of damages is entirely inapposite.

(3) Following from the above point, the termination provisions under clause 7(1) provide only for a termination on notice. That further distances the present case from the two damages cases upon which the SCG would rely.

53. Accordingly, to avoid error, the Court should look to the terms of the GMA without artificially restricting their meaning by an inapposite analogy with the general law of damages under the BGB.

GMA and German Insolvency Code

54. There is also a further point to the background of the GMA which the SCG has not considered which concerns InsO section 104 [AUTHS 2/84/E].

(1) InsO 104 takes effect on insolvency –"opening of insolvency proceedings": s104(3); "after the insolvency proceedings were initiated: s104(2)

(2) It prescribes a method of calculation which is mandatory on the opening of insolvency proceedings

(3) The mandatory calculation takes place by a pre-insolvency agreement on a date up to 5th working date after the opening of the insolvency proceedings or in the absence of such an agreement on the second working day after the opening of insolvency proceedings.

(4) InsO 104 was amended from initial enactment of 2 days to provide for 5 days due to concerns about inflexibility. See in this respect:

(a) [AUTHS 2/76/p2/ para 1], i.e. "*as situations are perceivable in this respect, in which it can be advantageous for at least one party to determine a later point in time for the calculation being relevant*";

(b) [AUTHS 2/101/71]: s.104 InsO key dates being revised from 2 days to 5 days so as to allow participants to select a close-out date as close as possible to "*intended settlement date*", i.e. up to T+5.

55. Clause 7 operates so as to enable a contracting out of InsO section 104:

(1) Clause 7(2) takes effect on the application for an insolvency:

(2) As explained by Judge Fischer, this is to contract out of InsO s104. See also:

(a) [AUTHS 1/54/para 11]

(b) [AUTHS 2/75/paras 37-40; 53]

(3) There is also a contracting out of the prescribed method of calculation: see Fischer 1/45-62 (especially at para 61) [4/8/135-139].

56. The contracting out adds greater flexibility to the process of calculation. The only requirement is that it be performed without "*undue delay*": clause 8(1).

57. Recognition in the amendment of the German insolvency code and in the wording of the GMA that the parties require flexibility in the calculation of the close-out amount is not consistent with the idea of an immediately due obligation.

<u>ISDA Master Agreement</u>

58. The relevance of German insolvency law as a background fact contrasts with Professor Mulbert's misplaced reliance on a superficial analogy with the ISDA Master Agreement.

59. Professor Mulbert was forced to acknowledge during cross-examination that the termination and close-out provisions in the ISDA Master Agreement are very different to those found in the GMA and do not provide any support for this argument: see Day 6/Page 61 - Page 70/Line 23]. There are five short points:

(1) The ISDA Master Agreement provides a detailed framework governing termination which is very different from the GMA.

(2) The ISDA Master Agreement does not provide for automatic termination on the insolvency of a party unless this option is chosen by the parties.

(3) The close-out payments under the ISDA Master Agreement do not become due until after the close-out calculation has been performed and the notice served on the other party. If relevant, this militates in favour of the claim under the GMA falling due after the netting under clauses 8 and 9 has been performed.

(4) The ISDA Master Agreement provides a contractual basis for a claim to default interest on the close-out amount – the GMA does not provide any contractual entitlement for interest on the single compensation claim under clauses 7-9.

(5) To the extent that any comparison is to be made with the ISDA Master Agreement in terms of the expectation of market users it tells us that market users would **not** expect a close-out amount to become payable until notified of the amount – the section 6(e) amount is "*payable*" only upon its notification. Accordingly, it is consistent with Wentworth's case.

<u>Construction of clauses 7 to 9 GMA</u>

60. Clause GMA 7(1) permits termination on notice for a "*material reason*" such as non-payment.

61. Clause 7(2) terminates the GMA automatically upon an application for insolvency.

62. The effect of termination, on whatever basis, is to discharge unperformed prospective obligations and to entitle a claim for compensation under clauses 8 and 9 in substitution of those obligations. This is the effect of clause 7(3).

63. Under clause 7(2) accrued but unpaid amounts, or accrued but unperformed obligations (e.g. for delivery), are not replaced by the damages claim under clause 8 but, under clause 9(1), are to be combined with the damages claims calculated under clause 8.

64. It is important to note that under clause 9(1) the unpaid amounts to be combined are not only those owed by the notified/insolvent party. The combination is to account for those unpaid amount as well as (by a deduction) unpaid amounts owed by the notifying/solvent party to the notified/insolvent party.

65. This combination is clear from the fact that:

    (1) Clause 9(1) simply refers to unpaid amounts and unperformed obligations without restricting those to such amounts or obligations owed to the notifying solvent party. The language works both ways. It is a 'two way' provision.

    (2) Clause 9(1) contrasts with clause 9(2) which deals with "Counterclaims" owed by the notifying/solvent party to the notified/insolvent party "for any legal reason whatsoever". This is a right of postponement and set-off for the benefit of the notifying party/solvent party.

66. It is important to be clear about the scope of clause 9(1) because it is by the combination directed by that clause that the "single compensation claim" is to become due. The "single compensation claim" is the final product of the netting calculation.

67. Clause 8 is the logically prior step in the netting process. It is the key provision for the calculation of damage:

    (1) Clause 8 permits the calculation of a damages claim on the basis of actual or hypothetical transactions. A choice has to be made in this respect and the choice and calculation is to be made without "*undue delay*".

(2) The reference time for the alternative basis of a claim – namely a calculation of damages where the Party Entitled to Damages refrains from entering into replacement transactions, including matters such as the exchange rates to be applied when determining the claim – is the time at which the counterparty became aware of the insolvency. This would not have been until after the making of the administration order in respect of LBIE.

(3) It is very difficult to see how performance can be regarded as being immediately due from the time of termination of the GMA when the key drivers for the determination of whether a payment has to be made and, if so, the quantum of the payment, are dependent upon steps to be taken only after the termination of the GMA.

(4) Clause 8 is a 'two-way' close-out provision because the financial benefit from termination must be accounted for. If the benefit exceeds the loss, the amount is owed by the notifying/solvent party to the notified/insolvent party.

(5) The consequence of the two-way close-out is that until the calculation is done it cannot be known whether the "Party Entitled to Damages" is the payee or the payer.

68. In the light of the nature of the two-way close out:

(1) Section 271(1) BGB would be applied by a German court to require the calculation to be completed in a reproducible manner before any claim for damages is due.

(2) This is because looking to the circumstances and the content of the two-way calculation provision, it cannot be right that any party is immediately liable to make payment before it is known, as between the parties, who is liable and for what amount.

(3) The best general guidance in this respect is the landlord's heating cost case referred to above [AUTHS 5/3]. In that case, the BGH based its reasoning on the

fact that either the tenant or the landlord might be owed money: the landlord for unpaid heating costs; and the tenant for a rebate in respect of overpayments made on the basis of an estimate. The BGH said that there was no agreement express or implied and no applicable statutory provision. It therefore said that the amount was due only upon the computation of a "verifiable" bill. The centrepiece of its reasoning was that the debt could not be due before calculation of who owed what.

(4) Furthermore, the fact that a postponement of the due date to the calculation of a bill necessarily postponed interest accruing under section 288 BGB played no part in the BGH's reasoning. This must be correct because it is bootstraps to say that the debt must be due immediately because if it is not one party will be denied interest payable from the date the debt is due.

69. Clause 9 does not alter this conclusion in any way:

(1) Clause 9(1) simply requires the addition or deduction of any accrued but unpaid amounts or the value of any accrued but unperformed obligations. The latter are to be valued and converted to Euros using the same mechanism as is in place in clause 9(2) for valuing non-money Counterclaims.

(2) The SCG however sought to make a point in relation to clause 9(1) about the continuity of interest on unpaid amounts. It was suggested to Judge Fischer that this showed that the damages claim is immediately due on termination. This is a bad point:

(a) The unpaid amounts or unperformed obligations as at termination date may be owed by or to either party.

(b) The unpaid amounts are "overdue" relative to an express payment date under clause 3.

(c) The fact such amount or obligations are unpaid or overdue as at termination provides no assistance in determining when the compensation claim under clause 8 becomes due.

(d) The compensation claim under Clause 8 exists, but is not due until calculated in a manner that can be reproduced to the other party.

(e) Interest due on unpaid amounts will continue to accrue throughout the calculation process, i.e. it is the unpaid amounts plus interest accrued on those amounts to the date of the combination which is to be combined with the compensation claim under clause 8 to form the single compensation claim under clause 9.

(f) There is therefore no interest lost in respect of unpaid amounts.

(g) The fact that there is no interest on the single compensation claim until calculated simply reflects the fact that the GMA does not contain any contractual provision for interest on the single compensation and that, in these circumstances, German law provides that interest cannot be claimed until payment is due.

(h) The 'loss' of interest on the claim as ultimately calculated, i.e. post-termination to the end of the calculation period, is overplayed by the SCG. The literature does not contemplate a protracted calculation process and clause 8 in fact requires that it be done without "*undue delay*".

(3) Clause 9(2) does not imply the single compensation claim is payable immediately. It simply confers on the solvent/notifying party a right to postpone the compensation claim to any Counterclaims. It does not imply that the compensation claim is immediately due on termination. It simply entitles a postponement relative to whatever date the compensation claim is due, whether on termination (on the SCG's case) or upon completion of a reproducible calculation (on Wentworth's case).

(4) Clause 9(2) in fact assists Wentworth:

(a) The single compensation claim calculated under clause 9(1), if owed to the notified/insolvent party, is payable only if either: (i) there are no Counterclaims of the notifying/solvent party; or (ii) if the notifying/solvent party "*fails*" to deduct such Counterclaims and the single compensation claim exceed the value of those Counterclaims.

(b) The notified/insolvent party cannot know whether or not it is entitled to be paid anything without the co-operation of the notifying/solvent party.

(5) It was for this reason that Judge Fischer placed some emphasis on the landlord and tenant deposit cases; not because of any security-deposit analogy, but because to the need for co-operation that he identified in that context. He said at Day 7/Page 58/Lines 16-23:

> "*This is because the due date of the claim for restoration by the tenant depends on the contract with the other party, the landlord.*
>
> *In a very different contract body to the German master agreement, what was important, significant, in my view, was that the due date - that the performance, only becomes due after the cooperation of the other party.*"

(6) He continued at Day 7/Page 59/Lines 5-12:

> "*This is because of the absence of decisions and views in the literature with regards to due date in the GMA. I have tried to find examples with different types of contracts from which I could draw conclusions for the interpretation for clauses 7 to 9 GMA. The link with this is that according to 7 to 9, there is a provision for cooperation between the two parties with regards to the damages compensation claim.*"

<u>Immediately</u>

70. In any event even if section 271(1) applies, "*immediately*" means objectively immediately so as to include a necessary amount of preparation time to perform – as accepted by Professor Mulbert at Day 6/Page 45/Line 21 – Page 46/Line 5.

71. In this case the administration application was made without notice to any party at around 7:30am on a Monday morning and the administration order was made before 8am.

72. No party would have been aware of the automatic termination of the GMA until after the administration order.

73. There is no sensible basis on which an objective meaning of "immediate" could require performance prior to the commencement of the administration.

Expert evidence of Judge Fischer

74. Judge Fischer has been clear and consistent in his evidence on this point throughout the proceedings.

    (1) Fischer 1/80 [4/8]: explains why a claim for compensation after clauses 7 to 9 GMA only became due after the commencement of the administration.

    (2) Fischer 2/35 [4/10]: restates that there was no default within section 286 BGB before the commencement of LBIE's administration.

    (3) Fischer 3/30 [4/12]: explains why the claim under clauses 7 to 9 only became due after LBIE's administration.

75. Professor Mulbert, by contrast, did not suggest in his first or second expert reports that the claim for compensation under clauses 7 to 9 became due prior to the commencement of LBIE's administration. He did not take issue with the evidence of Judge Fischer on this question of German law.

76. It was not until his third report that Professor Mulbert attempted to explain why the claim under clauses 7 to 9 should be regarded as becoming immediately due upon the termination of the GMA under clause 7(2) which occurred on the making of the administration application in respect of LBIE.

77. The SCG will no doubt contend that Judge Fischer was not clear in his oral evidence on this point when questioned by RD QC. This would be an unfair contention.

78. Judge Fischer was clear when asked an open question in re-examination: see Day 8/Pages 53/Line 17- Page 54/Line 5. He said:

> *"When the contract terminates according to clause 7 the compensation claim arises, but the compensation claim must be distinguished from the due date of the claim.*
>
> *[W]hen the claim arises it must be assumed to arise immediately when the contract terminates. But the due date presupposes a cooperation of both parties according to clauses 8 and 9, which we could call close-out netting.*
>
> *This becoming due presupposes that the – the close-out procedure of the reciprocal -reciprocally of the parties, that is all according to the decision in 9.2, the set-off happens.*
>
> *Then, only then, the claim becomes due.*"

79. He also explained the clear distinction in German law between the **existence** ("Entstehung") of a claim and its **enforceability** (i.e. when it is due for payment) ("Falligkeit") Day 8/Page 54/Line 15 – Page 55/Line 20. This was with reference to the passage in Zerey at [AUTHS 2/75/paras 50 and 54] which RD QC took Judge Fischer to without exploring that distinction: see Day 7/Page 82/Lines 14-17.

80. The passages upon which the SCG would seek to rely as concessions by Judge Fisher did not squarely put to Judge Fischer the distinction between the **existence** of a claim and its **enforceability** and in fact rolled up that discussion with (i) a discussion of termination "for cause" and (ii) the continuity of interest on the accrued but unpaid amount. As to this see:

    (1) Day 7/Page 67/Lines 11 to 15:

> "*If I understand the question correctly, as it has been translated to me, I see in 7 to 9 the – not the basis for a compensation claim but of an overall arrangement of anything which is due arising from termination.*"

(2) It is clear that the words "*which is due arising from termination*" were not intended by Judge Fischer to contradict his opinion on when the single compensation claim became due. The word "*arising*" makes this clear.

(3) Day 7/Page 69/Lines 7-11:

> "*The claims under 9(2)(1) concern whether, under what conditions, the insolvent party has a claim, not just a claim that exists but a claim which is actually due.*"

(4) It is again clear that the words "*not just a claim that exists but a claim which is actually due*" are no more than a summary expression of the issue as to the effect of those clauses, drawing a distinction between claims which exist and when they become due.

(5) Day 7/Page 80/Lines 4-11:

> MR DICKER: Judge Fischer, what I want to suggest is that that postponement only applies in the case of 9(2), the draftsman has not used similar words in 9(1).
> A. (Interpreted) No, I don't accept that view. My view is that 7 to 9 constitutes a united, a unified regulation so that irrespective of -- (Pause)
> So that the due, the amount is only due after the proceedings have gone on -- have terminated.

(6) It is again clear that the words "*only due after the proceedings have gone on – have terminated*" were, in response to the question, only meant to express disagreement that the netting process had been concluded ("*have terminated*").

(7) Judge Fischer then went onto say at Day 7/81/1-6:

> So when there are no counter claims, then once the insolvency has been declared then the sums become due, but not before the due date. Yes.
> If the insolvent party has no counterclaim, then the due date has occurred with the declaration of the insolvency.

(8) Judge Fischer here was only further expressing his disagreement to the same question, namely that the postponement under clause 9(2) was to be contrasted with clause 9(1).

(9) Similarly, Judge Fischer's comments in discussing interest on accrued but unpaid amount pre-insolvency and the continuity of interest on those amounts must not be taken out of context. At Day 7/Page 87/Lines 12-20 RD QC, having asked how interest on unpaid amount would be dealt with under clause 9, asked Judge Fischer whether the position would be different under a termination under clause 7(1):

> Q. What you say in relation to a situation where someone is insolvent, obviously applies also where there is a termination under 7(1)?
> A. (Interpreted) The decisive point is whether or not the default has occurred before insolvency has occurred or not, not when it has become due. I would emphasise that.
> The default, once it has occurred, is not stopped by the insolvency proceedings.

(10) This was picked up by RD QC after the break for the shorthand writers. The relevant exchange is at Day 7/Page 95/Line 17 to Page 96/Lines 1-8:

> Q. One further point. Going back to 9(1), we have the unpaid amounts under clause 3 and the damages claim under clause 8 and they are both turned into one single claim.
> What I want to suggest to you -- it sounds like you would agree -- if you ignore insolvency, those two claims must be dealt with in the same way, as far as interest is concerned.
> A. (Interpreted) Both claims have to be treated in the same way as if the contract had continued to run, it has to be treated exactly in the same way.
> Q. Just as there is no gap in relation to an unpaid amount under clause 3, there is also, as I think you have just agreed, no gap in respect of a damages claim under clause 8?
> A. (Interpreted) Yes, of course. Apart from insolvency, there is no gap in such a case.

(11) Accordingly, in extracting an apparent concession from Judge Fischer that interest on the single compensation claim ran from termination Mr Dicker rolled up the issue of interest on unpaid amounts. He did this because Judge Fischer had rightly said that, save for a post-insolvency default (which he say would not be legally effective), interest on unpaid amounts would continue to accrue post-termination and therefore there was no "*gap*".

81. The above extracts have been set out in full and in context because it is anticipated that the SCG will attempt to characterise Judge Fischer as having, by short expressions, contradicted his reasoned opinion. It is respectfully submitted that is not an inference the Court should lightly make.

82. In the earlier fuller discussion of clause 7(1) at Day 7/Page 62/Line 14 to Day 7/Page 63/Line 19, Judge Fischer in fact clearly rejected the suggestion that a damages analogy focused on termination for "material reason" under clause 7(1) indicated an immediately payable debt on termination. The full exchange reads:

> Q. 7(1) is essentially concerned with a situation of where there is a breach.
> A. (Interpreted) Yes, 7(1) refers to where there is a breach. (Pause)
> Q. As I understand it, under German law, clause 7 has to conform with the guiding principles of the BGB concerning immediate termination.
> A. (Interpreted) No, I see this differently. The immediate claim arises from the conditions of the contract according to the circumstances under section 271(1) of the BGB. That is why I said with respect to the termination of the loan contract, that this was correct in principle. But this cannot lead to the conclusion that this is therefore also mandatory with respect to the German master agreement.
> What is important is that the content and aim of the contract have to be deduced from the termination provisions contained in sections 7 to 9 of the GMA.
> The circumstances pertaining to the cases we have just discussed, which lead with regard to the immediate falling due of the claim, do not lead to a conclusion that this is also the, applies to the present case, and this case has to be examined anew.
> The special feature of this particular contract lies in the fact that several individual transactions are being summarised within a unified, or unity contract.

15 So that the individual, these individual transactions
16 may give rise to various reciprocal claims and they have
17 to be summarised in netting in one single final
18 contract, or transaction, sorry.

83. Judge Fischer has also been clear in his written evidence:

(1) Fischer 1/ 80 [4/8] – he explains why a claim for compensation after clauses 7 to 9 GMA only became due after the commencement of the administration.

(2) Fischer 2/35 [4/10] – he restates that there was no default within section 286 BGB before the commencement of LBIE's administration.

(3) Fischer 3/30 [4/12] – he explains why the claim under clauses 7 to 9 GMA only became due after LBIE's administration.

Conclusion

84. Wentworth therefore invites the Court to find that the obligation to pay the single compensation claim under clauses 7 to 9 GMA did not become due until after LBIE's administration.

85. The consequence is that the SCG is unable to establish that LBIE was in default of a payment obligation within the meaning of section 286 prior to LBIE's entry into administration.

86. The experts agree that a claim to *further damage* does not exist unless and until a default has occurred within the meaning of section 286: JS/para 19 [4/13].

87. This means that the counterparty to the GMA did not have any claim for *further damage* at the commencement of LBIE's administration.

DEFAULT: PROOF AS A WARNING NOTICE AND SERIOUS AND DEFINITIVE REFUSAL TO PERFORM

88. Even if Wentworth is wrong and the compensation claim under clauses 7-9 GMA can somehow be characterised as falling due for payment in the 20 minute period between the automatic termination of the GMA on the commencement of the hearing of the administration application and the making of the administration order before 8am on a Monday morning, this is not sufficient for the SCG.

89. Even if a payment obligation is due for performance there is also a need for the service of a warning notice under section 286(1) BGB or the application of one of the exceptions to the service of a warning notice under section 286(2) BGB in order for a default to arise. This was accepted by Professor Mulbert during cross-examination. Day 6/Page 71/Lines 3-10:

> 3 We agreed earlier that even if a claim is due, that
> 4 is not enough on its own for there to be a default
> 5 within section 286. That is right, isn't it?
> 6 **A. Yes.**
> 7 Q. You also need the service of a warning notice or the
> 9 application of one of the exceptions to the service of
> 9 a warning notice?
> 10 **A. Yes.**

90. As agreed by Professor Mulbert, the general rule is that a warning notice must be served to trigger a default: Day 6/Page 71/Lines 23-25.

91. No warning notices have been served against LBIE by a creditor with a claim under the GMA – whether before the administration order or after the administration order.

92. The experts agree that no warning notice can be served now as the proved debts under the GMA have been repaid in full: JS/para 25 [4/13].

93. The SCG seek to rely on the evidence of Professor Mulbert to make two arguments:

    (1) The filing of a proof of debt in LBIE's administration amounts to the service of a warning notice; and

(2) The administration application by LBIE's directors triggered a default under the exception at section 286(2)(iii) which applies in circumstances where there has been a serious and definitive refusal to perform by the debtor.

94. It is clear, based on the German materials and the evidence given by the experts, that these arguments should be rejected by the Court.

95. The Court will also be aware of the respective expertise of Judge Fischer and Professor Mulbert on these issues which raise the inter-relationship between a default under section 286 BGB and the commencement of insolvency proceedings.

96. Judge Fischer sat as a judge in Germany's highest court, the BGH, for 12 years. He sat in the 11th Senate which has responsibility for insolvency law amongst other areas. Judge Fischer was the presiding judge of the 11th Senate from 2003 until 2008.

97. Professor Mulbert has provided a detailed CV for the purpose of these proceedings [4/7/98-99]. His CV does not identify insolvency law as an area in which he has expertise. In fact, he confirmed during his cross-examination that he was "*not an expert in insolvency law*": Day 6/Page 66/Line 25 to Page 67/Line 2; and that he was "*not an expert in insolvency law as compared to Dr Fischer*": Day 6/Page 131/Lines 1-2.

98. It is respectfully submitted that where there is any conflict between the evidence of Judge Fischer and that of Professor Mulbert, the Court should prefer the evidence of Judge Fischer.

Proof in LBIE's administration does not constitute a warning notice

99. The expert evidence of Judge Fischer since his first report has been clear – the filing of a proof of debt does not constitute the service of a warning notice. He was equally clear on this issue during his cross-examination.

100. The highest that Professor Mulbert is able to put his evidence on this issue is that that while recognising that an effective warning notice cannot be served following the commencement of German insolvency proceedings "*this <u>may</u> be different in the case of an Administration*" (emphasis added): JS/para 23 [4/13].

101. Wentworth contends that the filing of a proof of debt in LBIE's administration does not amount to a warning notice as a proof of debt is not a request for payment. It is a request to participate in the distribution of the assets of the insolvent estate.

102. There are three topics to cover:

(1) The requirements for an effective warning notice.

(2) The reasons why a proof of debt does not constitute an effective warning notice in a German insolvency.

(3) The reasons why the same conclusion follows in the case of an English administration.

Requirements for an effective warning notice

103. The experts agree that a warning notice requires the obligor to receive a clear definite demand from the obligee for payment of an amount that is due: JS/para 22 [4/13].

104. In his cross-examination, Professor Mulbert agreed with this proposition and he further agreed that a warning notice "*requires an <u>unequivocal</u> demand for payment of a sum due*" (emphasis added): Day 6/Page 73/Lines 17-19.

105. This is consistent with the reasoning of the BGH. See, for example, the BGH decision at [AUTHS 1/28/paras 10-11] where the BGH described a warning notice as follows:

> "*A final payment demand that establishes default is any clear and specific request in which the creditor unambiguously expresses a demand for the performance owed*"

Reasons why a proof of debt in a German insolvency does not amount to a warning notice

106. A proof of debt in a German insolvency does not constitute a warning notice as it does not contain a request for payment of a debt.

107. Three key points can be taken from the evidence given by Professor Mulbert on this issue:

(1) First, Professor Mulbert agreed with the evidence of Judge Fischer that the filing of a proof of debt in a German insolvency is not considered to be warning notice as it is not a request by a creditor to the debtor for payment of a debt – it is actually a request to participate in the insolvency. See Day 6/ Page 75/Lines 2 -7:

> 2 Would you agree with Judge Fischer that -- his
> 3 evidence is that the filing of a proof of debt is not
> 4 a request by a creditor to the debtor for the payment of
> 5 the debt, it is actually a request to participate in the
> 6 insolvency. Do you agree with that?
> 7 **A. I agree with that, yes.**

(2) Professor Mulbert gave a similar confirmation at Day 6/Page 77/Lines 5-10.

(3) Secondly, Professor Mulbert agreed that the commentators speak with one voice on the issue in saying that a proof of debt does not constitute a warning notice as it does not include a request for payment. In this regard:

(a) The commentators include Judge Gruneberg in Palandt [AUTHS 1/48/B/para 21] and Lowisch and Feldman in Staudinger [AUTHS 2/59A/para 66].

(b) Professor Mulbert confirmed that he agreed with the reasoning of the commentators. Day 6/Page 77/Lines 5-10:

> 5 MR ALLISON: I see. The point I think is the same in both,
> 6 is that the author has expressed the view that the
> 7 filing of a claim in an insolvency does not replace the
> 8 need for a warning notice, because it does not include
> 9 a request for payment. You would agree with that?
> 10 **A. I would agree with that, yes.**

(4) Thirdly, Professor Mulbert agreed that the most significant relevant authority [AUTHS 1/37], a decision of the Reichsegericht as the predecessor to the BGH, had decided that a proof of debt does not constitute a warning notice as it does not entail a demand for payment. Day 6/Page 77/Line 22 to Page 78/Lines 15:

> 22 Q. Then if we can turn, there is just one paragraph that
> 23 deals with it, it is the very last page, and it is the
> 24 very last paragraph of the report. Do you see that what
> 25 the court says is the question to ask is: whether the
> 1 plaintiff went into default because the defendant filed
> 2 its claim in the bankruptcy proceedings against the
> 3 plaintiff's assets?
> 4 **A. Yes, I see that.**
> 5 Q. Yes? Then you see that the court answered that question
> 6 no and, reading what they say, they say it is to be
> 7 answered in the negative because the filing of the
> 8 bankruptcy claim to be entered in the schedule of claims
> 9 entails no demand made to the debtor for payment. Do
> 10 you see that?
> 11 **A. Yes, I see that.**
> 12 Q. The same point that was being made by the authors, you
> 14 don't have a demand for payment being made by proof of
> 14 debt?
> 15 **A. Yes, my Lord.**

Reasons why a proof of debt in LBIE's administration does not constitute a warning notice

108. The highest that Professor Mulbert was able to put his argument in the JS is that the filing of a proof in an English administration "*may*" constitute a warning notice: JS/para 23 [4/13].

109. The carefully reasoned reports of Judge Fischer identify the key question for the Court, namely what is the nature and function of a proof of debt in the insolvency of the obligor?

110. As explained by Judge Fischer in his evidence, the reason for the inability to trigger a default following the commencement of German insolvency proceedings arises from the fact that, following the commencement of the insolvency proceedings, there is a moratorium on legal process against the debtor; claims must instead be established by way of proof in the insolvency; and claims are to be discharged by the participation in the payment of dividends in the insolvency: see Fischer 3/paras 37-39 [4/12].

111. The carefully considered evidence of Judge Fischer was put to Professor Mulbert during his cross-examination. Professor Mulbert confirmed that he agreed with each and every aspect of the analysis of Judge Fischer: Day 6/Page 80/Line 15 to Page 82/Line 20.

112. As explained in his evidence, Judge Fischer has paid careful attention to the Administration Summary [4/14] and the particular aspects of an English administration and it is his opinion that there is no qualitative difference between the effect of a German insolvency proceeding and the effect LBIE's administration: Fischer 3/para 40 [4/12].

113. The key points are as follows:

(1) Following the commencement of an administration there is a moratorium on legal process against the debtor – para 43 Sch B1. The moratorium commences on the application for administration under para 44 Sch B1.

(2) The company's assets are to be dealt with in accordance with the statutory scheme of administration. They are no longer available to be used to meet claims in the ordinary course: see passages in the Court of Appeal decisions in *Polly Peck* and *Harms Offshore* and the decision of Briggs J in *Lehman* cited at [109(3)] of Wentworth's written submissions [3/10].

(3) From the time that an administrator gives notice of an intention to distribute, the assets are held on a statutory trust for the purpose of distribution to meet the claims of creditors who have proved their claims in the administration.

(4) Claims must be established by way of proof in the insolvency according to the process contained in Part 2 of the IR 1986. Proofs of debt are only submitted in response to a notice of intention of distribution and they are necessarily for the purpose of participating in any distribution by the payment of dividends in the insolvency.

(5) The filing of a proof of debt in an administration is not a demand for payment. It is a request to participate in a collective insolvency proceeding which may ultimately result in the payment of a dividend from the assets of the insolvent estate. In this regard:

(a) Oliver J in *Re Dynamics Corp of America (No. 2)* [1976] 1 W.L.R. 757:

> "*The provisions of both the Companies Act 1948 and the Bankruptcy Act 1914 with regard to the submission of proof are I think all directed to this end, that is to say, to ascertaining what, at the relevant date, were the liabilities of the company or the bankrupt as the case may be, in order to determine what at that date is the denominator in the fraction of which the numerator will be the net realised value of the property available for distribution. It is only in this way that a rateable, or pari passu, distribution of the available property can be achieved…*" (p. 764).
>
> "*…Secondly, even if these rights could be considered as of uncertain value, one has, I think, to inquire what it is that the creditor is seeking to do when he lodges his proof. What he is directed to do by the form of proof (and what all the previous authorities direct him to do) is to indicate the value of the claim at the date of the winding up order*" (p. 767).

(b) *Rubin v Eurofinance* at [165] to [167], citing *Robertson, Ex p; In re Morton* (1875) LR 20 Eq 733:

> "*[W]hat is the consequence of creditors coming in under a liquidation or bankruptcy? They come in under what is as much a compact as if each of them had signed and sealed and sworn to the*

> *terms of it—that the bankrupt's estate shall be duly administered among the creditors*"

(c) Lord Toulson and Lord Sumption in *Stichting Shell Pensioenfonds v Krys and another* [2015] A.C. 616 at [31]:

> "*For by submitting a proof the creditor obtains an immediate benefit consisting in the right to have his claim considered by the liquidator and ultimately by the court according to its merits and satisfied according to the rules of distribution if it is admitted.*"

114. Accordingly, the Court should reject the argument of the SCG that the filing of a proof of debt in LBIE's administration constituted a warning notice for the purpose of section 286(1) BGB.

115. In any event, the point does not assist the SCG as any default arising from a proof of debt would be after the commencement of LBIE's insolvency – in fact, a number of years after the commencement of the administration.

116. This would mean that the rate would not be a rate applicable to the debt proved for the purpose of Rule 2.88(9) for the reasons that will be considered in relation to Issue 20(2).

No "serious and definitive refusal" to perform as a result of the making of the administration application by LBIE's directors

Introduction

117. The inability of the SCG to rely on a warning notice under section 286(1) means that it therefore has to establish an automatic and immediate default under one of the exceptions to the service of a warning notice which occurred prior to the making of the administration order in respect of LBIE.

118. This would still not assist the SCG unless it could also establish that the payment obligation under clauses 7 to 9 fell due before the administration – but for the purpose of argument this assumption is made in this section of Wentworth's closing submissions.

119. There are a limited number of exceptions to the requirement to serve a warning notice which are listed at section 286(2).

120. Importantly, an application to commence insolvency proceedings is not an exception – nor is the commencement of insolvency proceedings.

121. The SCG is therefore forced to contend that the fact of the administration application by LBIE constituted an automatic and immediate default under section 286(2)(iii) BGB.

122. This requires the SCG to discharge the very high burden of establishing that making of the administration application by LBIE's directors should be characterised as LBIE "*seriously and definitively refuses performance*".

123. It should be noted at the outset that this would be a very surprising conclusion to reach in circumstances where the GMA expressly provides that the insolvency application terminates the contract without any indication that the termination gives rise to an immediately defaulted claim for a close-out payment under clauses 7 to 9.

124. The possible availability of an exception to the requirement to serve a warning notice was not even suggested in Mulbert 1 [4/7] and Mulbert 2 [4/9]. In this regard:

(1) Mulbert 1 refers to the requirement to serve a warning notice as a necessary precondition to a claim for *further damage* without even identifying the possibility that there would not have been a requirement for a warning notice in the present case: Mulbert 1/28 [4/7].

(2) Mulbert 2 discusses the requirement for a default under section 286 without suggesting that any of the exceptions applies in the present case: Mulbert 2/24 [4/7].

125. It was not until the service of Mulbert 3 that there was any expert evidence in support of the SCG's assertion that the making of an administration application in respect of LBIE – an act which occurred minutes before the making of the administration order and without any notice to LBIE's creditors (including the counterparties to the GMA) – should be regarded as amounting to a serious and definitive refusal by LBIE to perform its obligations under the GMA within the meaning of section 286(2)(iii).

126. This section of Wentworth's submissions is structured as follows:

(1) Existing authority on whether the opening of insolvency proceeding constitute a serious and definitive refusal to perform under s.286(2)(iii) BGB.

(2) Professor Mulbert's essential error in his report: the conflation of s.286(2)(iii) and s.323(4) BGB.

(3) The one authority relied upon by Professor Mulbert's for his assertion (at Mulbert 3/119 [4/11]) that a serious a definitive refusal need not be communicated – a case under section 634 BGB, which, as Professor Mulbert admitted during cross-examination, did not in fact even consider that issue.

(4) Communication/awareness of a serious and definitive refusal as a necessary part of the test under s.286(2)(iii), which is the correct test to be applied as consistently expounded by Judge Fischer and as supported by:

(a) the pre-legislative material;

(b) the commentaries; and

(c) the decisions of the BGH.

(5) The Munich HRC court decision which held that the opening of insolvency proceedings did not permit the inference of a serious and definitive refusal to perform.

(6) Consideration of LBIE's administration application.

Existing authority

127. Professor Mulbert agreed that he had not cited any German authority which supports his argument that an application to commence insolvency proceedings should be viewed as a serious and definitive refusal to perform by the debtor: see Day 6/Page 83/Lines 19-23; Day 6/Page 128/Lines 7-18.

128. Professor Mulbert agreed that if an application to commence insolvency proceedings constituted a serious and definitive refusal to perform, this would be important generally in German insolvency proceedings because interest was claimable from the insolvent estate only where there has been a default prior to the opening of insolvency proceedings: see Day 6/Page 84/Lines 12-23.

129. It is therefore telling as to what German law is that Professor Mulbert should have no authority to support his view that an insolvency application constitutes a serious and definitive refusal to perform.

130. Given the importance of such an issue, the absence of any authority supporting Professor Mulbert's view suggests that the opposite position – that of Judge Fischer – is true. This is the only explanation for the emphasis in the German literature upon a pre-insolvency default as a pre-requisite to claim interest against the insolvent estate. See in this respect:

(1) Judge Gruneberg [AUTHS 1/48/B/para 21] "*registration of the receivable in case of insolvency proceedings*" does not constitute the service of a warning notice.

(2) Lowisch and Feldman in Staudinger [AUTHS 2 /Tab 59A/para 66] which explains that the filing of a proof of debt does not constitute the service of a warning notice as a proof of debt does not contain a request for payment.

(3) Ernst [AUTHS 1/Tab 45B] which explains that the filing of a proof does not constitute the service of a warning notice.

131. Further the Reichgericht would not even have had to consider whether a proof of debt was a warning notice if the proceeding itself had triggered an automatic and immediate default: see [AUTH 1/37]. The consideration of whether a proof against the estate was a warning notice against the debtor would simply not have been necessary had the proceeding itself triggered a default.

Essential error made by PM: a conflation of section 323(4) BGB and section 286(2)(iii) BGB

132. Professor Mulbert said that he relied on section 323(2) BGB and section 323(4) BGB "*in conjunction*" to construe section 286(2): see Day 6/Page 87/Lines 9-10. He said at Day 6/Page 87/Line 21 to Page 88/Line 4 that:

> *"[I]f the debtor is serious and definitely refuses to perform. And the prerequisites for that to happen are* ***relaxed*** *based on paragraph 4, if it is obvious before the performance is due that the preconditions set out in paragraph 2 will be met.*" (Emphasis added)

133. There are two points to be made at this stage.

134. First, his statement is a change of case. Mulbert 3/109 said that "*s.323(4) is to be* ***distinguished*** *from s.323(2)(i) BGB*" (emphasis added). Mulbert 3/111 to 113 [4/11] then expounds a distinction between:

(1) the "*risk of failure to perform*" (Mulbert 3/112); and

(2) a "*refusal of performance*" (Mulbert 3/113),

which distinction he says (at Mulbert 3/111) is based solely on section 324(4) not on section 323(2)(i).

135. Secondly, any reliance on section 323(4) BGB or section 323(2)(i) BGB as "*relaxation*" of s.286(2)(iii) is simply misconceived. Section 323 BGB is about a creditor's right to withdraw from a contract for non-fulfilment [AUTHS 2/83/S]:

(1) Section 323(1) is the basic rule: a creditor can withdraw from a contract for non-performance (i.e. perform which is already due) if he first sets a grace period to give the debtor one last opportunity to perform;

(2) Section 323(2) concerns exceptions to the grace period required by section 323(1):

(a) Section 323(2)(i) provides that no grace period need be set in the event of a serious and definitive refusal to perform.

(b) This wording has parallels with section 286(2)(iii).

(c) Nothing however turns on the parallel between section 323(2)(i) and section 286(2)(iii) because – as apparent from the cases and commentaries – the serious and definitive refusal to perform language, which is the same in both sections, imports its own test and is subject to the same "*strict requirement*" in both s.323(2)(i) and s.286(2)(iii), of which neither is to be confused with s.323(4).

(3) Section 323(4) concerns non-performance prior to the due date that is virtually certain. It imposes a test of whether or not it is "*obvious*" that there will be non-fulfilment before the due date. This is a probability based test and Professor Mulbert accepted during cross-examination that it required a virtual certainty of non-fulfilment.

(4) The test under section 323(4) can be satisfied by a serious and definitive refusal to perform. It can however be satisfied by other events which do not amount to a serious and definitive refusal but nonetheless satisfy the test of virtually certain non-performance.

(5) This means that the test of "obvious", i.e. virtually certain non-performance does not inform in any way the test for serious and definitive refusal to perform.

(6) In other words, the fact that the test for a serious and definitive refusal may satisfy the test for s.323(4) so as to permit a revocation of the contract before the due date does not low**er** the bar for a serious and definitive refusal to perform.

(7) That test – the test under s.286(2)(iii) – is not a probability based test and is subject to its own "*strict requirements*".

136. Accordingly, it would be an erroneous application of German law for this Court to allow any part of the probability based test under section 323(4) to cloud its thinking in terms of applying the test under section 286(2)(iii).

137. In simple terms, it is wrong to conflate section 286(2)(iii) and section 323(4), yet this is precisely what Professor Mulbert does at Mulbert 3/108 to 120 [4/11]. This is the centrepiece of his opinion on the test for default and on LBIE's alleged default and it must be disregarded.

138. That Professor Mulbert is wrong to conflate section 286(2)(iii) and section 323(4) is clear from the commentaries:

(1) See Ernst in Muchener Kommentar [AUTHS 1/45/D]. In particular:

(a) At [132] – "*The provision [i.e. section 323(4)] is, however, by no means limited to cases of refusal to perform*".

(b) At [133]-[135]: under section 323(4) the question of whether something is "*obvious*" is a "*predictive decision*" requiring "*a high degree of probability*".

(c) At [137], in considering the "*individual cases*" that might fall to be considered under section 323(4), Ernst opines that a serious and definitive refusal to perform is a distinct case to which "*the **same** requirement shall apply as pursuant to Para 2, No 1"* (emphasis added), i.e. of a serious and

definitive refusal under 323(2)(i), which is the same test as under s.286(2)(iii).

(d) Ernst is saying precisely the opposite of Professor Mulbert: there is no "relaxation" of the test of a serious and definitive refusal. If there is such a refusal, it is simply one such event that might satisfy section 323(4).

(2) Similar conclusions are reached by the other commentators such as Judge Gruneberg in Palandt: see [AUTHS 1/48/E/paras 12 and 23].

(3) Indeed, there is no commentator that supports the inventive argument of Professor Mulbert.

139. It is clear that PM bases his reasoning and his conclusions as regards LBIE's administration application on section 323(4) which he says colours the application of section 286(2)(iii): see Mulbert 3/110 to 120 [1/11].

140. Professor Mulbert's opinion is therefore unsound and cannot be relied upon by this Court.

141. There is, in fact, no possibility of such reliance in any event because in cross-examination Professor Mulbert was forced to concede the error he had made. In this regard:

(1) Professor Mulbert agreed that section 323(4) introduced a test of highly probable non-performance in order to revoke a contract before the due date: see Day 6/Page 96/Lines 22-25. He agreed that the test is one of "*virtual certainty*": see Day 6/Page 100/Lines 3-7.

(2) Professor Mulbert agreed that section 323(2)(i) was dealing only with the dispensation of the grace period in section 323(1): see Day 6/Page 97/Lines 1-4.

(3) Professor Mulbert agreed that section 323(4) could be satisfied by a serious and definitive refusal or other grounds not amounting to a refusal but which

nonetheless satisfied the test of virtually certain non-performance: see Day 6/Page 100/Line 25 to Page 102/Line 1.

(4) Professor Mulbert agreed that section 286(2)(iii) imposed a different test. He said of its "*strict requirement*" at Day 6/Page 105/Lines 3-7:

> "*It means that it must be - it is not enough for the debtor to say that he won't pay because of - for some reason - it must be, as the courts have several times put it, the final word of the letter to say, no, I am not going to perform.*"

(5) Professor Mulbert also agreed at Day 6/Page 105/Lines 10-17 that "*a serious and definitive refusal to perform requires that the debtor unambiguously gives its final word that it won't perform*".

142. In cross-examination of Judge Fischer on Day 8/Pages 5-9, Mr Dicker QC ("RD QC") made an attempt to put Professor Mulbert's inventive case as regards section 323(4). As to this:

(1) RD QC did so initially by seeking to extract a concession that satisfaction of section 323(4) would <u>also</u> satisfy section 286(2)(iii).

(2) He did not squarely ask whether satisfaction of section 323(4)'s probability based test would also satisfy section 286(2)(iii).

(3) Judge Fischer did not however give him the answer RD QC hoped for. Judge Fischer instead emphasised that section 286(2)(iii) was distinct from section 323(4) and that only section 323(2)(i) used the wording "serious and definitive refusal".

(4) Thereafter, RD QC phrased his questions in terms of a "serious and definitive refusal": see, in particular, Day 8/Page 5/Lines 13-17; Page 6/Lines 9-21; Page 8/Lines 23-25; and Page 9/Lines 4-6. He did not seek to put Professor Mulbert's argument that section 286(2)(iii) could be engaged by reason of a probability of non-performance.

(5) RD therefore fell a long way short of establishing, as required by the SCG's case, that a serious and definitive refusal under section 286(2)(iii) could be inferred on the basis of the probabilities test under section 323(4).

Communication of the refusal

143. Professor Mulbert said at Day 6/Page 105/Line 24 to Page 106/Line 7:

> "*The communication means, implies, an element of a declaration from, and German courts and also some commentators have held that it is not necessary to be a declaration on the part of the debtor, but it can be what is termed a simple act implying that they will not be -- that they will not perform. In that sense, communication is, from my understanding, not the appropriate description of that fact.*"

144. He said "*Unequivocal conduct would suffice*" at Day 6/Pages 106/Lines 8-9 and, at Page 108/Lines 9-13, that:

> "*I do not agree with the requirement of an explicit statement by the creditor* ***if he conducts himself in a way that can be understood to be a definite refusal****, I would submit that this is enough to qualify as such an act.*" (emphasis added)

145. He however said that he disagreed with Staudinger [AUTHS 2/70/paras 91 to 93] that the "*refusal must be declared to the other creditor or the person authorised by the creditor*": see Day 6/Page 108/Lines 14-17.

146. He was then tested as to what the creditor had to be aware of by reason of any conduct of the debtor. He said, at Day 6/Page 115/Lines 17-21, in answer to the Judge's question that the act would have to be known to the creditor:

> "*[A]t the end of the day, yes, because without the creditor getting knowledge of the fact, he would never be, would know, about the right*"

147. There is no support for the view that a refusal need not be communicated in any way for section 286(2)(iii) to be satisfied.

Professor Mulbert's one authority for saying a refusal need not be communicated or known to the creditor

148. Professor Mulbert was able to rely on only one case in support of his argument that a refusal need not be communicated or known to the creditor: see Mulbert 3/119 fn 94 [4/11]. This is a decision of the BGH in 1990 [AUTHS 1/12] in relation to section 634 BGB. Section 634 is at [AUTHS 5/9/B].

149. The following points are immediately apparent in relation to this decision (as acknowledged by Professor Mulbert during his cross-examination):

(1) The case did not concern section 286(2)(iii);

(2) The case did not concern any other provision of the German Civil Code with the wording of a serious and definitive refusal to perform;

(3) It concerned section 634 BGB which applies in relation to the election of the remedy the completion of defective works or compensation;

(4) Professor Mulbert agreed the key facts of the case as follows:

(a) The debtor had initially refused to remedy the defect in the works performed;

(b) The creditor did not however elect either remedy (i.e. making good the defect or compensation);

(c) The debtor then said he would remedy the defect;

(d) The creditor then claimed compensation.

(5) The BGH considered the issue of whether the debtor's initial refusal meant that he could not subsequently say he would perform. The BGH simply held that:

> *The refusal is not a legal declaration that modifies the contractual relationship, to which the debtor can be bound. It merely constitutes a behaviour which makes it easier to not set an otherwise required deadline.*

(6) At Day 6/Pages 117-122, Professor Mulbert accepted that the BGH did not and did not need to consider the question whether a refusal had to be communicated or known to the creditor to be effective. He said at Day 6/Page 121/Line 25 to Page 122/Line 2:

> "*Namely that the court did not consider it, but that the court had no reason to consider it.*"

(7) The case simply concerned the question of whether a refusal (which had been communicated directly) amounted to a variation of contract such that the contractor could not take back the refusal and say he would perform after all. The BGH held that it did not modify the contract and, therefore, he could choose to perform, having initially refused to perform.

(8) Professor Mulbert's reliance upon the case is misconceived and does not support this crucial aspect of his opinion at Mulbert 3/119.

150. Professor Mulbert was unable to cite any other case or indeed any commentary in support of his assertion that a serious and definitive refusal to perform did not need to be communicated to the obligor.

151. Indeed, the debate that Professor Mulbert asks the Court to enter into appears to be a 'category debate' under German law. At [AUTH 2/70/para 93 (first sentence)] Staudinger states:

> "*The refusal to perform is to be **classified** as a transaction-like act not only as a **real act**.*"

152. Staudinger then goes on to say at para 93 (fourth sentence):

> "*[T]he refusal must be declared to the creditor or the person authorised to take delivery by the creditor.*"

153. He then says at para 94 that the refusal may be implied from the circumstances.

154. All this prefaced by his comment at para 91 (second sentence) that the perspective of "*the recipient is the decisive factor*".

155. There is, therefore, no sense in Staudinger that how a serious and definitive refusal is classified affects the content of the test of which the court has to be satisfied.

156. Indeed, in this respect, the case noted at para 93 of Staudinger for the minority view that the classification should be as a "*real act*" (as distinct from a "*transaction-like act*") is the 1990 decision relied on by Professor Mulbert at Mulbert 3/119. As the facts and reasoning of that decision demonstrate, there is nothing that the BGH said in that case which even indicates that a serious and definitive refusal need not be communicated or made known to the creditor concerned in order for section 286(2)(iii) BGB to be satisfied. Its citation is further confirmation that how a serious and definitive refusal is classified – whether a "*transaction-like act*", or a "*real act*" – has no impact upon the requirements of which the Court has to be satisfied.

Communication of a serious and definitive refusal: the correct view

157. Judge Fischer's clear and consistent evidence is that a serious and definitive refusal under section 286(2)(iii) requires communication by words or conduct to the creditor that the debtor will not perform. In this regard:

(1) Day 7/Page 99/Lines 2-5:

> *Usually a definitive refusal of performance is explained to the other party and there could be other circumstances which would also have to be explained to the other party.*

(2) Day 7/Page 99/Line 25 to Page 100/Lines 1-5:

> *I am of a different opinion [to PM], I think that a refusal to perform can be either explicit or implicit in the actions of the --in actions, **so that the party can see**. The other party must be capable of being aware that the party in default is in default and is refusing to perform.*

(3) Day 7/Page 101/Line 24 to Page 102/Line 13 (Hildyard J as regards the burning car example):

My understanding of the essence of your reply is that if what is relied on is implicit, or a fact, or an event. To qualify, that event must be explicable exclusively by reference to a refusal to pay…It must be the only reason, is what you have said.

So that in an extreme example that you gave of the drunk or lunatic, you are telling me that drunkenness or lunacy might be the explanation rather than a refusal to pay and therefore the event would not be entirely unequivocal, a refusal to pay. Is that what you are telling me?

(4) Day 7/Page 103/Lines 3-6:

Well I see this differently, because if there are no additional circumstances which indicate without doubt that they are intended to constitute a definitive and serious refusal, that should be then expressed.

(5) Day 7/Page 103/Lines 9-12 (in response to Hildyard J):

The act does not have to be precisely, directly communicated to the other party but the act has to be done in such a way that the other party is made aware of it.

(6) Day 7/Pages 103-104: RD QC took Judge Fischer to Schwarze in Staudinger at para 94, but not paras 91, 92 and 95. The first paragraphs emphasise the perspective of the creditor and communication. The last paragraph says that an insolvency petition is not sufficient.

(7) Day 7/Page 104/Lines 16-20:

That is exactly what I wanted to say, that it depends on the circumstances, and that is whether a final refusal is known to the other party. It must be acknowledgeable, or recognisable without doubt by the parties that that has been the case.

(8) Day 7/Page 104/Lines 21-24: RD QC asked Judge Fischer whether he agrees that a refusal can be a real act as opposed to a declaration of intent or a quasi-declaration of intent. He did not however go to Mulbert 3/119 and thereby elided (i) the debate about declarations of intent versus a real act, on the one hand; and (ii) the need for communication or the awareness of the refusal, on the other hand. As to the need for communication or awareness, whether refusal is by a declaration or conduct, Professor Mulbert is only able to rely on one case under

section 634 BGB to say that no communication or awareness is required. As explained above, Professor Mulbert accepted during cross-examination that the case was not authority for any such proposition.

(9) In any event Judge Fischer's answer to RD QC's question, at Day 7/Page 105/Lines 1-4, was:

> *I agree with Professor Mülbert that there is no - it does not need a declaration of intent. It can also constitute a definitive refusal by a particular act.*

(10) By this Judge Fischer only agreed that a serious and definitive refusal did not have to be by a statement of a refusal to perform, i.e. a declaration of intention, and that it could be by an act. He did not agree that it did not have to be communicated or made known to the creditor. RD QC did not ask him whether the act had to be a "transaction-like act" (to use Staudinger's expression) and he did not explore the need for communication or awareness.

(11) As to this Judge Fischer later said:

(a) Day 7/Page 117/Lines 18-19:

> *The word "Refusal" - "Verweigerung" in German - constitutes a declaration of intent.*

(b) Day 7/Page 117/Line 25 to Page 118/Line 1:

> *Even in a real act, to be assessed as such from this real act must be concluded an actual refusal.*

(12) Judge Fischer did not therefore say anything other than a refusal may be inferred from conduct, which did not in any way deviate from his previous answers as to the requirement that that act be communicated or at least made known to the other party to constitute a refusal under section 286(2)(iii) BGB.

(13) Judge Fischer thereby made clear that although a serious and definitive refusal might be inferred from conduct, that conduct had to have the hallmarks of a refusal, hence the commentaries use terms like "transaction-like act" or "quasi-

declaration of intent" to classify the conduct required. He was clear that a serious and definitive refusal by conduct must be communicated or made known to the creditor in order to satisfy s.286(2)(iii).

(14) RD QC then put a vague and theoretical question in terms of "*a generally available public statement*" at Day 7/Page 105/Lines 6-8. JF said that this was "*very theoretical*" and said that he assumed that the other party would have knowledge of a public statement.

(15) Judge Fischer then repeated at Day 7/Page 105/Lines 19-21: "*It has to be expressed very clearly that this is viewed as a definitive and final.*"

(16) In short, the only reliable evidence before the Court is that a serious and definitive refusal, even if by conduct, must be:

(a) Solely explicable by that conduct as a refusal to perform; and

(b) Communicated or at least known to the other party.

158. This is confirmed by the pre-legislative material, the German cases and commentaries.

159. Pre-legislative materials:

(1) [AUTHS 2/87/A]: 145 - Legislator acknowledged that default "*requires the fault of the debtor and a warning notice or equivalent circumstances*";

(2) The logic of the exceptions being referred to as "*equivalent circumstances*" or warning notice "*substitutes*" is that the exceptions should be seen as something equal to the refusal to perform in the face of a warning notice

(3) [AUTHS 2/87/A] 146 – addresses the exception which is at section 286(2)(iii) - it speaks of "*an earnest and final refusal to perform*" by the obligor;

(4) This tells us that it is about the refusal to perform and not the risk of non-performance

160. Commentaries:

(1) Schwarze in Staudinger [AUTHS 2/70]:

(a) At [91]:

"*One can only speak of a refusal of performance if the obligor denies performance in a certain manner as a final act…The horizon of the obligee as the recipient is the decisive factor. Such refusal must be considered as the last word of the obligor so that a change of the decision appears to be ruled out… Strict requirements should be imposed on the assumption that the obligor denies performance as a final act.*"

(b) At [93] it is made clear that the refusal to perform must be communicated to the creditor.

(c) At [95]: insolvency petition alone is a not a default

161. BGH decisions:

(1) BGH 2007 [AUTHS 1/28/81] as a warning notice under section 286(1) is the general rule, there is no reason to construe exceptions in s.286(2) broadly.

(2) BGH 2009 [AUTHS 5/6/101/at [29]]:

"[T]his requires that the debtor seriously and finally refuses to perform [citations of 1951 and 1976 BGH cases omitted]. Strict requirements are to be set for such a refusal. They are only satisfied if the debtor clearly expresses that he will not fulfil his obligations and, with this, it seems to be ruled out that a notice to perform will result in him changing his mind."

Munich HRC decision

162. In discussing the Munich HRC decision at [AUTH 3/98], Professor Mulbert sought to clarify the use of the word "*alone*" in paragraph 95 of Staudinger.

163. It is clear from a reading of the Munich HRC decision that it is not, contrary to the impression given by Professor Mulbert, focused only on a temporary lack of liquidity.

164. The judgment references s.17 KO, i.e. the section of the German insolvency law which conferred on an insolvency administrator a right to pay or perform under a prior contract.

165. The Munich HRC therefore also relied upon the option to pay or perform by the officeholder to say that the insolvency petition/proceeding alone did not permit the inference of serious and definitive refusal to perform.

166. The Munich HRC was saying that, without more, the nature of the proceedings precluded an inferred serious and definitive refusal to perform.

167. This is why Staudinger at paragraph 95 adds the word "*alone*".

168. See also in this respect Day 6/Pages 126-127 which considered Ernst [AUTHS 1/45/D/paragraph 140 and fn 244] which said that even under section 323(4) an insolvency proceeding or indeed insolvency application would not support a right to withdraw from a contract because of the insolvency administrator's power to pay or perform, which could not be pre-empted, i.e. it could not be said that non-payment or non-performance was a virtual certainty.

LBIE's administration application

169. Judge Fischer's expert reports contain a clear and carefully reasoned explanation of why the administration application by LBIE's directors does not give rise to a serious and definitive refusal to perform by LBIE under section 286(2)(iii): see Fischer 3/37-40 and 47-50 [4/12].

170. Having regard to the Administration Summary [4/14], Judge Fischer is of the view that an administration application would not constitute a requisite declaration of intent not to perform and, further, that no inference of serious and definitive refusal to perform the GMA is permitted given, in particular:

(1) the fact of insolvency is indicative only of a general inability to pay debts, not a refusal to perform a specific contract or pay a specific debt;

(2) the fact that an administrator has the option to carry on all or part of a company's business including whether or not to adopt a contract or cause a contract to be performed.

171. For these reasons, Judge Fischer does not agree that a serious and definitive refusal to perform the GMA can be inferred from the fact or grounds of LBIE's administration application or administration order. He is of the view that there was no automatic and immediate default by LBIE at the time of its administration application or order: see Fischer 3/48-52 [1/12].

172. The evidence of Judge Fischer was equally clear during his cross-examination.

173. RD QC said at Day 7/Pages 106/Lines 15-17:

> *I want to ask you about the effect of LBIE's application for an administration order.*

174. RD QC then proceeded wrongly to refer to the administration application as a "*public act*". He also wrongly characterised the evidence of Mr Sherratt in support of the administration application in an attempt to meet the very high burden of showing a serious and definitive refusal to perform.

175. After a line of questioning that became increasingly hypothetical and divergent from the witness statement filed in support of the administration application, RD QC said at Day 7/Page 117:

> *The exercise I am currently engaged on is essentially trying to test how serious and definitive refusal operates in practice. Taking this essentially as a rather less hypothetical example.*

176. The Court will recall that RD QC made this comment in response to the Judge's intervention at Day 7/Page 116/Lines 16-18, RD QC having overlooked parts of Mr

Sheratt's evidence (for example, paragraph 8.1 in relation to continued trading as noted by the Judge) and having inaccurately summarised Mr Sheratt's evidence as, variously:

(1) "*Objectively he is saying that LBIE will not perform its obligations*." (Day 7/Page 114/Lines 13-14)

(2) "*[I]magine he said it to a creditor…What Mr Sherratt was saying was, "I am not going to perform, I can't perform"*." (Day 7/Page 114/Line 25 to Page 115/Line 1)

177. Despite this tendentious (and misleading) line of questioning, Judge Fischer gave clear and consistent answers:

(1) At Day 7/Page 114/Lines 2-12:

> *An unconditional serious and definitive refusal, not necessarily, because it expresses not being able to, not not intending to -- not wanting to. He expresses only that LBIE at the time cannot fulfill its obligations but this is not necessarily definitive. It expresses no that he is incapable of paying but if one looks further ahead, with a further sight ahead, in my view that is still not even sufficient because he only says, they cannot pay but not that are not wanting to, or wishing to or have no intention to pay.*

(2) At Day 7/Page 114/Lines 15-19:

> *This is correct, but factually it is a fact that in perhaps not all but most insolvency cases, it is a declaration is made that they cannot fulfill, they cannot fulfill their obligations, meet their obligations.*

(3) At Day 7/Page 115/Lines 2-17:

> *Taking account of what appears in the literature and in the case law for a definitive refusal to perform, which is subject to very strict conditions, it is not sufficient to say, "I am not in a position, I cannot pay", one has to say, "I do not wish to pay, I do not want to pay". In practice there are many cases where one party says I cannot no longer pay. There is practically no case when this constitutes a definitive refusal within the meaning of 286(2), sentence 3. Particularly not if this concerns a group, a number of cases and not an individual case. As an insolvency [practitioner], I would know if any such insolvency application would have been assumed to be in refusal according to article 286 BGB, 286(2)(3). In my view this has not occurred.*

(4) In referencing his experience as an insolvency practitioner, Judge Fischer, in a rather understated way, was referring to his experience as the presiding judge of the 11th Senate of the BGH charged with dealing with insolvency cases.

178. As against the clear and convincingly reasoned opinion of Judge Fischer as to why section 286(2)(iii) is not satisfied in the case of LBIE's administration application is the opinion of Professor Mulbert, who has twice freely admitted he is not an insolvency expert and does not even list insolvency on his CV.

179. Wentworth contends that the evidence of Judge Fischer should be preferred.

180. The question is whether the fact of the administration application can be said to be a serious and definitive refusal to pay the single compensation claim under clauses 7-9 GMA. The question is not whether there had been a serious and definitive refusal to perform the Transactions under the GMA which are terminated on the administration application and made subject to the netting procedure.

181. As explained above, under the netting procedure LBIE could be the payee or payer. This fact alone shows that the mere making of the application cannot be considered to be the final word by LBIE on whether it would pay any compensation claim under the GMA.

182. Further, as set out below, it is clear from the facts of LBIE's application that the administration was to be a trading administration. The administrators would have power to pay or perform any contract they saw fit to do so in the interests of the administration. It cannot be said on Day One of the administration, let alone on the making of the administration application, that had been a serious and definitive refusal to pay any amount under the GMA. LBIE's administration was not converted to a distributing administration until December 2010.

183. The key facts relevant to the administration application by LBIE's directors are as follows:

(1) The application was made on a Monday morning before markets opened at around 7:30am.

(2) The administration order was made at 7:56am.

(3) The administration application was issued later pursuant to an undertaking given to the Court to do so.

(4) No creditor was given notice of the application.

(5) The application was made in this way to put administrators in place before markets opened.

(6) The administration order was only made public after it had been made.

(7) Sherratt 1 [2/1] does not support a finding that LBIE seriously and definitively refused to perform its obligations for the purpose of section 286(2)(iii). In particular:

(a) LBIE was said to be balance sheet solvent (with net assets as at 31 August 2008 of US$7.122bn): paragraph 7.1

(b) At paragraph 7.4 (which RD QC did not go to: see Day 7/Page 113/Lines 19-21) it is not said that LBIE will not pay only that it is unable to pay.

(c) The inability was the result of a cash shortfall of $800m required in 24hrs in circumstances in which there had been a cash sweep to the US and LBHI was to enter Chapter 11 in the US.

(d) It is also clear from paragraph 8.1 (which the Judge noted, but which RD QC did not go to) that LBIE was to be a trading administration, i.e. necessarily that at least some payments would be made and some contracts would be performed.

(e) No contract was referenced specifically in Sherratt 1 and no mention was made of any GMA contract.

184. Administration has different objects to a winding up.

185. The nature of an administration is explored in Wentworth's written submissions [3/10/35-37] at [115].

186. Wentworth contends that, when seen in its proper context, there is no substance to the SCG's argument that the administration application by LBIE's directors should be seen as a serious and definitive refusal to perform. In particular:

(1) Administration is a non-terminal insolvency proceeding which does not automatically terminate contracts or trigger a default under a contract.

(2) When seen in this context it would be extraordinary to conclude that the making of the administration application constituted a serious and definitive intention on the part of LBIE not to perform each of the contracts to which is was a party.

(3) This is particularly so in circumstances where there is no passage in the evidence in support of the administration application in which LBIE states that it does not intend to perform any claims under the GMA, let alone doing so in a way which was communicated to the GMA counterparties prior to the making of the administration order.

(4) The short point is that the authorities make clear such an intention cannot be inferred under section 286(2)(iii) BGB from making of an administration application.

(5) Wentworth's position is bolstered by the fact that in the absence of an express provision in a contract, administration does not, as a matter of English law, automatically terminate a contract or trigger a default under a contract.

(6) The SCG is wrong to suggest that English authorities which address the nature of administration are not relevant to the resolution of this issue. They are directly relevant to the question of whether the administration application is to be characterised as giving rise to the required serious and definitive intention not to perform.

187. In Wentworth's written submissions note is also made of the English cases which would suggest that the nature of administration does not amount to an anticipatory breach or a repudiatory breach of contract under English law: see [3/10/37-39] at [117].

188. Whilst it is recognised that the question for the Court concerns 286(2)(iii) BGB, the Court should note that the cases on repudiation and anticipatory breach under English law do reveal something about that the nature of an English law administration, namely that, in its nature, it alone does not permit the conclusion that performance has been refused (i.e. a repudiation) or that a contract will be breached (i.e. an anticipatory breach). It is in respect of a proceeding of this nature – in respect of which there is common ground between the parties (see the Administration Summary/paragraph 1.10 at [4/14/394]) – that the Court must ask whether there has been a serious and definitive refusal to perform by LBIE under s.286(2)(iii) BGB.

Timing of default

189. At Day 7/Page 106/Lines 12-13, Judge Fischer said: "*But there too one has to say that the default only occurs a day after the due date*."

190. RD QC did not challenge this evidence in cross-examination. He simply moved to another question.

191. The evidence before the Court is therefore that any default under s.286(2)(iii) in fact occurred the day after LBIE's administration application.

192. Accordingly, this is another reason why the SCG is unable to establish its case.

CONCLUSION ON ISSUE 20(1)

193. The SCG must establish that the compensation claim becomes immediately due and payable on the automatic termination of the GMA even in circumstances where (i) there had been no breach of contract; and (ii) the netting procedure had not been undertaken so LBIE had no idea if it owed any sum to its contractual counterparty and, if so, what amount. Wentworth contends that it cannot discharge this burden for the reasons developed above.

194. Even if the SCG can discharge this burden, in order to constitute a "default" under section 286 BGB so as to open the gateway for the possibility of a claim for further damage, the SCG must still establish either (i) that the proof of debt in LBIE's administration constituted a warning notice; or (ii) that the administration application constituted a serious and definitive refusal to perform so as to trigger an exception to the requirement for the service of a warning notice. Wentworth contends that it cannot discharge this burden for the reasons developed above.

195. This means that there is no possibility of a claim for *further damage* under section 288(4) BGB.

196. The result is that all issues in relation to the detail of the burden of proof of a claim for *further damage*; Issue 20(2) in relation to whether a claim for *further damage* is capable of constituting a rate applicable to the proved debt; and Issue 21 in relation to the claim of an assignee, are wholly academic.

ISSUE 20(2)

Introduction

197. Issue 20(2) asks the following question:

> *If the answer to question 20.1 is yes, whether (and if so, in what circumstances) all or part of such "damages interest claim" can constitute part of "the rate applicable to the debt apart from the administration" for the purpose of Rule 2.88(9)*

198. Wentworth contends that a claim for *further damage* under section 288(4) BGB does not constitute part of the "*rate applicable to the debt apart from the administration*" for the purpose of Rule 2.88(9).

199. Wentworth relies on three independent reasons. The SCG must knock down each of these reasons if it is to succeed on Issue 20(2).

200. The first two reasons are based on the findings of David Richards J in the *Waterfall II, Part A* judgment.

201. The judgment is analysed in more detail in a moment, but there are two key points to note at the outset.

(1) David Richards J found that when considering whether, for the purpose of rule 2.88(9), there is a rate applicable to the debt apart from the administration which exceeds the Judgments Act Rate, this question is to be answered by reference to the rights actually held by the creditor at the commencement of the administration.

(2) The learned Judge found that, as a result, a creditor is not entitled to rely on a contingent right to a rate – i.e. a rate to which the creditor would only become entitled if it took certain steps or if certain events occurred after the commencement of the administration.

202. Having identified the two key points that can be taken from the Waterfall IIA judgment, it is convenient to look at the two reasons why a claim for *further damage* is

not capable of being a rate applicable to the debt apart from the administration for the purpose of rule 2.88(9) that flow from the judgment.

203. The first reason is based on the agreed position of the experts that a claim to *further damage* does not exist unless and until a default has occurred within the meaning of section 286 BGB: JS/para 19 [4/13].

204. The *Waterfall IIA* judgment means that claim for *further damage* cannot be a rate applicable to the debt apart from the administration unless a default has occurred under section 286 BGB prior to the making of the administration order.

205. For example, even if a proof of debt can be seen as constituting the service of a warning notice after the administration so as to trigger a default (and thereby bring into existence the possibility of claim to *further damages* under section 288(4) BGB) this does not assist the SCG as no such right was actually held by the creditor at the commencement of the administration.

206. The second reason is that even if a default under section 286 BGB was triggered prior to the commencement of LBIE's administration – a matter that Wentworth disputes for the reasons set out above in relation to Issue 20(1) - a claim to *further damage* under section 288(4) BGB is still not a "*rate*" applicable to the debt that creditor actually held at the commencement of the administration.

207. A claim for *further damage* under section 288(4) BGB must be pleaded and proved to the satisfaction of the Court – its award is something which is in the discretion of the Court.

208. It is therefore subject to a number of contingencies which mean - following the reasoning in the *Waterfall IIA* judgment - that it does not constitute a "*rate*" within rule 2.88(9).

Waterfall IIA judgment

209. The relevant passage of the *Waterfall IIA* judgment is at [171]-[183].

210. The issue that was considered by David Richards J is set out at [171]:

> *Whether the words "the rate applicable to the debt apart from the administration" in rule 2.88(9) of the Rules are apt to include (and, if so, in what circumstances) a foreign judgment rate of interest or other statutory interest rate.*

211. It should be noted that the SCG did not seek to contend, at the *Waterfall IIA* trial, that section 288(4) BGB was a statutory rate of interest which satisfied the requirement of being a "*rate applicable to the debt apart from the administration*".

212. The SCG advanced two arguments at the *Part A* trial.

213. First, the SCG contended that a creditor entitled under the terms of its contract to bring proceedings in New York should be entitled to statutory interest at the rate of 9% (as opposed to the Judgments Act Rate of 8%) on the basis that this rate would be applicable to a New York judgment and this is what the creditor could have obtained but for the administration.

214. The SCG contended that, in circumstances where the New York Judgments Act rate is 9%, there was no difference in substance between the rights of a creditor who had bargained for a contractual interest rate of 9% and a creditor who had bargained for a New York jurisdiction clause.

215. A summary of the submission of the SCG is recorded in the judgment at [173]:

> "*…the SCG and York submit that the words "the rate applicable to the debt apart from the administration" are apt to include not only a rate which is in fact applicable to the debt but also a rate which <u>would</u> be applicable to the debt if the creditor obtained judgment for it.*" (emphasis added)

216. Second, also as recorded at [173], the SCG contended that where a creditor did, in fact, obtain a judgment from the New York court during the course of LBIE's administration then the 9% New York judgment rate would be the relevant rate for the purpose of rule 2.88(9).

217. David Richards J rejected both of the SCG's submissions. He held that the "*rate applicable to the debt apart from the administration*" was to be determined solely by reference to the rights of the creditor at the commencement of the administration.

218. He found that it was not permissible for a creditor to rely on a rate which would be applicable to a debt if a creditor took certain steps after the commencement of the administration.

219. The key passages of the judgment - which are directly applicable to the arguments pursued by the SCG in support of its case based on section 288(4) BGB - can be found at [177]-[183].

220. David Richards J found that the words "*the rate applicable to the debt apart from the administration*" cannot be read as including a hypothetical rate which would be applicable to a debt if the creditor took certain steps: see [177]. This would deal with the case where a creditor had a jurisdiction clause in favour of New York, but had not obtained a judgment from the New York court.

221. The learned Judge then considered the case where a creditor actually obtained judgment in New York after the commencement of administration: see the question posed at [178] and the conclusions at [181] and [183].

222. The reasoning at [182] is important. The Judge expressly rejected the relevance of the test for contingent debts as part of the exercise of ascertaining the interest rate applicable to the debt at the commencement of the administration.

223. The Judge rejected the SCG's submission and said that the way in which contingencies are viewed for the purpose of proof is "*irrelevant*" when identifying the rate for the purpose of rule 2.88(9).

***Waterfall IIA* judgment leads to the conclusion that a claim for *further damage* is not a "*rate*" applicable to the debt proved apart from the administration**

224. The SCG's case on section 288(4) BGB is analytically no different from its case in relation to the New York Judgment Act which was rejected by the Court in *Waterfall IIA*.

225. As to the first reason relied upon by Wentworth, namely the requirement to take further steps to trigger a default which the experts agree is required for a claim for *further*

damage under section 288(4) BGB to exist: JS/para 19 [1/13], the reasoning in *Waterfall IIA* is directly applicable.

226. The short point is that section 288(4) does not constitute a "*rate applicable to the debt apart from the administration*" as it is not a right actually held by the creditor at the commencement of the administration.

227. There remain contingencies which need to be satisfied after the commencement of the administration and the *Waterfall IIA* judgment tells us that we cannot have regard to such contingencies when identifying the "*rate*" for the purpose of rule 2.88(9).

228. As to the second reason relied upon by Wentworth, namely the requirement for *further damage* under section 288(4) BGB to be pleaded and proved to the satisfaction of the Court based on the actual damage suffered by the creditor, the reasoning in *Waterfall IIA* is again directly applicable.

229. The SCG is unable to distinguish the present situation from *Waterfall IIA* on the footing that a right to claim *further damage* is analogous to a tortious claim in respect of which damage has occurred as at the administration date and, from that perspective, is distinct from a suit not yet commenced in a foreign jurisdiction.

230. The construction of Rule 2.88(9) is, as the Judge made clear in *Waterfall IIA*, at [182], not to be conflated with the concept of provability under Rule 13.12:

> *"The determination of the existence of debts and liabilities for the purposes of proof, governed by Rule 13.12, is irrelevant to the meaning of the phrase "the rate applicable to the debt apart from the administration" in rule 2.88(9)"*

231. That the SCG is wrongly attempting to do so is clear from the way its case is put in the SCG's Reply Skeleton Argument at paragraph 7(2) [3/11/5]. There the SCG relies on paragraph 225 of the *Waterfall IIA* judgment. That paragraph is however concerned with Statutory Interest on contingent obligations assessed and admitted as proved debts. It says nothing about a contingent right to interest (such as a New York Judgment Act rate) or a contingent claim to *further damage* to be assessed (such as s.288(4) BGB). Neither of these satisfies the test of applicability to the debt proved at the commencement of the administration.

232. The contingencies which might result in an award of *further damage* are analytically no different from those in relation to a foreign judgment act rate.

233. Indeed, a claim for *further damage* under section 288(4) BGB is in fact more remote.

234. This is because an award of damages and how that is expressed are ultimately matters for the discretion of the Court, whereas an award of post-judgment interest is at a prescribed rate.

235. The evidence of Professor Mulbert confirms that a claim for *further damage* is subject to a large number of contingencies. In this regard:

(1) Professor Mulbert agreed that a claim for damages is assessed in the discretion of the Court according to the principles set out at section 287 of the German Civil Procedure Code. Day 6/Page 133/Line 25 to Page 134/Line 23:

25 It is correct, isn't it, that the way that the
1 courts assess damages is addressed by section 287 of the
2 German civil procedure code?
3 **A. That is correct. That is the basis for assessing**
4 **damages.**
5 Q. Can we just have a look at that together. It is behind
6 tab 85, sub tab B.
7 **A. Yes.**
8 Q. Do you have it? A couple of quick questions. This
9 provision applies to damages claimed generally, doesn't
10 it?
11 **A. Yes.**
12 Q. What it tells you is that the assessment of damages is
13 in the discretion of the court, doesn't it?
14 **A. Yes.**
15 Q. Section 286, which you will find at the previous tab,
16 tells you again what the court will look at when
17 exercising its discretion.
18 **A. Yes.**
19 Q. Because of that discretion, because damages are assessed
20 by the court in the exercise of their discretion, there
21 is a limited power to interfere with a trial judge's
22 assessment of damages, isn't there?
23 **A. Yes, there is.**

(2) Professor Mulbert agreed that the claimant has to prove the type of investment he would have made to claim lost profits. Day 6/Page 135/Lines 5 to 10:

> 5 Just looking at it in general first, you would agree
> 6 that a claimant still to get lost profits -- apart from
> 7 the special rule which we will look at in a moment --
> 8 has to plead and prove the type of investment that it
> 9 would have made in the usual course?
> 10 **A. Yes. Yes.**

(3) Professor Mulbert said that although there were differing decisions in the BGH as to the standard of probability required, he would not disagree with the BGH if it were to settle on the view that what had to be shown was profit that was more probable than not: see Day 6/Page 142/Line 15 to Page 143/Line 5.

236. The wide discretion of the trial judge in the assessment of damages is reflected in the decisions of the BGH. One example is a decision of the BGH in 2012 [AUTHS 1/31] at [65].

237. Accordingly, a claim for *further damage* is not a "rate" applicable to the debt proved at the commencement of the administration as required by the *Waterfall IIA* judgment.

York's argument

238. York has raised an issue as to whether the Default Rate under the ISDA Master Agreement is capable of being a rate applicable to the debt apart from the administration under Rule 2.88(9).

239. Wentworth's position is that there is no real risk of cross-over between this issue and Issue 20(2) in relation to the GMA:

(1) A claim for *further damage* founded on a German statutory provision is very different from the claim for Default Interest under the ISDA Master Agreement

(2) The ISDA Master Agreement provides a contractual entitlement to Default Interest.

(3) The GMA does not contain any contractual entitlement to interest which could be said to be applicable to any compensation claim that becomes payable by LBIE following the termination of the GMA.

(4) David Richards J expressly distinguished the case of a contractual interest rate to a case where there was no such rate at [177].

(5) Likewise a variable interest rate, e.g. LIBOR + 1%, is a contractual right applicable to the debt by virtue of its terms. It is irrelevant in those circumstances that the right might fluctuate.

Claim for further damage is not a "rate" applicable to the debt proved

240. Moving now to the third reason why Wentworth contends that a claim for *further damage* under section 288(4) BGB is not a "rate" for the purpose of rule 2.88(9).

241. This reason is not founded on the judgment in *Waterfall IIA*.

242. Instead, it concerns the question of whether a claim for *further damage* under section 288(4) BGB is to be characterised, as a matter of English insolvency law, as the "*rate*" applicable to the debt proved for the purpose of Rule 2.88(9), as opposed to a rate referable to some *other* amount.

243. The practice of the German court is to allow a claimant to elect to have a claim for *further damage* expressed as a rate if, as a result of the delay in payment of the debt due, the claimant has either incurred an interest expense to close the 'funding-gap' as a result of the delay or suffered a loss of interest income by reason of an investment opportunity lost by reason of the 'funding gap'.

244. In such a case, the rate awarded is based upon the sum borrowed or which would have been invested and not the amount owed to the claimant.

245. The significance of the need for an election by the claimant and the ultimate control of the remedy by the Court is that it cannot be said that there is any necessary connection

in terms of a "*rate*" between *further damage* and the unpaid amount. If awarded at all, it can only be said that such *further damage* might be expressed as a rate.

246. This basic distinction is reflected in the language of the BGB, which uses the word "*interest*" for section 288(1) BGB, but the word "*damage*" for section 288(4) BGB: see Wentworth's written submissions at [130] [3/10/42-44].

247. Judge Fischer has been clear and consistent in his evidence that any rate awarded as *further damage* under section 288(4) BGB is assessed by reference to the principal sum of any amount borrowed to close the funding gap or which would have been invested but for the delay in payment. It is a fact sensitive question that is not determined by reference to the amount of the compensation claim under Clauses 7-9 GMA: see Fischer 1/84-89 [4/8/147-149].

248. Professor Mulbert agreed with Judge Fischer on this point during the course of his cross-examination. In this regard:

(1) He agreed with the example that interest is awarded by reference to principal which would have been invested by the creditor and not by reference to the unpaid amount, which may be greater: see Day 7/Page 15/Lines 5-18.

(2) He agreed that it would be possible to have multiple applicable rates, depending on what was borrowed or what investment opportunities were lost: see Day 7/Page 16/Lines 8-11.

249. Accordingly, a claim for *further damage* is not to be characterised as a "*rate*" applicable to the debt proved at the commencement of the administration. It cannot therefore be "*the rate applicable to the debt apart from the administration*" for the purpose of Rule 2.88(9).

ISSUE 21

250. Issue 21(i) and (ii) only arise for consideration in the event that the SCG is able to establish first that a creditor is entitled to bring a claim in LBIE's administration for *further damage* under section 288(4) and that the claim constitutes a rate applicable to the proved debt for the purposes of rule 2.88(9).

251. For the reasons that developed above, Wentworth contends that the SCG falls far short of establishing these matters.

252. The closing submissions made in relation to Issue 21 assume, for the moment, these matters against Wentworth.

ISSUE 21(I)

253. Starting with Issue 21(i):

> *If the answer to question 20(2) is that a further claim for damages can be included as part of the "rate applicable to the debt apart from the administration" for the purposes of Rule 2.88(9), how in such circumstances is the relevant rate to be determined?*
>
> *(i) in circumstances where the relevant claim under the German Master Agreement has been transferred (by assignment or otherwise) to a third party, is it the Damages Interest Claim which could be asserted by the assignor or the assignee which is relevant for the purposes of Rule 2.88(9)?*

254. It can be seen that the issue is focused on whether the claim of the assignee who has acquired the claim against LBIE under the GMA since the date of administration is the relevant claim for the purposes of rule 2.88(9) – it is not focused on the German law issue of whether an assignee can recover more than the assignor – this issue is raised by Issue 21(ii).

255. Wentworth's answer to Issue 21(i) is that the *further damage* which could be asserted by the assignee under section 288(4) following the assignment of the claim is not relevant when determining the "*rate*" for the purposes of Rule 2.88(9).

256. This conclusion flows directly from the reasoning of the *Waterfall IIA* judgment. There are 4 steps in the analysis:

257. First, as developed above, the *Waterfall IIA* judgment establishes that the "*rate*" applicable to the proved debt "*apart from the administration*" is to be determined by reference to the rights of the creditor as at the commencement of the administration: see *Waterfall IIA*, at [177]-[183].

258. Secondly, the "*rate*" applicable to the proved debt under the GMA (i.e. the close-out amount claimed by the assignor) at the commencement of the administration is determined by reference to the damages incurred by the assignor – it is the only person that held a claim for *further damage* at the commencement of the administration;

259. Thirdly, the assignment of the proved debt has taken place after the commencement of the administration. This means that there is no way in which the assignee could be

described as having any actual rights to *further damage* under section 288(4) BGB at the commencement of the administration.

260. It is agreed by the experts that an assignee can assert a claim for *further damage* only by reference to the period following the assignment – a claim for *further damage* prior to an assignment is based on the rights of the assignor and is not even transferred to the assignee unless it is included in the assignment: see JS/paras 27 to 30 [4/13].

261. Fourthly, when one considers the agreed position between the experts, there is no basis on which an assignee's claim for *further damage* under section 288(4) can be characterised as a "rate" applicable to the debt proved at the commencement of the administration as required by *Waterfall IIA*.

262. Any rights of the assignee to *further damage* as a rate necessarily post-date the commencement of the administration.

263. Professor Mulbert however says that what is transferred is a "*future (potential) Damages Interest Claim*": Mulbert 3/130 [4/11].

264. He was asked to explain what he meant by this during cross-examination:

(1) At Day 7/Page 9/Lines 7-11 he agreed:

> "*A claim for further damage is a claim for damage actually suffered by reason of the delay.*"

(2) At Day 7/Page 9/Line 12 to Page 10/Line 3 he agreed:

> "*The assignee cannot make a claim in respect of his further damage the period before the assignment.*"

(3) The Court will recall the example of a default in April with an assignment two months later with which Professor Mulbert agreed: see Day 7/Page 10/Line 4 to Page 11/Line 15.

(4) He also agreed:

(a) At Day 7/Page 11/Lines 12 to 15, that the assignee can only claim "*in his own right*" in respect of his post-assignment *further damage*.

(b) At Day 7/Page 11/Lines 23 to Page 12/Line 4, that the claim of the assignee "*did not materialise*" or become "*fully existent*" until actual damage was sustained post-assignment.

(c) At Day 7/Page 12/Line 5-8, that he was not saying that "*the assignor actually had the assignee's claim for further damage before the assignment*".

(d) At Day 7/Page 14/Lines 2-4, that the BGH in 1991 held that "*after the assignment, the assignee owns, as a new creditor, the claim for its own further damages*".

265. Similarly, Judge Fischer in Fischer 2/46 [4/10/222] says:

> "*There are no future damages claims of the assignee that could be transferred", i.e. transferred by the assignor*."

266. In other words, the potential claim is a claim under the BGB, which is a claim under statute not transferred at all.

267. Accordingly, Wentworth says Judge Fischer's view is to be preferred, being logically coherent:

(1) *Further damage* is actual damage.

(2) The assignee as a new creditor can claim *further damage* for post-assignment delay in respect of loss actually suffered by it by reason of that post-assignment delay.

(3) That is simply not a claim in any way transferred by the assignor.

(4) As a consequence, any "*rate*" awarded as *further damage* cannot be a rate applicable to the debt apart from the administration for the purpose of rule 2.88(9).

(5) As David Richards J held in *Waterfall IIA*, any such rate has to be applicable by reason of the creditor's rights as at the commencement of the administration.

268. Secondly, even if Professor Mulbert's view is assumed to be correct, that view is insufficient to satisfy Rule 2.88(9):

(1) Professor Mulbert's s agreement as to what a further damage claim is, what it can be asserted in respect of by an assignee and when that claim should **materialise** is fatal to is characterisation as a rate applicable to the debt proved apart from the administration.

(2) On his view, a right to "*future (potential)*" further damage is merely **inchoate** at the commencement of the administration and, at that date, is necessarily limited to any "*future (potential)*" loss of the assignor. The assignee is not even in the picture at that time.

(3) It follows from what David Richards J said in *Waterfall IIA* that, even on Professor Mulbert's view, the SCG cannot characterise the assignee's claim for further damage as falling within the scope of Rule 2.88(9). To hold otherwise would be to fall into the contingencies analysis applicable to the proof of debts but rejected by David Richards J in relation to the wording of Rule 2.88(9) which is focused upon applicability of a rate at the commencement of the administration.

ISSUE 21(II)

269. Moving now to Issue 21(ii):

> *If the answer to question 20.2 is that a further claim for damages can be included as part of the "rate applicable to the debt apart from the administration" for the purposes of Rule 2.88(9), how in such circumstances is the relevant rate to be determined?*
>
> *(ii) where the relevant claim under the German Master Agreement has been acquired by a third party, in what circumstances (if any) is such a third party precluded from asserting a Damages Interest Claim under principles of German law?*

270. This issue is concerned with whether, as a matter of German law, an assignee can recover a greater amount of *further damage* than that which could have been recovered by the assignor.

271. Let's start by identifying the agreed position of the experts:

(1) It is only the assignor that can assert a claim for *further damage* for the period prior to the assignment: JS/para 29 [4/13].

(2) The assignor's claim for *further damage* may be retained by it or may be transferred to the assignee is provided for in the assignment: JS/para 28 [4/13].

(3) For the period after the assignment, it is the *further damage* of the assignee that is relevant: JS/para 31 [4/13].

(4) The burden of proof is placed on the person asserting the claim for *further damage*: JS/para 33 [4/13].

272. The experts part company on the question of whether an assignee can recover a greater amount of *further damage* than that which could have been recovered by the assignor: JS/para 31 [4/13].

273. There is one German decision which expressly considers whether an assignee might claim *further damage* in excess of those that might have been claimed by the assignor. This is the decision of the BGH at [AUTHS 1/14].

274. Both experts agree that the BGH expressly left open the question of whether an assignee might claim *further damage* in excess of those that might have been claimed by the assignor: see Fischer 1/104 [4/8]; Day 6/Page 165/Lines 14-20.

275. Wentworth contends (as supported by the expert reports of Judge Fischer) that German law recognises a principle that the debtor should not be prejudiced by an assignment of a claim, such that the assignee cannot recover a greater amount of *further damage*.

276. It is also consistent with the views of a number of the commentators: see the analysis of Peters at [AUTHS 2/81] and Juncker at [AUTHS 2/80].

277. The evidence of Judge Fischer explains that the principle that the debtor should not be prejudiced by an assignment of a claim is implicit in the BGB and recognised by the German Federal Court: in particular, in section 404, 406 and 407 BGB. The effect of the principle is that the assignee is necessarily limited to the *further damage* claim that the assignor could have asserted.

278. Wentworth highlights the following matters in support of its position that an assignee is limited to the *further damage* that might have been claimed by the assignor:

(1) It is implicit in the BGB, in particular by reason of section 404 BGB, the legal position of the debtor cannot be made worse by an assignment. Section 404 BGB provides as follows:

> "*The obligor may raise against the new obligee the objections that he was entitled to raise against the previous obligee at the time of assignment.*"

(2) The German Federal Court has, in a number of decisions, taken a broad view of the effect of section 404 BGB and the principle which it reflects. These decisions have interpreted section 404 BGB as requiring that the legal position of the debtor

should not be made worse by an assignment of the claim to the new creditor. This is explained at Fischer 1/104-105 [4/8]. It should be noted that the SCG did not seek to cross-examine Judge Fischer on the detail of any of the decisions on which he relies.

(3) The 2006 decision of the BGH [AUTHS 1/25] relied on by Judge Fischer makes this point very clearly. In particular:

(a) The BGH expressly invokes the principle of debtor protection to guard against the debtor having an increased liability as a result of an assignment.

(b) It did so to enable the debtor to rely on a right of appropriation which was not otherwise available under the BGB (under section 366(1) of the BGB, which it said was not applicable to the facts because of limitation under the wording of that provision).

(4) Professor Mulbert was cross-examined on these decisions and he was forced to recognise that the BGH had stated the principle of debtor protection in general terms: see Day 6/Page171/Line 22-Page174/Line 24. Professor Mulbert was also forced to acknowledge that this principle was not confined to protection against the imposition of new obligations. It extended to protect against any worsening of the legal position: see Day 6/Page 173/Lines 5-15; Page 174/Lines 2-3; and Page 174/Lines 10-24.

(5) In cross examination it was put to Judge Fischer that the general principle he had identified in the case law simply protected against a worsening of the legal position and did not protect against a worsening of the factual position, which would include a higher damages claim by an assignee. Judge Fischer rejected this: Day 8/Page 35/Line 10 to Page 36/Line 15; and Day 8/Page 42/Line 14 to Page 43/Line 8. Judge Fischer was correct to reject this. There is no coherent distinction between a worsening of a debtor's legal position and the increase in the quantum of the obligation he has to meet. An increase in the quantum that has to be paid for a good discharge is a worsening of the legal position.

(6) There is a further general principle of German law that a contract should not impose obligations on a third party. One consequence is that a contract of assignment cannot by its terms make worse the position of the debtor.

(7) This principle informs whether an assignment should, by the effect of the transfer, enable the debtor to be placed in a worse position.

(8) Judge Fischer also places reliance upon section 398 BGB which refers to the assignee as "a new creditor" who "steps into the shoes of the previous creditor." Judge Fischer explained to YL that the translation "steps into the shoes of the previous creditor" conveys "very well" the German language which it "comes in the place of", which imposts that the new creditor is limited to the rights of the previous creditor: Day 8/Page 56/Line 19 to Page 57/Line 10.

(9) Accordingly, the debtor does not have to bear the detriment resulting from a greater loss incurred by the assignee: see Fischer 1/105 [4/8].

(10) There are strong policy reasons why an assignee should not be able to recover a greater loss than the assignor as such a conclusion would encourage 'debt-trafficking' to the detriment of the debtor: for example, an assignment on the footing that some part of the higher damages are rebated back to the assignor: see Fischer 1/106 [4/8].

(11) Moreover, the assignees are very likely to have purchased the claims under the GMA at a discount to their face value. It would represent an unfair windfall to the creditor and an unjustifiable detriment to LBIE if, in these circumstances, the creditor could assert a higher claim for *further damage* than that which could have been asserted by the assignor.

ISSUE 21(III)

279. The final issue is Issue 21(iii):

> *If the answer to question 20.2 is that a further claim for damages can be included as part of the "rate applicable to the debt apart from the administration" for the purposes of Rule 2.88(9), how in such circumstances is the relevant rate to be determined?*
>
> *(iii) where does the burden of proof lie in establishing a Damages Interest Claim, and what is required to demonstrate, that a relevant creditor has or has not met such requirement?*

280. It can be seen that this issue concerns the way in which a claim for *further damage* under section 288(4) is assessed by the Court, including matters such as the burden of proof and whether there are any rules or presumptions which are to be applied when determining the claim.

281. These issues are relevant to claims for *further damage* by both an assignor and an assignee.

282. There are two topics to cover:

(1) The general position in relation to the assessment of damages;

(2) The simplified method of demonstrating lost profits and whether this is available only to banks or to all investors;

General position

283. There are four points which are not in dispute on the basis of the expert evidence:

(1) The Court assesses damages according to section 286 and 287 German Civil Procedure Code – these provisions make it clear that the assessment of damages is in the discretion of the Court: see the evidence of Professor Mulbert at Day 6/Page 133/Line 25 to Page 135/Line 23.

(2) The experts agree that the obligee bears the burden of proof and must establish both the causal connection for the damage and its amount: JS/para 8 [4/13].

(3) A claim for lost profits under section 252 BGB requires the claimant to plead and prove the type of investment that it would have made in the usual course: see the evidence of Professor Mulbert at Day 6/Page 135/Lines 5-9.

(4) The burden of proof under section 252 BGB is a balance of probabilities:

(a) Judge Fischer: Fischer 2/26 [4/10].

(b) BGH [AUTH 5/4/p2, last para]: Of section 252(2) "*These conditions should be granted if according to the circumstances of the case it is more probable that the profits would have been achieve without the event causing such a liability than that it would fail to materialise*."

(c) During cross-examination, Professor Mulbert said that if the BGH were to take the requirement as "*more certain than not*" then he "*would not disagree with that*": see Day 6/Page 142/Line 21 to Page 143/Line 5.

Simplified Method

284. There are two questions that arise:

(1) How the simplified method operates?

(2) Who is able to benefit from the simplified method?

<u>How it operates</u>

285. There are two key decisions of the BGH on the simplified method [AUTH 1/5] and [AUTH 1/11].

286. The reasoning in these decisions was explored with Professor Mulbert at Day 6/Page 144/Line 10 to Page 154/Line 8.

287. Five key points arise from detail of the cases and the answers of Professor Mulbert:

(1) The Court considers what is the typical lending business of the bank in question;

(2) The Court takes a weighted average of the business lines of the bank. In other words, the bank cannot single out a certain type of lending in its lending business with higher interest rates such as consumer credit (e.g. credit cards, or unarranged overdrafts) and use it as the basis for the measurement of the lost profits.

(3) The Court uses publicly available statistics from the German Federal Bank in order to assess the appropriate interest rate of the particular line of business.

(4) If the bank wants to recover at an interest rate greater than those published by the German Federal Bank, it is unable to use the simplified method of measuring lost profits. This will require is to disclose the detail of its business operational structure and actually prove what it would have done invested the money at a higher interest rate during the period of delay.

(5) In this respect, Professor Mulbert accepted (at Day 6/Page 158/Line 9 to Page 159/Line 2) that a bank not wishing to rely on publically available statistics would have to satisfy the stricter standard of the concrete approach.

<u>Those entitled to benefit from it</u>

288. Wentworth contends that only a bank can benefit from utilising the simplified method of measuring its lost profits. The SCG contends that it applies to all investors.

289. There are five short points which support the approach of Wentworth and Judge Fischer:

(1) There is no decision which has enabled an investor other than a bank to utilise the simplified method of measuring lost profits. If such a method were prevalent then in a thriving economy such as Germany one would expect must more authority showing that it was a viable method used by other investors.

(2) The only decision in the German materials which considers the issue for another investor rejects it as a possibility. The Court rejected a request by an insurer to utilise the simplified method and concluded that the method was available only to banks based on the publicly available rates for banks [AUTHS 5/10].

(3) Judge Gruneberg – a member of the BGH Senate responsible for banking and finance – takes the view that it is only banks that are able to utilise the simplified method for lost profits [AUTHS 1/48C/para bb]. He says that "*all other creditors*" must prove their interest loss specifically.

(4) The contrary opinion – a minority opinion – is that of Lowisch & Feldman [AUTHS 1/59/B/para 47]. The Court should note that that opinion cites an earlier 1967 decision not followed by the later decision of the Cologne HRC [AUTHS 5/10].

(5) Professor Mulbert agreed that there are no publicly available published rates in relation to investors other than banks which could form the basis for the application of the simplified method to other investors: Day 6/Page 157/Line 22-Page 158/Line 5.

(6) Further Professor Mulbert's accepted that a bank not wishing to rely on publicly available statistics would have to satisfy the stricter standard of the concrete approach. This confirms that the simplified form of the damages calculation applies only to banks making standard interest rate claims by reference to the published rates.

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24 NOVEMBER 2015