

Update – Waterfall II Application – Tranche C Judgment – 6 October 2016

On 5 October 2016 Mr Justice Hildyard handed down his judgment in Tranche C of the Waterfall II Application, following the hearing between 9 and 25 November 2015.

In brief, the Judge's decisions were as follows:

ISDA Master Agreement – cost of funding

- (i) in respect of the Default Rate in the ISDA Master Agreements, the “relevant payee” only refers to LBIE's original contractual counterparty and the term does not extend to any third party to whom LBIE's counterparty has transferred its interest in any amount payable to it under section 6(e) of the ISDA Master Agreement;
- (ii) a party's “cost of funding” means its cost of borrowing the relevant amount under a loan transaction and does not extend to costs associated with any wider types of funding such as equity funding. Further, it excludes other costs or expenses that cannot properly be described as interest including any impact on the relevant payee's overall cost of borrowing or any increase in the cost of its equity capital;
- (iii) borrowing should be assumed to have recourse to the relevant payee's unencumbered assets and the certifiable cost is the price which the relevant payee has paid, or would have to pay, to a counterparty to a transaction to borrow a sum equivalent to the relevant amount taking into account all relevant circumstances;
- (iv) it may be rational and in good faith for the relevant payee to certify its cost of borrowing on the basis of overnight funding, or funding for any other duration;
- (v) a relevant payee's cost of funding may be calculated either by reference to a particular date or on a fluctuating basis, taking into account relevant market conditions and any other relevant facts or circumstances known to the relevant payee from time to time;
- (vi) a certification is conclusive except where: (a) it is made irrationally (i.e. where it is arbitrary, capricious, perverse or reflects a decision so unreasonable that no reasonable person exercising the relevant discretion could have reached it); (b) it contains manifest numerical or mathematical error; (c) where the certified cost does not fall within the scope of the expression “*cost ... if it were to fund or of funding the relevant amount*”, as construed by the Court; or (d) where it is made otherwise than in good faith. In the event of challenge by the Defaulting Party on any of these bases, it will bear the burden of proving, on the balance of probabilities, that the relevant payee's certification has not met the relevant requirements;
- (vii) anyone expressly or impliedly authorised by the relevant payee can certify on its behalf and that the existence of such authorisation is a question of fact to be determined on a case by case basis. In circumstances where the relevant payee is incapable of certification, the court will determine what decision it would have made;
- (viii) a party's right under section 7(b) of the 1992 ISDA Master Agreement to transfer any amount payable to it from a Defaulting Party without its written consent includes any amount payable to it under section 6(e);
- (ix) the nature of a counterparty does not impact the answers to the cost of funding issues considered in the Waterfall II Application;
- (x) each of the issues considered by the Court in respect of the ISDA Master Agreements should be answered in the same way under both English and New York law;

German Master Agreement

- (xi) in respect of claims existing under the German Master Agreement, a creditor cannot rely on the interest and further damages provisions under the German Civil Code to make a claim against LBIE for interest in respect of the delayed payment of the close-out amount; and even if such a claim did arise, it would not constitute a “*rate applicable to the debt apart from the administration*” for the purpose of Rule 2.88(9) as any such right cannot be equated to a right existing as at the date of administration; and

Supplemental Issue 1(a)

- (xii) the words “*the rate applicable to the debt apart from the administration*” in Rule 2.88(9) include, in the case of a provable debt that is a close-out sum under a contract, a contractual rate of interest that began to accrue only after the close-out sum became due and payable due to action taken by the creditor after the date of the commencement of LBIE's administration.

Should you have any queries regarding this update, please contact LBIE's Communications and Counterparty Management team at generalqueries@lbia-eu.com.