Waterfall II Application
No 7942 of 2008

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

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) JULIAN GUY 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

Respondents

REPLY WRITTEN SUBMISSIONS ON BEHALF OF WENTWORTH ON SUPPLEMENTAL ISSUES 1(C) TO 5

Capitalised terms used but not otherwise defined herein are defined in the amended application dated 9 March 2015 (the "Application"), unless the context requires otherwise.

ISSUE 1(C)

In a case where contractual interest first starts to run on a provable debt at some point after the Date of Administration, is the "rate applicable" for the period from the Date of Administration to the date when contractual interest first starts to run:

> **i. the rate of interest which is payable once the interest is running (so that such rate is treated as being applicable for the whole of the post-administration period); or**
>
> **ii. a zero rate.**

Further for the purposes of Rule 2.88(9) should Statutory Interest be calculated by assessing the greater of the "rate applicable" and Judgments Act 1838 rate separately for the periods prior to and post the commencement of contractual interest or should such assessment be performed taking the periods together.

1. If the position advanced by York on Issue 1(a), which Wentworth supports, is accepted, then this issue 1(c) does not arise. That is because if the consequence of the creditor having no entitlement to be paid interest, as at the Date of Administration, is that it has no rate applicable apart from administration within the meaning of Rule 2.88(9), then it is irrelevant to ask how such rate is to be calculated. Wentworth's submissions on Issue 1(c) arise in the event that it is wrong to support York's position on Issue 1(a).

2. Wentworth, in its submissions dated 22 December 2015 (the "22 December submissions"), referred to two approaches to the calculation of interest at the rate applicable apart from administration under Rule 2.88(9) in respect of future and contingent debts. Under the First Approach interest is calculated by reference to the rate that would actually have applied to the debt, apart from administration, from time to time. Under the Second Approach interest is to be calculated on the assumption that 'the' rate that would have applied to the debt once it fell due for payment applied for the whole period of the administration. For the reasons set out in 22 December submissions, Wentworth contends that the First Approach is the correct one.

3. The SCG contends that the Second Approach is correct. Its argument is based on the following points made by Court in the Part IIA judgment: (1) the purpose of Rule 2.88(7) is to compensate the creditor for delay in payment of its proved debt, not for the delay in payment of its underlying claims; (2) proved debts are ascertained as at the Date of Administration so as to ensure the *pari passu* distribution of assets; (3) in the case of future and contingent debts this requires a present value to be put upon the debts, whether by way of discounting back of future debts, or as part of the estimation of the value of contingent debts; and (4) all proved debts, including in respect of future or contingent claims, are 'outstanding' from the Date of Administration.

4. The SCG contends that the application of a contractual rate that only applied from the date that a contingent or future debt became due, for the whole period of the administration, is justified in light of the nature and effect of the rules governing the estimation of contingent debts and the payment of dividends on future debts, because it "*ensures that future and contingent creditors receive compensation for the time value of money lost as a result of their claims having been given a present value as at the date of administration*" for the purposes of proof or dividend.

5. Wentworth accepts (without prejudice to arguments it intends to advance on appeal) that the points relied on by the SCG from the Part IIA judgment justify the conclusion that a future or contingent creditor is entitled to interest under Rule 2.88(7) from the Date of Administration on the amount of its proved debt.

6. Wentworth disputes, however, that any of those points justify the further conclusion that the calculation of the amount of interest payable, at the rate applicable to the debt apart from administration, proceeds on the assumption that the contractual rate that would have applied (but for the administration) from the date in the future when the debt fell due for payment applies to the debt for the whole period from the Date of Administration.

7. In particular, whilst the fact that in at least some circumstances the value of the provable debt is discounted back to a present day value as at the Date of Administration justifies (again, without prejudice to Wentworth's arguments on appeal) the conclusion that interest is payable from that same date irrespective of the

fact that the underlying claim had not fallen due for payment as of that date, it does not justify the payment of interest at a rate to which the creditor had no contractual entitlement during the relevant period.

8. As noted in the Part IIA judgment at [180], the White Paper preceding the 1986 insolvency legislation stated that "*if a higher contractual rate applies to the debt, post-insolvency interest will be chargeable at that rate*". The self-evident purpose of Rule 2.88(9) is to preserve such contractual (or other) rights as that creditor had to interest if they would have resulted in a greater amount of interest being paid than interest at the Judgments Act Rate. There is nothing either in the wording of Rule 2.88, or in the White Paper preceding it, to suggest that the purpose of Rule 2..88(9) was positively to *improve* the position of the creditor, by a fictional enhancement of the creditor's contractual or other rights specifically by treating the contractual or other rate as 'applicable' for that part of the period when it would not be.

9. The SCG accepts that in relation to debts that were due and payable at the Date of Administration, the rate applicable to the debt apart from administration includes any contractual rate applying to the underlying debt. It appears that the SCG thus accepts that where such contractual rate fluctuates over time, then it is the rate from time to time that is applied. As pointed out in Wentworth's 22 December submissions, it logically follows from the fact that "*the rate applicable to the debt apart from administration*" changes to reflect the rate that would have been payable from time to time pursuant to the creditor's contractual rights that where, as a matter of contract, no interest would be payable during a particular period, the rate applicable apart from administration is zero for that period.

10. Moreover, the SCG's submissions fail to explain how the *rate applicable to the debt apart from administration* is to be identified for the period prior to the date when the debt fell due for payment when the contract provides for multiple possible rates of interest applicable *after* that date (as in the case of an ISDA Master Agreement).

11. Wentworth notes that the Joint Administrators support the position of Wentworth on Issue 1(c). Wentworth supports the arguments advanced by the Joint Administrators in their written submissions.

ISSUE 2

Whether and (if so) in what circumstances and in what manner a Currency Conversion Claim can arise from the discharge of a debt by way of set-off pursuant to Rule 2.85(3).

12. York's essential premise in its submissions on Issue 2 (at paragraph 11) is that insolvency set-off is equivalent to the payment of a dividend. It is from this premise that York asserts that there is "*no difficulty*" in calculating a Currency Conversion Claim where the 'payment' is by way of insolvency set-off rather than by way of dividend.

13. This essential premise is wrong because, as explained in Wentworth's 22 December submissions:

    (1) the Court of Appeal's decision in *Waterfall I* is that a currency conversion claim is dependent on the premise that conversion of foreign currency debts into sterling for the purposes of proof is for a limited purpose only and thus the contractual right to be paid in the foreign currency revives once all proved debts and statutory interest have been paid in full; whereas

    (2) in contrast, the discharge of a debt via the operation of set-off is permanent in effect, meaning that both the creditor's original claim and the debtor's original claim cease to exist for all purposes (as confirmed in particular by Briggs LJ at [152]: the conversion to sterling for the purpose of insolvency set-off was "*a substantive and permanent alteration of the creditor's contractual rights*").

ISSUE 3

Whether, and if so to what extent, a non-provable claim to interest on a Currency Conversion Claim should be reduced by interest received by the creditor pursuant to Rule 2.88 on its proved debt.

14. The SCG contends that the Court's conclusions on Issues 2A and 28 preclude there being any account taken of amounts paid, by way of statutory interest, when calculating interest due on a currency conversion claim.

15. The first point to note is that, as the Court itself pointed out at the hearing on 9 October 2015 on hand down of the Part IIA judgment, its conclusions on Issue 2A or Issue 28 were not to be taken as extending to non-provable claims for interest (which had not been canvassed), as opposed to free-standing non-provable claims such as a tort claim: transcript of hearing on 9 October 2015 before David Richards J, at pp.45-48.

16. This is critical, because the Judge's reasoning is apposite in the context of a free-standing non-provable claim, such as a non-provable claim in tort, but not so in the context of the non-provable claim to interest on a currency conversion claim.

17. The reasoning of the Court relied on by the SCG was that:

(1) Rule 2.88 is a complete code. This was expressed most clearly at [228] of the Part IIA judgment:

> *"Rule 2.88 is a complete code for the payment of post-administration interest and it replaces all prior rights, including contractual rights. The only right of the creditor, whether its original debt was in sterling or in a foreign currency, is to receive interest in accordance with rule 2.88(7)-(9) on its admitted debt, which necessarily is expressed in sterling, from the date of administration."*

(2) Rule 2.88 is, however, a complete code in respect of proved debts only, and thus does not interfere with a contractual right to interest as part of a non-provable claims (see [169] of the Part IIA judgment);

(3) Since Rule 2.88 is a complete code in relation to proved debts, the only right of a creditor, whether its original claim was in sterling or a foreign currency, is to receive interest in accordance with Rule 2.88, and such interest is not paid in or towards satisfaction of the creditor's contractual right to interest (see [228] of the Part IIA judgment).

18. In the context of interest on a free-standing non-provable claim, such as a non-provable tort claim, this reasoning makes sense. There is no duplication between the claim itself and any provable claim. There is thus no relationship between the interest payable on the non-provable claim and any part of the statutory interest paid and the latter should not be taken account of in calculating the former.

19. That is not the case, however, with a non-provable claim to interest on a currency conversion claim. Here:

(1) The non-provable claim and the creditor's proved claim are each a part of the same underlying claim: the claim to be paid a certain sum in a foreign currency. The currency conversion claim is merely that part of the proved debt (expressed in its original currency) that is not satisfied by the payment of sterling dividends.

(2) The conclusion that the creditor is entitled to interest on the non-provable claim thus involves a departure from, or exception to, the conclusion that Rule 2.88 is a complete code in respect of post-administration interest on proved debts. That is necessarily so, because to allow interest pursuant to the creditor's contractual rights on the currency conversion claim is to allow interest on a part of the proved debt (i.e. the portion of the proved debt that is not satisfied from the payment of sterling dividends).

(3) The premise (that a creditor has no right to interest other than pursuant to the complete code represented by Rule 2.88) of the Judge's conclusion at [228] (that a creditor does not receive statutory interest in or towards satisfaction of its contractual right to interest) is therefore missing. Without that premise, the conclusion ought not to apply. Instead, for the reasons set out in Wentworth's

22 December submissions, credit should be given, in calculating interest on the currency conversion claim for the period that the proved debt was outstanding, for statutory interest received on the proved debt. Both the contractual right to interest and interest under Rule 2.88 relate to the same debt for the same period, and unless account is taken of the latter in calculating the former, there is a risk of a windfall benefit falling to the creditor.

20. The SCG contends (paragraph 18 of is submission on Supplemental Issue 3) that giving credit for interest received under Rule 2.88 would result in the creditor not receiving the full amount of statutory interest to which it is entitled. This is wrong. As the worked examples in Wentworth's 22 December submissions demonstrate, the only effect of giving credit for interest received under Rule 2.88 is to preclude the creditor from receiving more, through the combination of interest under Rule 2.88 and interest on its non-provable currency conversion claim than it was entitled to for the relevant period under its contract. Wentworth does not suggest that the offset for which it contends can in any circumstances result in the amount of interest to which the creditor is entitled under Rule 2.88 being reduced. It contends only that the creditor's claim to interest on its non-provable currency conversion claim can be reduced. Since the claim to interest on its currency conversion claim is based on its contractual rights, it must follow that such claim should be reduced if and to the extent that the total interest received by the creditor, for the relevant period, would otherwise exceed its contractual right.

ISSUE 5

Whether, to the extent that a creditor has a non-provable claim for interest on a Currency Conversion Claim, such non-provable claim has been released under the terms of the CRA and/or CDD and if so, whether the Administrators would be directed not to enforce such release(s).

21. The SCG attempts to distinguish the Judge's dicta at [116] and [147] of the Waterfall IIB Judgment, to the effect that non-provable rights to interest had been released by the CRA and the CDDs, on the footing that the Judge is said only to have had in mind non-provable interest on a creditor's *proved* debt, not non-provable interest on a creditor's *non-provable* debt, such as interest on a currency conversion claim.

22. The distinction is a bad one.

23. Clause 25.1 of the CRA provides: "*For the avoidance of doubt, no interest shall accrue on any Net Financial Claim, save to the extent provided in Rule 2.88 of the Insolvency Rules.*" This is the wording which the Judge said at [116] CRA precludes any non-provable claim to interest. The nature of the claim precluded by this wording is any interest on any Net Financial Claim (other than interest pursuant to Rule 2.88). A non-provable claim to interest on a non-provable currency conversion claim is without doubt a claim to interest on a Net Financial Claim (see Wentworth's 22 December submissions at [66]-[68]). The suggested distinction is not one in fact drawn by the Court, and is unsustainable on the wording of the CRA.

24. Similarly, the relevant wording of the CDDs (set out in full at [139] of the Part IIB judgment) releases "*all Claims for interest*", without any distinction between interest on proved claims and interest on non-provable claims. In particular, the wording releases all Claims for interest under the Creditor Agreement (i.e. the agreement pursuant to which the creditor's contractual entitlement to be paid in the relevant foreign currency arises). The non-provable claim to interest on the non-provable currency conversion claim is without doubt a claim pursuant to the contractual rights of the creditor under the Creditor Agreement. Accordingly, the suggested distinction is unsustainable on the wording of the CDDs, as well as not being one drawn by the Court.

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