IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

No. 7942 of 2008

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)
AND IN THE MATTER OF THE INSOLVENCY ACT 1986
B E T W E E N:

(1) ANTHONY VICTOR LOMAS
(2) STEVEN ANTHONY PEARSON
(3) RUSSELL DOWNS
(4) JULIAN GUY PARR
(in their capacity as the joint administrators of the above-named company)

Applicants

-and-

(1) BARCLAYS CAPITAL INC
(2) WENTWORTH SONS SUB-DEBT SARL

Respondents

POSITION PAPER OF THE ADMINISTRATORS

Unless otherwise stated, defined terms should be construed in accordance with the application notice dated 5 September 2016 (the "**Application**"). The background to the Application is set out in the 10th witness statement of Russell Downs ("**Downs 10**").

Issues 1, 2, 7(5) and 7A have been stayed pursuant to the order of Hildyard J dated 29 November 2016. Those Issues are not addressed below.

INTRODUCTION

1. On 26 July 2012, Barclays filed a proof of debt in the administration of LBIE for GBP 559,718,757.20 (equal to USD 1.002bn as at the Time of Administration).[1] This is defined in the Application as the "**Barclays Proof**". Barclays purchased its claims by assignment from LBI, an affiliate of LBIE. The relevant claims arose out of dealings between LBI and LBIE in respect of certain exchange-traded derivatives (defined in the Application as the "**ETD Trades**").

2. The Administrators consider that Barclays acquired two basic claims against LBIE as a result of the assignment. First, Barclays acquired a beneficial interest in the Client Money Pool held by LBIE as trustee. (This is defined in the Application as a "**Client Money Claim**".)[2] Second, Barclays acquired a parallel unsecured contractual claim provable in LBIE's administration. (This is defined in the Application as a "**Parallel Unsecured Claim**".)

3. About three years after the Barclays Proof was filed (on 2 July 2015), Barclays received a payment of USD 777m from LBI. This is defined in the Application as the "**LBI Payment**". Barclays agreed to apply the LBI Payment towards the reduction of its claims against LBIE in respect of the ETD Trades.

4. At the present time, the Barclays Proof has neither been admitted nor rejected. The Administrators consider, however, that Barclays' Parallel Unsecured Claim must be valued and admitted in an amount which takes into account Barclays' receipt of the LBI Payment, which reduced *pro tanto* its Client Money Entitlement and Parallel Unsecured Claim.

5. This has significant consequences for Barclays' entitlement to receive Statutory Interest under Rule 2.88(7). If the LBI Payment is required to be taken into account

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[1] In recent correspondence with the Administrators, Barclays has agreed that the sum claimed in the Barclays Proof should be reduced (to USD 930.136m): see Downs 10 at [63]-[67].

[2] There is an issue as to the precise quantum of Barclays' Client Money Entitlement: see Issues 1 and 2, both of which have been stayed. The Administrators consider, however, that Barclays has a Client Money Claim in respect of at least some of the ETD Trades.

for the purposes of valuing and admitting the Barclays Proof, then Barclays is not entitled to receive any Statutory Interest on the USD 777m of its claim which has been paid by LBI (see Issue 17) – just as Barclays would not have received Statutory Interest on that sum had it been received from LBIE as a distribution from the Client Money Pool.

6. There are two reasons why the LBI Payment is required to be taken into account for the purposes of valuing and admitting the Barclays Proof.

(1) First reason

7. As a result of the LBI Payment, USD 777m falls to be deducted from Barclays' Client Money Entitlement: see Issue 10.

8. Where a client receives part of its Client Money Entitlement, the provable amount of the client's Parallel Unsecured Claim is thereby reduced by the same amount (regardless of whether the receipt occurred before or after proof): see *Re MF Global UK Ltd* [2014] 1 WLR 1558 and Issue 6.

9. Barclays has the ability to waive its Client Money Claim: see Issue 7. However:

   (1) Barclays had not waived its Client Money Claim at the time it received the LBI Payment and has not done so to date.

   (2) If Barclays now elects to waive its Client Money Claim, its waiver will not affect pre-waiver receipts relating to its Client Money Entitlement (including the LBI Payment).

10. This reasoning assumes that Barclays had a Client Money Entitlement in respect of the ETD Trades at the date of the LBI Payment of at least USD 777m.

(2) Second reason

11. If Barclays' Client Money Entitlement in respect of the ETD Trades was less than USD 777m at the date of the LBI Payment:

    (1) The LBI Payment extinguished Barclays' Client Money Entitlement in respect of the ETD Trades, and thereby reduced Barclays' Parallel Unsecured Claim by an equivalent amount: see above.

    (2) Barclays' remaining Unsecured Claim in respect of the ETD Trades was further reduced up to the full amount of the LBI Payment, resulting in a total reduction of USD 777m from Barclays' Unsecured Claim in respect of the ETD Trades: see Issue 10.

    (3) In calculating the amount for which a proof should be admitted, the office-holder must take into account the most up-to-date information available as to the status of the relevant debt: see Issue 11. The office-holder is required to take into account any events affecting the existence or quantum of the debt, including events occurring after the company went into a formal insolvency proceeding and after the creditor submitted his proof. If the quantum of the debt has reduced for any reason, the proof should only be admitted for that reduced amount.

12. Thus, regardless of the amount of Barclays' Client Money Entitlement in respect of the ETD Trades, the full amount of the LBI Payment is required to be taken into account for the purposes of valuing and admitting the Barclays Proof.

PART A: CLIENT MONEY ENTITLEMENTS

ISSUE 3

If Barclays has a Client Money Entitlement and a Parallel Unsecured Claim, and the Parallel Unsecured Claim is reduced by any set-off (whether under Rule 2.85 or otherwise), does the Client Money Entitlement fall to be reduced by the same (or any other) amount?

13. The Administrators' position as regards Issue 3 is premised on the assumption that set-off under Rule 2.85 takes effect as at the date when the administrator gives notice of a proposed distribution under Rule 2.95 (a "**2.95 Notice**") (as to which see the Administrators' section (A) of their position on Issue 9 below).

14. The Administrators consider that, if Barclays' Parallel Unsecured Claim is reduced by any set-off, the Client Money Entitlement does not (by that reason alone) fall to be reduced by any amount.

15. Barclays' Client Money Entitlement must be calculated in accordance with Chapter 7 of the Client Assets Sourcebook (as in force on 15 September 2008) ("**CASS7**"), as interpreted by the Supreme Court in *Re Lehman Brothers International (Europe)* [2012] Bus LR 667. The principal provisions of CASS7 are as follows:

    (1) By CASS 7.9.6R(2), the firm must distribute client money "*in accordance with CASS 7.7.2R, so that each client receives a sum which is rateable to the client money entitlement calculated in accordance with CASS 7.9.7R*". CASS 7.9.9R(2) also makes it clear that Client Money Entitlements must be calculated in accordance with CASS 7.9.7R at the time of the primary pooling event.

    (2) CASS 7.9.7R requires a netting process to be carried out between each client's "*individual client balance*" and that client's "*client equity balance*".

    (3) The phrase "*client equity balance*" is defined in the glossary by reference to the amount which a firm would be liable to pay to a client in respect of that

client's margined transactions if his open positions were liquidated at the prices published by the relevant exchange and his account closed.

(4) The phrase "*individual client balance*" is not a term defined in the glossary. However, the calculation of the individual client balance is explained in paragraph 7 of Annex 1.

16. In *Re Lehman Brothers International (Europe)* [2012] Bus LR 667, the Supreme Court held that the Client Money Entitlement is to be calculated by reference to the client's contractual right to have money segregated by LBIE on its behalf. The amount of money which was actually segregated by LBIE for the client is irrelevant to the calculation of the Client Money Entitlement.

17. Alongside the Client Money Entitlement, the client may also have a Parallel Unsecured Claim: see Issue 5 below. In the Application, a Parallel Unsecured Claim is defined as "*an Unsecured Claim by a client against LBIE which exists concurrently with a Client Money Entitlement arising out of the same underlying contractual obligation, and which is not a Shortfall Unsecured Claim*".[3]

18. The regime for the calculation of the Parallel Unsecured Claim is distinct from the regime for the calculation of the Client Money Entitlement. The calculation of the Client Money Entitlement depends on CASS7, whereas the calculation of the Parallel Unsecured Claim depends on the Rules.

19. The value of a Client Money Entitlement will often differ from the Parallel Unsecured Claim: see *Re MF Global UK Ltd* [2013] Bus LR 1030, in which David Richards J confirmed that the 'hindsight principle' applies only to the quantification of the Parallel Unsecured Claim (and not to the quantification of the Client Money Entitlement).

20. CASS7 is intended to operate as a code giving effect to Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on Markets in Financial

[3] As to the definition of Shortfall Unsecured Claim, see below.

Instruments ("**MIFID**"): see *Re MF Global UK Ltd* [2013] Bus LR 1030 at [66] and *Re Lehman Brothers International (Europe)* [2012] Bus LR 667 at [110] and [121] (Lord Clarke), [129] (Lord Dyson) and [196] (Lord Collins JSC). See also *Re Lehman Brothers International (Europe)* [2011] Bus LR 277, where Lord Neuberger said at [226]:

> "*CASS7 is intended to be a code, and while it will have some 'gaps' which will have to be filled in by the general law, it is dangerous to assume that the general law is intended to be followed by specific provisions.*"

21. In particular, the Client Money Entitlement is not subject to the same set-off regime as the Parallel Unsecured Claim:

    (1) Where the relevant firm enters into administration, the Parallel Unsecured Claim is subject to the mandatory rules of insolvency set-off in Rule 2.85. A set-off under Rule 2.85 takes effect as at the date of the 2.95 Notice: see Issue 9 below.

    (2) Rule 2.85 has no application to the calculation of the Client Money Entitlement. The Client Money Entitlement is to be calculated as at the date of the primary pooling event (see *Re MF Global UK Ltd* [2013] Bus LR 1030), which was significantly earlier than the 2.95 Notice in LBIE's administration.

    (3) Rather than being subject to a set-off under Rule 2.85, the Client Money Entitlement is subject to the netting procedure in CASS 7.9.7R, which provides:

    > "*(1) When, in respect of a client, there is a positive individual client balance and a negative client equity balance, the credit must be offset against the debit reducing the individual client balance for that client.*
    > *(2) When, in respect of a client, there is a negative individual client balance and a positive client equity balance, the credit must be offset against the debit reducing the client equity balance for that client.*"

22. No form of set-off can affect the Client Money Entitlement (save to the extent contemplated by CASS7, which is juridically independent of any set-off affecting the Parallel Unsecured Claim). This is because the Client Money Entitlement is a

proprietary claim against a trust fund, which is not subject to set-off: see *Re Pollitt* [1893] 1 KB 455.

23. It follows that any reduction of Barclays' Parallel Unsecured Claim by way of set-off has no impact, by that reason alone, on the calculation of Barclays' Client Money Entitlement. If Barclays' Parallel Unsecured Claim is reduced by any set-off, then the Client Money Entitlement does not thereby fall to be reduced by any amount.

PART B: UNSECURED CLAIMS

ISSUE 4

To the extent that Barclays (i) does not have a Client Money Entitlement in respect of some or all of the ETD Trades; or (ii) has a Client Money Entitlement but is estopped or otherwise precluded from asserting such Client Money Entitlement in respect of some or all of the ETD Trades, does Barclays have an Unsecured Claim in respect of such ETD Trades?

24. The Administrators accept that Barclays has an Unsecured Claim against LBIE in respect of the ETD Trades. The precise quantum of Barclays' Unsecured Claim is not a matter for the present Application.

25. As noted above (under Issue 3), the regime for the calculation of Barclays' Client Money Entitlement is distinct from the regime for the calculation of Barclays' Unsecured Claim.

26. It is submitted that:

    (1) The existence of an Unsecured Claim in respect of a particular ETD Trade does not depend on the existence of a Client Money Entitlement in respect of the same ETD Trade.

(2) The existence of an Unsecured Claim in respect of a particular ETD Trade does not depend on whether Barclays is estopped from asserting a Client Money Entitlement in respect of the same ETD Trade.

27. Accordingly, to the extent that Barclays: (i) does not have a Client Money Entitlement in respect of some of the ETD Trades; or (ii) has a Client Money Entitlement but is estopped or otherwise precluded from asserting such Client Money Entitlement in respect of some of the ETD Trades, the Administrators consider that Barclays is not (by that reason alone) deprived of any Unsecured Claim in respect of such ETD Trades.

28. The foregoing analysis does not apply to Shortfall Unsecured Claims. A Shortfall Unsecured Claim is defined in the Application as "*an Unsecured Claim against LBIE to recover the Shortfall in respect of a Client Money Claim*". A Shortfall is defined as follows:

> "*Where the total distributions received by a client from the Client Money Pool (X) are less than his Client Money Entitlement (Y), the difference between X and Y.*"

29. It follows that the existence of a Shortfall Unsecured Claim is dependent on the client having a Client Money Entitlement.

30. To the extent that Barclays does not have a Client Money Entitlement in respect of some of the ETD Trades, the Administrators consider that Barclays cannot have a Shortfall Unsecured Claim in respect of such ETD Trades. To the extent that Barclays has a Client Money Entitlement but is estopped or otherwise precluded from asserting such Client Money Entitlement in respect of some of the ETD Trades, the Administrators consider that Barclays is likewise estopped or otherwise precluded from asserting a Shortfall Unsecured Claim in respect of such ETD Trades.

ISSUE 5

To the extent that Barclays has a Client Money Entitlement in respect of some or all of the ETD Trades (and is not estopped or otherwise precluded from asserting such Client Money Entitlement), does Barclays also have a Parallel Unsecured Claim?

31. To the extent that Barclays has a Client Money Entitlement in respect of some or all of the ETD Trades (and is not estopped or otherwise precluded from asserting such Client Money Entitlement), the Administrators consider that Barclays also has a Parallel Unsecured Claim (where the contractual debt was in LBI's favour) in respect of such ETD Trades. The fact that Barclays has a Client Money Entitlement in respect of an ETD Trade does not cut across, or otherwise usurp, the existence of the contractual claim on which the Client Money Entitlement is founded.[4] That contractual claim co-exists with the Client Money Entitlement as a Parallel Unsecured Claim in LBIE's administration.

32. The quantum of Barclays' Parallel Unsecured Claim depends on its contractual rights against LBIE. The quantum of Barclays' Client Money Entitlement depends on the provisions of CASS7. LBIE and Barclays have agreed that Barclays' Client Money Entitlement in respect of its ETD Trades (assuming that it has one in respect of all ETD Trades) has a different value from its Parallel Unsecured Claim in respect of the same ETD Trades (see Annex 2 of Downs 10), since the principles for quantifying the former are different from the principles for quantifying the latter: see *Re MF Global UK Ltd* [2013] Bus LR 1030. However, if Barclays does have a Client Money Entitlement, it is submitted that Barclays is not (by that reason alone) prevented from having an Unsecured Claim.

33. In the Application, a Parallel Unsecured Claim is defined as "*an Unsecured Claim by a client against LBIE which exists concurrently with a Client Money Entitlement arising out of the same underlying contractual obligation, and which is not a Shortfall Unsecured Claim*". The Administrators understand that Wentworth intends to argue that, to the extent that there is a Client Money Entitlement, no Parallel Unsecured

[4] Although it will affect the amount for which the Parallel Unsecured Claim is admitted to proof (as to which see the Administrators' position on Issue 6 below).

Claim (so defined) can exist as a matter of law. For the reasons set out below, Wentworth's position should be rejected.

34. The Client Money Pool was notionally constituted upon the occurrence of a "*primary pooling event*" in respect of LBIE: see CASS 7.9.3G. The primary pooling event did not have any relevant effect on clients' underlying contractual rights.

35. There is no basis for suggesting that clients' contractual rights were somehow discharged upon the occurrence of the primary pooling event. This would amount to a form of legislative expropriation, which could not have been intended by the draftsman of CASS7. In particular:

(1) CASS7 is intended to provide a high level of protection to clients: see *Re MF Global UK Ltd* [2014] 1 WLR 1558 (Ch) at [20] (David Richards J), *Re Lehman Brothers International (Europe)* [2012] Bus LR 667 at [110] (Lord Clarke) and recital 2 of MIFID. The discharge of clients' contractual rights upon the occurrence of a primary pooling event could only have a detrimental effect, and would be contrary to the objective of providing a high level of protection for clients.

(2) There is nothing in the language of CASS7 or the *travaux préparatoires* which suggests that clients' contractual rights are discharged upon the occurrence of a primary pooling event.

(3) In *Re Lehman Brothers International (Europe)* [2012] Bus LR 667, the Supreme Court held that a Client Money Entitlement is to be calculated by reference to the contractual rights of the relevant client. The Supreme Court did not hold, and the Administrators do not consider, that clients' contractual rights are discharged upon the occurrence of a primary pooling event.

(4) The Administrators' position is supported by the analysis of David Richards J in *Re MF Global UK Ltd* [2014] 1 WLR 1558. David Richards J held that the occurrence of a primary pooling event "*does not alter*" the pre-existing

contractual rights of creditors, including creditors with a Client Money Entitlement: see the judgment at [57]-[58].[5]

(5) The Administrators' position is also consistent with the general law of insolvency. As Lord Hoffmann explained in *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147 at [27], it is a fundamental principle of insolvency law that:

> "*The winding up leaves the debts of the creditors untouched. It only affects the way in which they can be enforced … The winding up does not either create new substantive rights in the creditors or destroy the old ones. The debts, if they are owing, remain debts throughout. They are discharged by the winding up only to the extent that they are paid out of dividends*" (emphasis added).

36. For these purposes, a Parallel Unsecured Claim must be distinguished from a Shortfall Unsecured Claim. In *Re MF Global UK Ltd* [2014] 1 WLR 1558 (Ch), David Richards J held that clients can have both a Parallel Unsecured Claim and a Shortfall Unsecured Claim. A client cannot ordinarily prove for both the Parallel Unsecured Claim and the Shortfall Unsecured Claim (by reason of the rule against double proof). See the judgment at [77]:

> "*If, as I have held, a client's contractual claim and the amount for which it may prove in respect of such claim is reduced by payments from the CMP,*[6] *it must follow that the client cannot prove for both the shortfall claim and the balance of its contractual claim. A payment in respect of its shortfall claim would, to that extent, reduce the contractual claim. They are in substance, though not in form, claims in respect of the same liability.*"

37. Nevertheless, it cannot be suggested that the Parallel Unsecured Claim is redundant. This is expressly recognised by David Richards J in the foregoing judgment at [78]. There are at least two significant scenarios in which the quantum of a Parallel Unsecured Claim will differ from the quantum of a Shortfall Unsecured Claim:

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[5] Strictly speaking, the existence of Parallel Unsecured Claims was conceded by all parties before David Richards J: but David Richards J plainly considered that this concession was correctly made. Indeed, it has never been suggested in any of the cases on CASS7 that a primary pooling event results in the discharge of creditors' contractual rights.

[6] This finding is considered in further detail below: see Issue 6.

(1) Where the client waives its Client Money Claim (see Issue 7 below), there can be no Shortfall for that client (and hence no Shortfall Unsecured Claim). Yet the Parallel Unsecured Claim will continue to exist.[7]

(2) Where the Parallel Unsecured Claim is valued in accordance with the 'hindsight principle', it will diverge from the Client Money Entitlement (to which no such principle applies): see *Re MF Global UK Ltd* [2013] Bus LR 1030. In such circumstances, the Client Money Entitlement will either be greater or lesser than the Parallel Unsecured Claim. By the same token, any Shortfall Unsecured Claim will diverge from the Parallel Unsecured Claim.

38. For these reasons, the Administrators consider that Barclays is not prevented from having an Unsecured Claim in respect of a particular ETD Trade merely by virtue of the fact that Barclays has a Client Money Entitlement in respect of the same ETD Trade.

ISSUE 6

To the extent that the answer to Issue 5 is "yes", on what basis is the Parallel Unsecured Claim to be valued?

39. The quantum of Barclays' Parallel Unsecured Claim is determined by the terms of the contracts between LBIE and LBI in respect of the ETD Trades (the benefit of which was assigned to Barclays).

40. Once the administration of LBIE was converted into a distributing administration (by way of a notification under Rule 2.95), a statutory scheme of proof and distribution came into effect. Barclays retains its underlying contractual rights, but the valuation of such rights for the purposes of proof must be conducted in accordance with the statutory scheme.

41. The Administrators consider that:

[7] Post-waiver, the Parallel Unsecured Claim will simply become an Unsecured Claim.

(1) For the purposes of proof, the value of Barclays' Parallel Unsecured Claim falls to be estimated in accordance with Rule 2.81. The estimate made by the Administrators (from time to time) represents the provable amount of the Parallel Unsecured Claim.

(2) In estimating the value of Barclays' Parallel Unsecured Claim under Rule 2.81, the amount of that claim falls to be reduced by:

(a) The amount of any actual distributions from the Client Money Pool (regardless of whether such distributions are made before or after the date of the Barclays Proof); and

(b) The amount of any distributions from the Client Money Pool which are likely to be made in the future.

(3) If Barclays lawfully waives its Client Money Claim (see Issue 7 below), then any prior distributions from the Client Money Pool, and the consequences of such distributions, will be undisturbed. A waiver has no effect on past distributions, which must continue to be taken into account when valuing Barclays' Unsecured Claim.

42. In support of their position, the Administrators rely on the judgment of David Richards J in *Re MF Global UK Ltd* [2014] 1 WLR 1558. Following a detailed analysis, David Richards J said at [58]:

> "*Accordingly, having regard to what I consider to be the continuing purpose of the client money trust after a PPE, I conclude that a distribution from the CMP will reduce a client's contractual claim, and hence the amount for which it may prove, just as a payment from client money before the PPE reduced or discharged the client's contractual claim.*" (emphasis added)

43. It is submitted that the conclusion reached by David Richards J is correct. As David Richards J noted, the Client Money Entitlement is ultimately based on the client's underlying contractual rights. See the judgment at [47]-[52]:

"*… It is not open to doubt that if the firm pays on maturity of a contract the whole or part of the amount due to the client from the funds held as client money, the contractual liability is reduced or discharged. Nor is there any obligation on the firm to reimburse the client money trust for the sum paid out of client money. Likewise, if the firm pays the sum due to the client from its own resources, the amount required to be held as client money will be correspondingly reduced, subject to other adjustments required at the next reconciliation. Or, to take another example, if the firm receives the proceeds of sale of a security to the account of a client and holds those proceeds as client money, and assuming that there is also a contractual obligation on the firm to pay the proceeds to the client, it cannot be in doubt that a payment from the client money account to the client in respect of such proceeds would reduce or discharge the corresponding contractual obligation …*

I find it difficult to see why the pooling of client money and the modification of the basis on which clients are entitled to client money following a PPE should result in payments of client money, which prior to the PPE would have reduced the clients' contractual claims, ceasing to have that effect."

44. David Richards J held that <u>all</u> distributions from the Client Money Pool in respect of a Client Money Entitlement will discharge the Parallel Unsecured Claim *pro tanto*, including distributions made before and after the date of proof. See the judgment at [66]:

> "*It would be contrary to the nature and purpose of the client money trust if account were not to be taken of payments made from the CMP after the submission of claims against the general estate in arriving at the amount at which such claims could be proved.*"[8]

45. Further, David Richards J held that Rule 2.81 provides the legal basis for quantifying the Parallel Unsecured Claim.[9] Rule 2.81 provides:

> "*(1) The administrator shall estimate the value of any debt which, by reason of its being subject to any contingency or for any other reason, does not bear a certain value; and he may revise any estimate previously made, if he thinks fit by reference to any change of circumstances or to information becoming available to him. He shall inform the creditor as to his estimate and any revision of it.*

[8] David Richards J's reasoning on this point is considered further below in relation to Issues 11 and 12.

[9] Strictly speaking, David Richards J referred to rule 160 of the Investment Bank Special Administration (England and Wales) Rules 2011 (SI 2011/1301), which is directly equivalent to (and derived from) Rule 2.81. The special administration legislation relating to investment banks had not been brought into force on 15 September 2008 (when LBIE entered into administration), and has no application in the present case.

(2) Where the value of a debt is estimated under this Rule, the amount provable in the administration in the case of that debt is that of the estimate for the time being."

46. David Richards J said (at [68]-[69]):

> "*… Mr Arden and Mr Snowden submitted that this familiar provision dealing with contingent or unascertained claims is not applicable to a claim on a contract, at any rate after application of the hindsight principle has fixed its value as the amount at which it matures or closes out. If, however, as I consider to be the correct position, the claim of a client against the general estate is to be taken as such amount as is due to him after deducting payments from the CMP, then the value of his debt does not bear a certain value until the distributions from the CMP are ascertained. The amount of his contractual claim, fixed with the benefit of hindsight, is only one component of the debt due to him from the firm. In cases where it is apparent that there will be or is likely to be a distribution from the CMP, it seems to me right that an estimate should be made of such distributions in arriving at the amount for which the client may prove and that the amount of such estimates should be revised in line with future developments, in particular actual distributions from the CMP.*
>
> *It follows, therefore, that the amount of a provable debt by a client falls to be reduced by the amount of any distributions from the CMP, whether made before or after the proof of debt is submitted*." (emphasis added)

47. Thus, the estimate of a Parallel Unsecured Claim under Rule 2.81 does not only fall to be reduced by the amount of any actual distributions from the Client Money Pool. It also falls to be reduced by any further distributions from the Client Money Pool which are likely to be made: see the passage quoted above (read together with [9], [37] and [39] of the judgment). This must be correct, because otherwise the estimate of the Parallel Unsecured Claim under Rule 2.81 would be inaccurate. There is no doubt that an estimate under Rule 2.81 can (and must) take into account future events, including future distributions from the Client Money Pool. Such estimate would similarly fall to be adjusted by any subsequent decision of the client to waive its Client Money Claim, because there would be no future distributions to take into account.

48. Accordingly, a Client Money Claim can be regarded as the client's primary claim in the administration of LBIE. The Parallel Unsecured Claim can be regarded as a secondary claim in respect of the client's residual underlying contractual entitlement

(if any) which has not been satisfied through payments received in respect of the Client Money Entitlement.

ISSUE 7

If Barclays has both a Client Money Entitlement and a Parallel Unsecured Claim, is Barclays entitled to elect to pursue the Parallel Unsecured Claim to the exclusion of the Client Money Entitlement?

49. The Administrators consider that Barclays is entitled to waive its Client Money Claim (without thereby waiving its Parallel Unsecured Claim which, upon waiver of the Client Money Claim, becomes simply an Unsecured Claim).

(A) WAIVER

50. There can be no doubt but that a person can voluntarily agree to relinquish a legal right. By way of example:

(1) A creditor can agree to subordinate the ranking of his claim in the insolvency of the debtor, notwithstanding the mandatory requirement for *pari passu* distribution: see *Re Maxwell Communications Corp (No. 2)* [1994] 1 BCLC 1 (Vinelott J).

(2) A secured creditor can voluntarily surrender his security. See Rule 2.83(2):

"*If a secured creditor voluntarily surrenders his security for the general benefit of creditors, he may prove for his whole debt, as if it were unsecured.*"

It follows that a creditor may surrender his security for the specific purpose of receiving a greater amount of Statutory Interest, which is only payable on the amount admitted for dividend: see Issue 17 below.

(3) A beneficiary of a will can disclaim any gifts made to him thereunder. See *Townson v Tickell* (1819) 3 B & Ald 31 at 36-37 per Abbott CJ ("*the law certainly is not so absurd as to force a man to take an estate against his will*

… if it turns out that the party to whom the gift is made does not consider it beneficial, the law will certainly, by some mode or other, allow him to renounce or refuse the gift") and at 38 per Holroyd J ("*I cannot think that it is necessary for a party to go through the form of disclaiming a deed to show that he did not assent to the devise*"); and *Re Stratton's Disclaimer* [1958] Ch 42 at 55 per Jenkins LJ ("*I entirely agree with the judge that the disclaimer must be held to have operated as an extinguishment of Mrs Stratton's right in respect of the specific bequest and devise. It seems to me that a disclaimer such as this is a typical example of the extinguishment of a right*").

(4) A beneficiary of a trust can disclaim his beneficial interest in the trust property: see *Re Paradise Motor Co* [1968] 1 WLR 1125 at 1141-1144 (Dankwerts LJ).

(5) A legal interest in personal property can be abandoned if a clear intention to do so is established: see *Robot Arenas Ltd v Waterfield* [2010] EWHC 115 (QB).

51. By the same token, Barclays can relinquish its Client Money Claim. This can be characterised as a form of surrender, disclaimer or abandonment. For present purposes, the precise terminology is irrelevant. In this position paper, the word "*waiver*" is used as a convenient term to describe any decision by which Barclays relinquishes its Client Money Claim (but without prejudice to the foregoing analysis).

52. By waiving its Client Money Claim, Barclays will not thereby waive its Parallel Unsecured Claim. As a matter of law (and as a matter of logic), there is no reason why Barclays should be unable to waive its Client Money Claim whilst maintaining its Parallel Unsecured Claim.

53. Statutory Interest will only be payable in the LBIE administration on Unsecured Claims and will not be payable on Client Money Claims. Thus, it may be beneficial for a client to waive its Client Money Claim so as to increase the provable amount of its Unsecured Claim. This motivation does not impugn the validity of the waiver. It should be noted that secured creditors have a statutory right to surrender their

security, which may be done for precisely the same motivation: see Rule 2.83(2), quoted above.

54. The right to waive a Client Money Claim is not inconsistent with the judgment of David Richards J in *Re MF Global UK Ltd* [2014] 1 WLR 1558. The result of a waiver is that no distribution of client money will thereafter be received and hence there will be nothing to deduct from the proof in respect of future distributions of client money, although past distributions will be undisturbed: see Issue 6.

(B) THE POLICY OF CASS7

55. The foregoing analysis is consistent with the policy of CASS7. As noted above, CASS7 is intended to provide a high level of protection to clients: see *Re MF Global UK Ltd* [2014] 1 WLR 1558 at [20] (David Richards J), *Re Lehman Brothers International (Europe)* [2012] Bus LR 667 at [110] (Lord Clarke) and recital 2 of MIFID. However, there is no logical reason (based on the language of CASS7 or the policies underlying the same) why a client should be barred from voluntarily giving up its Client Money Claim – particularly in circumstances where such an election would be economically advantageous for the client.

56. This analysis derives further support from the fact that clients can 'contract out' of client money protection by entering into a title transfer collateral arrangement. In particular:

(1) By CASS 7.2.3R, "*Where a client transfers full ownership of money to a firm for the purpose of securing or otherwise covering present or future, actual or contingent or prospective obligations, such money should no longer be regarded as client money*."

(2) Thus, where a client enters into a title transfer collateral arrangement (as defined in the Financial Collateral Directive (2002/47/EC)), money transferred by the client to the firm under that arrangement will not constitute client money: see CASS 7.2.4G.

57. It should be noted that:

(1) Prior to 1 November 2007, the client money rules were contained in Chapter 4 of the Client Assets Sourcebook. There was a regime for 'opting out' of client money protection under CASS 4.1.9R, but this regime only applied to certain sophisticated clients known as "*intermediate customers*" and "*market counterparties*". See CASS 4.1.8G (as in force prior to 1 November 2007): "*The 'opt out' provisions provide a firm with the option of allowing an intermediate customer or market counterparty to choose whether their money is subject to the client money rules…*"

(2) When CASS7 came into force on 1 November 2007, it became possible for all clients (including retail clients and professional clients) to 'contract out' of client money protection by entering into a title transfer collateral arrangement. Sir Andrew Park so held in *Re Global Trader Ltd* [2009] 2 BCLC 18 at [41]:

> "… *Global Trader introduced new application forms for clients who wished to open accounts with it, and that the forms included a page, which the potential clients signed, designed to ensure that there was a [title transfer collateral arrangement] which would come within CASS 7.2.3R and would mean that money received by Global Trader from new clients would not be client money within the meaning of CASS 7.2.1R. I note incidentally that this could be done in the case of all clients, retail clients as well as professional clients, whereas the nearest equivalent under CASS 4, which was the opt-out route provided for by CASS 4.1.9R, was only available for intermediate customers, and could not be used in the case of private customers*."[10]

58. For the purposes of the present Application, the relevant rules are those which were in force on 15 September 2008. A highly sophisticated client (and affiliate) such as LBI would have been permitted to 'contract out' of client money protection by entering into a title transfer collateral arrangement in relation to its ETD trading with LBIE. Such an arrangement would have ensured that LBIE had full beneficial title to any money which would otherwise have been held as client money on behalf of LBI.

[10] See also the same judgment at [39].

59. There is accordingly no reason why Barclays (as LBI's assignee) should be unable to waive its Client Money Claim at the present time. Any such prohibition would make no sense.

60. It would be particularly nonsensical if Barclays could not waive its Client Money Claim after the occurrence of a primary pooling event. In particular:

(1) Prior to the occurrence a primary pooling event, CASS7 requires firms to segregate client money. This requirement is designed to protect clients in the event of the firm's insolvency.

(2) After a primary pooling event has occurred, the foregoing objective is complete. The firm will either have segregated client money in accordance with CASS7, or it will have failed to do so. Either way, there is no further protection which could be provided by preventing clients from waiving their Client Money Claims after a primary pooling event.

61. In correspondence, Wentworth has contended that: "*the client cannot waive [its Client Money Entitlement] once it has crystallised – for the benefit of clients as a class, the statutory scheme is geared towards a swift and efficient distribution of client money, which requires certainty as to all parties' interests from the outset*". The Administrators accept that CASS7 aims to ensure that client money can be distributed in a swift and efficient manner. However, this objective plainly does not require that a client is unable to waive its Client Money Claim.

ISSUE 7(1)

(a) Is Barclays required to disclaim, surrender, abandon, assign or take any other step in relation to the Client Money Claim before the Parallel Unsecured Claim can be admitted by the Administrators; (b) If so, is Barclays entitled to disclaim, surrender, abandon, assign or take such other step in relation to the Client Money Claim?

62. As to Issue 7(1)(a), the Administrators consider that Barclays is not required to disclaim, surrender, abandon, assign or take any other step in relation to its Client Money Claim before its Parallel Unsecured Claim can be admitted for dividend.[11]

63. These conclusions follow from the Administrators' position on Issue 6. As noted above:

(1) The value of Barclays' Parallel Unsecured Claim falls to be estimated in accordance with Rule 2.81. The estimate made by the Administrators (from time to time) represents the provable amount of Barclays' Parallel Unsecured Claim.

(2) In estimating the value of Barclays' Parallel Unsecured Claim under Rule 2.81, the amount of that claim falls to be reduced by:

(a) The amount of any actual distributions from the Client Money Pool in respect of the corresponding Client Money Entitlement (regardless of whether such distributions are made before or after the date of the Barclays Proof); and

(b) The amount of any distributions from the Client Money Pool which are likely to be made in the future.

(3) If Barclays lawfully waives its Client Money Claim, then its Unsecured Claim in respect of the ETD Trades will no longer constitute a Parallel Unsecured

[11] Issue 7(1)(b) overlaps with Issue 6 and the Administrators rely upon their position on Issue 6 above in answer to Issue 7(1)(b).

Claim (as defined). Following such a waiver, any prior distributions from the Client Money Pool will continue to be deducted from Barclays' Unsecured Claim in respect of the ETD Trades but no future distributions from the Client Money Pool will be taken into account for the purposes of quantifying the Barclays Proof.

64. Accordingly, in order for the Administrators to admit the Parallel Unsecured Claim without reference to the value of any Client Money Entitlement, Barclays would first need lawfully to waive its Client Money Claim.

65. While it is true that the value of the Parallel Unsecured Claim must be estimated under Rule 2.81, the estimate does not fix the amount of the provable debt for all times. On the contrary, Rule 2.81(2) provides: "*Where the value of a debt is estimated under this Rule, the amount provable in the administration in the case of that debt is that of the estimate for the time being*" (emphasis added).

ISSUE 7(2)

If the value of the Parallel Unsecured Claim is impacted by the Client Money Entitlement, prior to the Client Money Pool being distributed are the Administrators entitled and/or obliged (a) to admit the Parallel Unsecured Claim; and/or (b) to pay a dividend in respect of the Parallel Unsecured Claim? If so, in each case, to what extent should the Client Money Entitlement be taken into account when admitting or paying a dividend in respect of the Parallel Unsecured Claim?

66. It is submitted that:

(1) The Administrators are entitled to admit the Parallel Unsecured Claim for dividend (and pay dividends on the admitted amount) prior to the Client Money Pool being distributed.

(2) In estimating the value of the Parallel Unsecured Claim, any actual or anticipated distributions from the Client Money Pool should be deducted.

67. As to the reasons for these conclusions, see Issue 6 and Issue 7(1) above.

68. There is no requirement in CASS7 or the Rules for the Client Money Pool to be distributed before any dividends are paid in respect of the Parallel Unsecured Claim. On the contrary, the manner in which the Parallel Unsecured Claim is quantified (viz. by deducting anticipated distributions from the Client Money Pool) ensures that dividends can be paid on the Parallel Unsecured Claim before the Client Money Pool is distributed.

ISSUE 7(3)

If the Parallel Unsecured Claim should not be admitted until a particular time or event, what interim steps (if any) are the Administrators entitled and/or obliged to take to make a provision for the Parallel Unsecured Claim?

69. For the reasons set out above, the Administrators consider that Issue 7(3) does not arise.

ISSUE 7(4)

If the Parallel Unsecured Claim may be admitted but no dividend(s) may be paid in relation thereto until a particular time or event, what interim steps (if any) are the Administrators entitled and/or obliged to take to make a provision for the Parallel Unsecured Claim?

70. For the reasons set out above, the Administrators consider that Issue 7(4) does not arise.

ISSUE 8

If Barclays is not entitled to elect to pursue the Parallel Unsecured Claim to the exclusion of the Client Money Entitlement:

(1) Are the Administrators entitled and/or obliged to admit any Unsecured Claim prior to the Client Money Pool being distributed? If so, to what extent should the Client Money Entitlement be taken into account when admitting the Unsecured Claim?

(2) If any Unsecured Claim should not be admitted until a particular time or event, what interim steps (if any) are the Administrators entitled and/or obliged to take to provide for the Unsecured Claim?

71. The Administrators consider that Issue 8 does not arise, because Barclays is entitled to elect to pursue the Parallel Unsecured Claim to the exclusion of the Client Money Entitlement: see Issue 7 above.

72. If that submission is wrong, then the Administrators would answer Issue 8 as follows:

(1) The Administrators are entitled to admit the Parallel Unsecured Claim for dividend (and pay dividends on the admitted amount) prior to the Client Money Pool being distributed. In estimating the value of the Parallel Unsecured Claim, any actual or anticipated distributions from the Client Money Pool should be deducted. As to both points, see Issue 6, Issue 7(1) and Issue 7(2) above.

(2) There is no particular time or event which must occur before any Unsecured Claim can be admitted for dividend. Accordingly, Issue 8(2) does not arise.

ISSUE 9

If Barclays has an Unsecured Claim (whether a Parallel Unsecured Claim, a Shortfall Unsecured Claim or any other Unsecured Claim):

(1) Is such Unsecured Claim subject to a mandatory set-off under Rule 2.85 against any sums owing by LBI to LBIE?

73. The Administrators consider that none of the Unsecured Claims held by Barclays is affected by or subject to any form of set-off under Rule 2.85.

74. In correspondence, Wentworth has asserted that "*set-off as between LBI and LBIE operates to extinguish LBI's claim (later assigned to Barclays) as at the date of administration*". For the reasons set out below, this assertion is wrong.

(A) THE LAW

75. So far as material, Rule 2.85 provides:

> "*(1) This Rule applies where the administrator, being authorised to make the distribution in question, has, pursuant to Rule 2.95 given notice that he proposes to make it …*
> *(3) An account shall be taken as at the date of the notice referred to in paragraph (1) of what is due from each party to the other in respect of the mutual dealings and the sums due from one party shall be set off against the sums due from the other.*"

76. Accordingly, any set-off under Rule 2.85 takes effect as at the date when the administrator gives a 2.95 Notice. This is clear from the language of Rule 2.85.

77. David Richards J reached the same conclusion in *Revenue and Customs Commissioners v Football League Ltd* [2012] Bus LR 1539, where he said at [84]:

> "*The ascertainment of provable debts is as at the date when the company entered administration. However, the set-off of mutual debts is as at the date on which the administrator gives notice that he proposes to make a distribution: rule 2.85.*"

78. This is consistent with the fact that a company's entry into administration does not prevent creditors from exercising contractual rights of set-off (including multilateral set-off) before the date of the 2.95 Notice. If insolvency set-off operated retrospectively, then contractual rights of set-off would be ineffective from the date of administration. This would be undesirable and contrary to principle. See Lightman & Moss, *The Law of Administrators and Receivers of Companies* (5th edition) at §22-039:

> "*When the concept of a mandatory and self-executing administration set-off rule was first raised in the consultation regarding the Enterprise Act 2002, some concern was expressed at the idea that such a rule might apply from the commencement of the administration. This would have had the effect of freezing positions (for example under running accounts or hedging agreements) and could have prevented the administrator from being able to continue to trade. This was hardly in keeping with the emphasis on rescue in respect of the new administration provisions. It was agreed that the administration set-off rule was only necessary once the administrator had concluded that a rescue of the company was not possible and that the administration should be used, instead, to make distributions to creditors (i.e. a liquidating administration). This is why r.2.85 does not apply automatically from the moment of administration (as r.4.90 does in a liquidation). The rule only applies if and when the administrator gives notice under r.2.95 that he proposes to make a distribution (the meaning of which is considered below). Up to that point, the usual contractual, transaction or independent set-off rights will continue to apply.*
>
> *The account for set-off purposes is therefore taken at the date the administrator gives notice of the distribution (i.e. the 'set-off date' is the date of notice of the distribution); it is not backdated to the date of administration*."

79. In this respect, set-off in an administration is different from set-off in a liquidation. This is necessarily so, because the administrator may wish to continue trading: see the FMLC's November 2007 paper on *Administration Set-Off and Expenses*, Issue 108 (at §2.6).

(B) THE PRESENT CASE

80. The Asset Purchase Agreement (governed by the law of New York) was executed by LBI and Barclays on 16 September 2008. This was only one day after LBIE entered

into administration but more than 14 months before the Administrators gave notice under Rule 2.95.

81. Accordingly, LBI's Unsecured Claim in respect of the ETD Trades remained in existence at the time of the Asset Purchase Agreement, and was capable of being assigned to Barclays at that time. There followed litigation between, amongst others, LBI and Barclays in the United States as regards exactly what Barclays had acquired. However on 5 August 2014, the US Court of Appeals for the Second Circuit confirmed that the Asset Purchase Agreement effected the transfer to Barclays of (amongst other things) margin assets of approximately USD 4 billion supporting the exchange-traded derivatives business. On 4 May 2015, the United States Supreme Court denied LBI's petition for a writ of certiorari of the Second Circuit's 5 August 2014 ruling.

82. A mandatory set-off under Rule 2.85 was subsequently effected on 4 December 2009, being the date of the 2.95 Notice. By that time, LBI was no longer the owner of any Unsecured Claim in respect of the ETD Trades. The relevant claims were vested in Barclays.

83. It follows that Barclays' Unsecured Claim in respect of the ETD Trades cannot be brought into account for the purposes of a set-off between LBIE and LBI under Rule 2.85. Any such set-off would lack the necessary requirement of mutuality, contrary to the express words of Rule 2.85(2).

(C) WENTWORTH'S POSITION

84. The Administrators understand that Wentworth intends to argue that set-off under Rule 2.85 operates retrospectively from the date of administration (rather than the date of the 2.95 Notice), so as to affect claims assigned prior to the 2.95 Notice. Where the assignor was subject to a cross-claim by the company at the date of administration, Wentworth contends that the assignor's claim will be reduced or discharged with retrospective effect (in the hands of the assignee) to the extent of the company's cross-claim at that date.

85. In correspondence, Wentworth has referred to the decision of David Richards J in *Re Lehman Brothers International (Europe)* [2016] EWHC 2131 (Ch) (the "**Waterfall II Supplemental Issues Judgment**") in support of that contention.

86. It is submitted that Wentworth's contention is wrong and that the Waterfall II Supplemental Issues Judgment provides no support for it.

87. In the Waterfall II Supplemental Issues Judgment at [37] *ff*, David Richards J considered "*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*". The learned Judge concluded that no such currency conversion claim can arise. He said (at [42]-[44]):

> "*… The flaw in York's argument is to say that because the account for the purposes of set-off is taken as at the date on which the notice of an intention to make a distribution is given, that is the date on which the creditor's claim is, to the extent of the set-off, discharged ...*
>
> *The effect of the provisions in the Rules is that, although the set-off account is taken as at the date of the administrator's notice, the creditor's claim is discharged, to the extent of the set-off, as at the Date of Administration. The claims and cross-claims subject to set-off exclude any that arise out of an obligation incurred after the commencement of the administration: Rule 2.85(2)(a). The debts and liabilities (in the wide sense used in this context) due from the company to the creditor are therefore restricted to those as at the Date of Administration. Any claims in a foreign currency are converted into sterling for the purposes of set-off at the exchange rate prevailing as at the Date of Administration: Rule 2.85(6). The creditor's provable debt is the balance after set-off of its debt as at the Date of Administration: Rule 2.85(8).*
>
> *Although the entire machinery for ascertaining and valuing claims is brought into operation by the giving of a notice of an intention to make a distribution, it has a retrospective effect. The creditor's claim, which must have existed even if only as a contingent claim at the Date of Administration, is reduced or extinguished by set-off against a cross-claim which likewise must have then existed*."

88. Whilst David Richards J stated that insolvency set-off operates on cross-claims existing at the date of administration, he did not hold that insolvency set-off in administration is capable of extinguishing or reducing a claim which was assigned prior to the 2.95 Notice. These are two separate propositions, and the latter does not follow from the former.

89. To the extent that David Richards J's reasoning supports Wentworth's analysis, the Administrators will contend that such reasoning should not be followed. The wording of Rule 2.85(3), which states that the "*account shall be taken as at the date of the [notice of proposed distribution] … and the sums due from one party shall be set off against the sums due from the other*" suggests that set-off is not retrospective, but rather that it takes effect as at the date of the 2.95 Notice. The fact that the set-off takes effect in respect of the claims and cross-claims quantified as at the administration date does not mean that the set-off takes effect at that date.

90. It should be noted that:

(1) The Judge gave permission to appeal against his declarations.

(2) The Judge's analysis is his own. No party to the Waterfall II Supplemental Issues proceedings argued that set-off under Rule 2.85 operates retrospectively from the date of administration.

(3) The Judge's analysis was not tested in oral argument (because the Waterfall II Supplemental Issues were dealt with on the basis of written submissions only).

(4) The Judge did not refer to his analysis in the earlier case of *HMRC v Football League* at [84], quoted above at paragraph 77.

91. Further or alternatively, the Administrators will contend that Wentworth's position is inconsistent with, and cannot stand in light of, the settlement agreement entered into between LBI and LBIE on 21 February 2013 (the "**LBI/LBIE Settlement**"). The LBI/LBIE Settlement recognises the existence of an Unsecured Claim in respect of the ETD Trades, and makes express provision for dealing with Barclays' position in respect of that claim.

92. By way of example, section 10.06(d) of the LBI/LBIE Settlement provides:

> "*For the avoidance of doubt … neither LBIE (in any capacity) nor the Joint Administrators shall, at any time prior to the Dedicated Reserve Termination Date, in relation to any Barclays LBIE ETD Claim (or of any other Barclays Client Money Pool Entitlement) or against Barclays in relation to any Barclays LBIE ETD Claim (or any other Barclays Client Money Pool Entitlement), assert, apply, exercise or enforce, or seek to assert, apply, exercise or enforce, (i) any Encumbrance or Setoff to the extent such Encumbrance or Setoff is based upon or is on account of any Liability of LBI (or the LBI Trustee) to LBIE (including any LBIE Released Claim or any Liability of LBI (or the LBI Trustee) pursuant to this Agreement) other than a Liability which was assumed by Barclays under the Barclays APA or otherwise …*"[12]

93. This provision is inconsistent with the analysis that Wentworth now seeks to advance.

94. The Administrators have a broad statutory power of compromise pursuant to paragraph 18 of Schedule 1 to the Act, which empowers them to "*make any arrangement or compromise on behalf of the company*". This has been described as a "*very wide*" provision (see *Re Collins & Aikman Europe SA* [2006] BCC 861 at [26]), and goes beyond the compromise powers available to liquidators under paragraphs 2 and 6A of Schedule 4. The scope of the Administrators' power of compromise is further enhanced by paragraph 59(1) of Schedule B1, which states:

> "*The administrator of a company may do anything necessary or expedient for the management of the affairs, business and property of the company*."

95. The Administrators consider that an Unsecured Claim in respect of the ETD Trades must be treated as subsisting (free of any set-off) in order to give effect to the LBI/LBIE Settlement.

(2) Is such Unsecured Claim subject to a mandatory set-off under Rule 2.85 against any sums owing by Barclays to LBIE?

96. The Administrators consider that the answer to this question is 'no'.

[12] As to the definition of Barclays LBIE ETD Claim, see Issue 10 below.

97. No sums were owing by Barclays to LBIE at the date on which the Administrators gave their 2.95 Notice. Accordingly, Rule 2.85 has no application as between Barclays and LBIE.

(3) Does LBIE have an equitable right to set off such Unsecured Claim against any sums owing by Barclays and/or LBI to LBIE?

98. The Administrators consider that the answer to this question is 'no'.

99. As noted above, no sums are owing by Barclays to LBIE. The only issue is whether LBIE has an equitable right to set off Barclays' Unsecured Claims against sums owing by LBI.

100. Unlike insolvency set-off, equitable set-off is not automatic. It must be 'asserted' or 'exercised' by the person who is entitled to assert the set-off. Prior to being asserted, a right of equitable set-off has no effect on the debts which are subject to that right: see *Derham on the Law of Set-Off* (4th edition) at §4.30 *ff*.

101. To date, LBIE has not exercised any right of equitable set-off against Barclays. The issue is whether LBIE has retained such a right, and whether it remains exercisable at the present time.

102. It is a general rule of English law that the assignee of a debt (viz. Barclays) takes the assignment subject to any equitable right of set-off held by the debtor (viz. LBIE) against the assignor (viz. LBI) at the date of the assignment (viz. the Asset Purchase Agreement). However, "*an assignee takes subject to a cross-demand available to the debtor against the assignor <u>only if the cross-demand would have been available as a set-off as between the assignor and the debtor</u> in circumstances where neither was insolvent*": see *Derham* at §17.06 (emphasis added) and the cases there cited. If the debtor's cross-claims (which existed at the date of the assignment) cease to be available against the assignor, they cannot be asserted by way of set-off against the assignee.

103. LBIE's cross-claims against LBI have been settled and compromised in their entirety by the LBI/LBIE Settlement. Accordingly, the cross-claims which LBIE had against LBI at the date of the Asset Purchase Agreement are no longer available.

104. Further (and in any event), the cross-claims between LBI and LBIE were subject to mandatory insolvency set-off under Rule 2.85 at the date of the 2.95 Notice. As a result, those cross-claims were converted into a single claim for the net balance. The latter claim has a new legal identity, separate from the legal identity of the cross-claims which preceded it. See *Stein v Blake (No. 1)* [1996] AC 243 at 255 (Lord Hoffmann):

> "*The principles so far discussed should provide an answer to the first of the issues in this appeal, namely, whether if A, against whom B has a cross-claim, becomes bankrupt, A's claim against B continues to exist as a chose in action so that A's trustee can assign it to a third party. In my judgment the conclusion must be that the original chose in action ceases to exist and is replaced by a claim to a net balance. If the set-off is mandatory and self-executing and results, as of the bankruptcy date, in only a net balance being owing, I find it impossible to understand how the cross-claims can, as choses in action, each continue to exist*."

105. It follows that the cross-claims which LBIE had against LBI at the date of the Asset Purchase Agreement are no longer available. This prevents LBIE from exercising any right of equitable set-off against Barclays.

(4) Does LBIE have a common law right to set off such Unsecured Claim against any sums owing by Barclays and/or LBI to LBIE?

106. The Administrators consider that the answer to this question is 'no'.

107. The doctrine of legal set-off operates in circumstances where there are cross-claims between the parties to civil litigation: see *Derham* at §2.08. The cross-claims must be due and payable (*ibid*).

108. It is unclear how (and indeed whether) legal set-off applies in circumstances where one of the parties is in administration or liquidation, so that normal civil litigation is impossible.

109. In any event, the only relevant parties in the present case are LBIE and Barclays. LBIE does not have any cross-claim against Barclays. It follows that the doctrine of legal set-off does not apply.

PART C: THE LBI PAYMENT

ISSUE 10

In what manner, and from what date, does the LBI Payment fall to be applied towards the discharge or reduction of:

(1) Barclays' Client Money Entitlement (if any);

(2) Barclays' Unsecured Claim(s) in respect of the ETD Trades (if any); and/or

(3) Barclays' other claims (if any)?

110. The Administrators' position is that:

(1) The entire amount of the LBI Payment was applied towards the reduction of Barclays' Client Money Entitlement in respect of the ETD Trades by USD 777m with effect from the date of the LBI Payment; and

(2) The effect of (1) above is that Barclays' Parallel Unsecured Claim was reduced in like amount.

111. The Administrators' position assumes that Barclays had a Client Money Entitlement of at least USD 777m in respect of the ETD Trades. If this assumption is incorrect, the Administrators consider that Barclays' Unsecured Claim in respect of the ETD Trades was nevertheless reduced by USD 777m as a result of the LBI Payment: see the alternative position set out below.

112. In support of these contentions, the Administrators will rely on: (i) the terms of the LBI/LBIE Settlement, the settlement agreement entered into between LBI and Barclays on 29 June 2015 (the "**LBI/Barclays Settlement**") and the order made by the US Bankruptcy Court approving the LBI/Barclays Settlement on 29 June 2015 (the "**June 2015 Order**"); (ii) the terms of the Barclays Proof; and (iii) the general law governing the relationship between Client Money Entitlements and Parallel Unsecured Claims.

113. The LBI/LBIE Settlement, the LBI/Barclays Settlement and the June 2015 Order are governed by the law of New York. To the extent necessary, the Administrators will rely on expert evidence of New York law in support of their position on Issue 10.

(A) THE TERMS OF THE RELEVANT DOCUMENTS

114. The LBI/LBIE Settlement was approved by an order of the Honorable James M. Peck in the US Bankruptcy Court for the Southern District of New York on 16 April 2013. On 1 May 2013, David Richards J in the High Court of Justice of England and Wales ordered that the Administrators were at liberty to cause LBIE to perform its obligations under the LBI/LBIE Settlement.

115. Section 10.08 of the LBI/LBIE Settlement requires LBI to hold a reserve in the sum of USD 777m. This is described in the Application as the Dedicated Reserve. Pursuant to section 10.08 of the LBI/LBIE Settlement, the Dedicated Reserve must be used for the purpose of:

(1) Making a payment to LBIE, in the event that Barclays succeeds in asserting the "*Barclays LBIE ETD Claim*" against LBIE; or

(2) Making a payment to Barclays, on the basis that LBI's obligation to hold the Dedicated Reserve would be extinguished only if (and to the extent that) such payment had the effect of reducing LBIE's liability to Barclays in respect of the "*Barclays LBIE ETD Claim*".

116. The "*Barclays LBIE ETD Claim*" is defined in Annex A of the LBI/LBIE Settlement as follows:

> "*… (i) the Claim asserted by Barclays against LBIE in respect of the LBI/LBIE ETD Accounts as a contingent unsecured claim in the Barclays Proof of Debt, or (ii) any Barclays LBIE Client Money Claim, in the case of each of (i) and (ii), to the extent (and only to the extent) that such Claim constitutes a Barclays ETD Claim.*"

117. The "*Barclays ETD Claim*" is defined as follows:

> "*… any existing or future Claim by Barclays against LBIE (in its individual capacity or as LBIE Client Money Trustee), LBI or the LBI Trustee (including the Barclays LBIE Proof of Debt), to the extent (and only to the extent) (i) such Claim is on account of the LBI/LBIE ETD Accounts and (ii) Barclays' interest in such Claim arises under, or is asserted by Barclays to arise under, the Barclays APA or under a transfer of LBI Pre-SIPA Proceeding Transferred Property.*"

118. The June 2015 Order states as follows:

> "*… the [trustee of LBI] and Barclays agreed in the [LBI/Barclays Settlement] that, to implement the District Court's Judgment and the orders entered in the Litigation, the [LBI Trustee] would pay Barclays … USD 777,000,000 out of the [Dedicated Reserve] with respect to Barclays' LBIE ETD Claim*".

119. Further, the June 2015 Order provides that:

> "*... upon payment by the [trustee of LBI] of the $777,000,000, (i) the maximum aggregate undischarged liability of [LBIE] and/or the trustee of the UK statutory trust of client money arising under CASS 7 in relation to LBIE (including the LBIE Client Money Trustee) to [Barclays], with respect to the Barclays LBIE ETD Claims shall automatically, unconditionally and irrevocably be reduced by $777,000,000 and (ii) Barclays hereby releases LBIE (including the LBIE Client Money Trustee) with respect to the Barclays LBIE ETD Claims in such amount*."

120. Notwithstanding the foregoing provisions, the June 2015 Order does not purport to constitute an admission by LBIE of any claims asserted by Barclays:

> *"… except for the reduction in, and release of, the maximum aggregate undischarged liability of LBIE, and the receipt by Barclays of $777,000,000, with respect to the Barclays LBIE ETD Claims provided for by the third sentence of paragraph 5 of the Settlement Agreement, nothing in the Settlement Agreement or in this Order shall act as collateral estoppel, res*

judicata or judicial estoppel as between Barclays and LBIE, or prejudice the merits of any rights, defenses or arguments of Barclays or LBIE against each other."

121. Materially identical provisions are contained in the LBI/Barclays Settlement: see paragraphs 4, 5 and 6 thereof.

122. LBIE is designated as a third party beneficiary of the relevant provisions of the LBI/Barclays Settlement. See paragraph 6, which provides:

> "*The Parties intend for LBIE (including the LBIE Client Money Trustee) to be entitled to rely on the third and fourth sentences of paragraph 5 hereof, this paragraph 6, and the first sentence of paragraph 16, as a third party beneficiary thereof.*"

123. The LBI Payment was duly made in accordance with the LBI/Barclays Settlement on about 2 July 2015: see Downs 10 at [41].

(B) ANALYSIS

The Administrators' primary position

124. The Administrators' primary position on Issue 10 can be summarised as follows:

(1) The LBI Payment is first to be applied against Barclays' Client Money Entitlement which, assuming this is greater than USD 777m, is reduced accordingly. This follows from the contractual provisions set out above (including, *inter alia*, the definition of "*Barclays LBIE ETD Claim*") and the June 2015 Order. LBIE is entitled to rely on the LBI/Barclays Settlement and the June 2015 Order as a third party beneficiary thereof, even though it is not a party to those agreements.

(2) Where a client receives part of its Client Money Entitlement, the client's Parallel Unsecured Claim is thereby reduced by the same amount: see Issue 6 above and *Re MF Global UK Ltd* [2014] 1 WLR 1558.

(3) Thus, the reduction of Barclays' Client Money Entitlement by USD 777m resulted in the *pro tanto* reduction of Barclays' Parallel Unsecured Claim.

(4) The LBI Payment is, therefore, required to be taken into account for the purposes of valuing and admitting the Barclays Proof. It matters not that the LBI Payment was received after the date when the Barclays Proof was submitted. As David Richards J said in *Re MF Global UK Ltd* [2014] 1 WLR 1558 at [66], "*it would be contrary to the nature and purpose of the client money trust if account were not to be taken of payments made from the CMP after the submission of claims against the general estate in arriving at the amount at which such claims could be proved*".

125. True it is that Barclays did not receive the LBI Payment from the Client Money Pool. That, however, does not lead to the conclusion that Barclays' Client Money Entitlement was unaffected by the LBI Payment. By virtue of the contractual provisions described above and the June 2015 Order, Barclays agreed that its Client Money Entitlement would "*automatically, unconditionally and irrevocably be reduced*" by USD 777m.

126. The foregoing analysis is consistent with the fact that Barclays' Client Money Claim is its primary claim in the administration of LBIE. Barclays' Parallel Unsecured Claim is a secondary claim for the residue of its underlying contractual entitlement – to the extent that its contractual rights have not been fully satisfied by distributions made to Barclays in respect of its Client Money Entitlement.

127. The status of Barclays' Parallel Unsecured Claim as a secondary claim is reflected by the language of the Barclays Proof, which describes the Parallel Unsecured Claim as a "*contingent unsecured claim*". The ETD Annex to the Barclays Proof states:

> "*Barclays is submitting this contingent unsecured claim as a protective matter in the event and to the extent it is determined that (a) there is any shortfall in recoveries from [the Client Money Claim] or other proprietary claim or (b) Barclays' claim in relation to the balances in some or all of the Accounts and/or the LBI Margin Assets is properly characterized as an unsecured claim under applicable law.*"

128. The same phrase ("*contingent unsecured claim*") is used in the definition of "*Barclays LBIE ETD Claim*" in the LBI/LBIE Settlement. Having regard to the decision of David Richards J in *Re MF Global UK Ltd* [2014] 1 WLR 1558, the phrase "*contingent unsecured claim*" is an apt description of the Parallel Unsecured Claim.

129. If Barclays elects to waive its Client Money Claim (see Issue 7), the above analysis will not be affected in any way. Notwithstanding the waiver, Barclays will have received USD 777m of its Client Money Entitlement (which must be taken into account for the purposes of valuing and admitting the Barclays Proof).

The Administrators' alternative position

130. The Administrators' primary position (set out above) assumes that Barclays had a Client Money Entitlement of at least USD 777m in respect of the ETD Trades.

131. Having regard to the contractual provisions set out above (including, *inter alia*, the definition of "*Barclays LBIE ETD Claim*") and the June 2015 Order, the parties clearly intended that Barclays' Unsecured Claim in respect of the ETD Trades should be reduced by a total of USD 777m – regardless of the value of the Client Money Entitlement. See also the Administrators' position on Issue 6.

132. Accordingly, if Barclays had a Client Money Entitlement of less than USD 777m in respect of the ETD Trades, then the Administrators adopt the following analysis:

    (1) The LBI Payment extinguished Barclays' Client Money Entitlement in respect of the ETD Trades (being an amount less than USD 777m), and thereby reduced Barclays' Parallel Unsecured Claim by an equivalent amount: see above.

    (2) Barclays' remaining Unsecured Claim in respect of the ETD Trades[13] was further reduced up to the full amount of the LBI Payment, resulting in a total

[13] Which would not, on this hypothesis, constitute a Parallel Unsecured Claim.

reduction of USD 777m from Barclays' Unsecured Claim in respect of the ETD Trades.

133. On this analysis, Barclays' Parallel Unsecured Claim in respect of the ETD Trades was reduced in two conceptual stages. First, Barclays' Unsecured Claim in respect of the ETD Trades was reduced by virtue of the extinction of the corresponding Client Money Entitlement. Second, Barclays' remaining Unsecured Claim in respect of the ETD Trades was further reduced so as to achieve a total reduction of USD 777m.

ISSUE 11

Rule 2.72(3)(b)(ii) provides that a proof of debt must state "*the total amount of [the creditor's] claim as at the date on which the company entered administration, less any payments that have been made to [the creditor] after that date in respect of [the creditor's] claim* …" On the true construction of the latter provision, does the LBI Payment, or any part thereof, constitute a payment in respect of Barclays' claim within the scope of Rule 2.72(3)(b)(ii)?

134. If the Administrators' primary position on Issue 10 is correct, then it will not strictly be necessary for the Court to consider Issue 11.

135. As explained above:

(1) The Administrators' primary position on Issue 10 is that the LBI Payment is to be applied towards the reduction of Barclays' Client Money Entitlement, which automatically operates so as to reduce the provable amount of the Parallel Unsecured Claim.

(2) It follows that Barclays' Parallel Unsecured Claim must be valued and admitted in an amount which takes into account Barclays' receipt of the LBI Payment.

If this answer is correct, then there is no need for the Court to consider Rule 2.72(3)(b)(ii) – although the foregoing analysis is consistent with that Rule, the effect of which is described below.

136. If Barclays does not have a Client Money Entitlement of at least USD 777m in respect of the ETD Trades, then a different analysis applies. The Administrators submit that, in those circumstances, Barclays' Unsecured Claim in respect of the ETD Trades was nevertheless reduced by USD 777m as a result of the LBI Payment (although some of that reduction would not be attributable to a corresponding reduction of a Client Money Entitlement: see Issue 10).

137. The question then arises as to whether USD 777m should be deducted from the Barclays' Proof, whether by reason of Rule 2.72(3)(b)(ii) or otherwise. The Administrators submit that:

(1) The LBI Payment is a payment "*in respect of*" Barclays' claim within the scope of Rule 2.72(3)(b)(ii); and that

(2) The Administrators are entitled and obliged to admit the Barclays Proof for a reduced amount deducting USD 777m, being the amount of the LBI Payment. (The precise method of calculating this deduction is the subject of Issue 15.)

138. Accordingly, the remainder of Issue 11 proceeds on the basis that Barclays does not have a Client Money Entitlement of at least USD 777m in respect of the ETD Trades (such that the Administrators' alternative position on Issue 10 applies).

(A) LEGAL PRINCIPLES

139. Rule 2.77(1) provides: "*A proof may be admitted for dividend either for the whole amount claimed by the creditor, or for part of that amount*". A proof can only be admitted for dividend: it cannot be admitted for any other purpose. There is no mechanism known to English law whereby a proof can be admitted for any purpose other than the payment of dividends on the admitted amount.

140. It is a basic principle of insolvency law that, in calculating the amount for which a proof should be admitted, the office-holder is required to take into account the most up-to-date information available as to the status of the relevant debt. In particular, the office-holder is required to take into account any events affecting the existence or quantum of the debt, including events occurring after the company went into a formal insolvency proceeding and after the creditor submitted his proof. If the quantum of the debt has reduced for any reason, the proof should only be admitted for that reduced amount.

141. This principle is supported by authority at the highest level. It is also supported by the express provisions of the Rules (including Rule 2.72, to which Issue 11 refers).

142. The leading case is the decision of the Privy Council in *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147. In that case, the respondent (Eckhardt) submitted a proof of debt in a Cayman liquidation. Eckhardt's debt was governed by Bangladeshi law. After the proof was submitted, the debt was discharged under its proper law by means of a scheme of arrangement in Bangladesh. Eckhardt argued that the proof should nevertheless be admitted for the full amount outstanding at the time when the proof was originally submitted. The liquidator disagreed, and rejected the proof. Eckhardt successfully argued in the Cayman Court of Appeal that the proof should be admitted. The liquidator appealed to the Privy Council.

143. The Privy Council allowed the liquidator's appeal. Lord Hoffmann, who gave the only speech, held that the liquidator was right to reject the proof in circumstances where the underlying debt had been discharged. It was irrelevant that the debt was discharged after the proof was submitted. It was equally irrelevant that the debt was not 'contingent' at the date of the winding-up.[14]

144. Counsel for Eckhardt argued that "*the question of whether Eckhardt was owed a debt must be ascertained at the date of the winding up. If, as is assumed to be the case, it was at that date entitled to payment under the law of Bangladesh, it cannot be*

[14] For present purposes, there is no material difference between the law of insolvency in England and the Cayman Islands.

deprived of that entitlement by subsequent events": see the judgment at [25]. Lord Hoffmann said:

> "[26] *This argument was skilfully deployed but their Lordships think that it is wrong. It is first necessary to remember that a winding up order is not the equivalent of a judgment against the company which converts the creditor's claim into something juridically different, like a judgment debt. Winding up is, as Brightman LJ said in In re Lines Bros Ltd [1983] Ch 1 at 20, 'a process of collective enforcement of debts'. The creditor who petitions for a winding up is 'not engaged in proceedings to establish the company's liability or the quantum of the liability (although liability and quantum may be put in issue) but to enforce the liability'.*
>
> [27] *The winding up leaves the debts of the creditors untouched. It only affects the way in which they can be enforced. When the order is made, ordinary proceedings against the company are stayed (although the stay can be enforced only against creditors subject to the personal jurisdiction of the court). The creditors are confined to a collective enforcement procedure that results in pari passu distribution of the company's assets. The winding up does not either create new substantive rights in the creditors or destroy the old ones. Their debts, if they are owing, remain debts throughout …*
>
> [29] *The image of collecting and uno flatu distributing the assets of the company on the day of the winding up order is a vivid one, but the courts apply it to give effect to the underlying purpose of fair distribution between creditors pari passu and not as a rigid rule … The principle of valuation at the date of winding up ensures that distribution among creditors is truly pari passu. It would, however, be pure conceptualism to apply it so as to require payment of a dividend to someone who, at the time of the distribution, is not a creditor at all.*
>
> [30] *So, for example, a policy of insurance on the life of a person living at the date of the order winding up the insurance company is a contingent debt which will be ordinarily valued in accordance with mortality tables as at the date of the winding up …*
>
> [31] *On the other hand, if the life drops during the course of the winding up, the claim at the date of winding up will be revalued on the assumption that it was known at that date that the person insured would die when he did. If all the assets have been distributed, this will not help the beneficiaries because previous distributions cannot be set aside. But if there are still assets to be distributed, the beneficiaries will participate on the basis of the new valuation. Similarly in In re Northern Counties of England Fire Insurance Co (1880) 17 Ch D 337, the premises of an insured under a fire policy with an insolvent company were burned down during the course of the winding up. He was held entitled to prove for the full loss, that being (with hindsight) the value which would have been attributed at the date of winding up to his contingent claim under the policy if it had been known that his premises would burn down.*

> [32] *These cases on the use of hindsight to value debts which were contingent at the date of the winding up order show that the scene does not freeze at the date of the winding up order. Adjustments are made to give effect to the underlying principle of pari passu distribution between creditors. Hindsight is used because it is not considered fair to a creditor to value a contingent debt at what it might have been worth at the date of the winding up order when one now knows that prescience would have shown it to be worth more. The same must be true of a contingent debt which prescience would have shown to be worth less.*
>
> [33] *It therefore seems to their Lordships that the principle of pari passu distribution according to the values of debts at the date of winding up does not necessarily lead to the conclusion that someone who was a creditor at that date must be allowed to participate in the distribution even when he is no longer a creditor at all. There is nothing unfair, or contrary to principle, in a rule which requires that anyone who claims to participate in a distribution should have the status of a creditor at the time when he makes that claim. It would be strange if the court can have regard to subsequent events in valuing a creditor's contingent claim at much less than it would have been thought to be worth at the date of the order but not to the fact that someone has ceased to be a creditor at all.*
>
> [34] *This view is supported by the statutory form of proof. The Companies Law (2002 rev) appears to be based upon the United Kingdom Companies Act 1948 and their Lordships will therefore refer to the form of proof prescribed by rule 94 and Form 59 of the Companies (Winding-up) Rules 1949 (SI 1949/330). In the United Kingdom these have been replaced by rule 4.77 and Form 4.26 of the Insolvency Rules 1986 (SI 1986/1925) but there is no material difference. In each case the creditor is required to swear that the company 'on ... the date when the company went into liquidation was and still is justly and truly indebted to me ...'*
>
> [35] *Their Lordships therefore consider that ... the right to participate at any stage in the process of collective enforcement by liquidation depends upon being a creditor. So when the debt was discharged under its proper law, it ceased to be provable in the Cayman Islands liquidation and was properly rejected*." (emphasis added)

145. The same analysis applies where part of a debt is discharged after the creditor submits his proof. Following the partial discharge, the creditor is no longer entitled to participate in the distribution of the estate to the extent of the discharged amount. The proof is instead to be admitted for a reduced sum reflecting the partial discharge. It is irrelevant that the partial discharge occurred after the proof was submitted.

146. As Lord Hoffmann observed, the contrary view is inconsistent with the principle of *pari passu* distribution. If a debt of £100 is discharged (for any reason) by £50 after

the creditor submits his proof, the proof cannot subsequently be admitted for dividend in the sum of £100. This would cause the relevant creditor to receive a higher rate of dividend (measured against the true outstanding amount of the underlying debt) than other creditors. The creditor could even recover more than 100p in the £. Such a result would be manifestly unjustifiable.

147. The analysis in *Wight v Eckhardt* derives clear support from the Rules. The relevant provisions are found in Chapter 10 of Part 2, which deals with distributions to creditors in an administration, including the "*machinery of proving a debt*" (Section B) and the "*quantification of claims*" (Section C). Numerous provisions are designed to ensure that, in calculating the amount for which a proof is to be admitted, the administrator can take into account the most up-to-date information available as to the status of the relevant debt. In particular:

(1) Rule 2.72(3)(b)(ii) provides that a proof of debt must state "*the total amount of [the creditor's] claim as at the date on which the company entered administration, less any payments that have been made to [the creditor] after that date in respect of [the creditor's] claim*". It is therefore clear that the amount of the debt stated in a proof must be reduced by the amount of any payments by third parties which the creditor voluntarily accepted in discharge of the debt.

(2) Rule 2.77(1) provides that "*a proof may be admitted for dividend either for the whole amount claimed by the creditor, or for part of that amount*". Amongst other things, this provision ensures that, if subsequent events have reduced the quantum of a debt, the proof can be admitted for an appropriately reduced amount.

(3) Rule 2.79 provides that "*a creditor's proof may at any time, by agreement between himself and the administrator, be withdrawn or varied as to the amount claimed*". This provision would, among other things, enable a creditor to increase or decrease the amount of his proof depending on the occurrence of subsequent events.

(4) Rule 2.81(1) provides that "*the administrator shall estimate the value of any debt which, by reason of its being subject to any contingency or for any other reason, does not bear a certain value; and he may revise any estimate previously made, if he thinks fit by reference to any change of circumstances or to information becoming available to him*". This provision has been given a broad interpretation, and does not only apply to 'contingent' debts in the traditional sense: see *Re MF Global UK Ltd* [2014] 1 WLR 1558 at [66]-[68] (David Richards J), considered below.

(5) Rule 2.94 provides that "*if a creditor who has valued his security subsequently realises it (whether or not at the instance of the administrator) – (a) the net amount realised shall be substituted for the value previously put by the creditor on the security; and (b) that amount shall be treated in all respects as an amended valuation made by him*". Thus, if a secured creditor proves for the unsecured part of his debt (based on an estimate of the value of his security under Rule 2.72(3)(b)(vii)), and the security is subsequently enforced, the proof will be revised to reflect the precise amount of the realisation.

(6) Rule 2.101(3) provides that "*if, after a creditor's proof has been admitted, the proof is withdrawn or expunged, or the amount is reduced, the creditor is liable to repay to the administrator any amount overpaid by way of dividend*". Analogous provisions apply where the amount claimed in a proof increases after dividends have been paid: see Rules 2.101(1) and 2.101(2).

(7) Finally, there is no time period within which an administrator must determine a proof. Many months or even years may elapse between the submission of a proof and its ultimate determination – as in the present case.[15] This means that significant developments will often take place between the date when a proof

[15] The position was different under the old law. At the dawn of insolvency law, a debt was 'proved' by adducing evidence of the debt before the commissioners in bankruptcy. In this context, "*the proof and the admission and the filing of the proof were one and the same*": see *Amalgamated Investment & Property Co Ltd* [1985] Ch 349 at 385. In due course, a gap arose between the submission and admission of a proof. However, there were strict time limits on admission: for example, rule 117 of the Companies Winding Up Rules 1949 required the liquidator determine the proof within 28 days of its submission. Under the current Rules, there is no such time limit. This must have been a deliberate choice by the draftsman to give office-holders more flexibility.

is submitted and the date when the proof is determined. It is not surprising, in these circumstances, that the Rules should provide so many mechanisms for revising the amount of a proof to account for changed circumstances.

148. The whole tenor of the Rules therefore supports the view that, in calculating the amount for which a proof should be admitted, the office-holder should take into account the most up-to-date information available as to the status of the relevant debt.

(B) THE PRESENT CASE

149. In light of the foregoing discussion, the appropriate course of action in the present case is clear.

150. The LBI Payment is a payment "*in respect of*" Barclays' claim within the scope of Rule 2.72(3)(b)(ii). This is because Barclays voluntarily agreed to apply the LBI Payment towards the reduction of its claim against LBIE. But for this consensual act, the LBI Payment would not have been made and would have had no effect whatsoever on Barclays' claims against LBIE: see *Re Rowe* [1904] 2 KB 483.

151. It follows that the Administrators are entitled and obliged to admit the Barclays Proof for a reduced amount deducting USD 777m, being the amount of the LBI Payment.

152. It is irrelevant that the LBI Payment was made after LBIE went into administration. It is likewise irrelevant that the LBI Payment was made after the Barclays Proof was submitted.

(C) THE GUARANTEE CASES

153. In correspondence, Barclays has sought to rely on a series of cases relating to the law of guarantees (the "**Guarantee Cases**") to argue that the Barclays Proof should be admitted without any deduction in respect of the LBI Payment. However, for the reasons set out below, the Guarantee Cases have no application in the present context. There is no relation of suretyship between LBI, LBIE and Barclays.

154. By way of introduction to the Guarantee Cases, assume that a creditor is owed a debt by a principal debtor in the sum of £1,000. The whole of the debt is guaranteed by a third party, whose liability is unlimited. The principal debtor enters into liquidation. The guarantor pays the creditor part of the debt (e.g. £777), but fails to discharge the entire debt. The question arises whether the creditor should be permitted to prove in the principal debtor's liquidation for the entire amount of the debt (£1,000), or whether the guarantor's part-payment should be deducted from the creditor's proof.

155. The normal rule is that, in calculating the amount for which a proof should be admitted, the office-holder should take into account the most up-to-date information available as to the status of the relevant debt: see above. This rule may appear to entail that the creditor's proof should only be admitted in the sum of £223.

156. However, the special nature of suretyship adds an extra level of complexity to the analysis. The additional complexity arises from (i) the guarantor's right of indemnity and (ii) the rule against double proof. In particular:

(1) The guarantor has a right of indemnity against the principal debtor to recover any payments made to the creditor: see Millett and Andrews, *The Law of Guarantees* (7th edition) at §10-004 and §10-006. In the example described above, the principal debtor is indebted to the creditor for £223 (being the outstanding balance of the principal debt), and to the guarantor for £777 (being the amount of the guarantor's right of indemnity).

(2) The guarantor is not, however, entitled to prove for its right of indemnity in the liquidation of the principal debtor until the creditor has been repaid in full: see Millett and Andrews (*op cit*) at §13-002. This is known as the rule against double proof.

157. In light of these factors, it has been suggested that the creditor should be entitled to prove for the entire amount of the debt in the liquidation of the principal debtor (namely £1,000) without giving credit for the guarantor's part-payment. On this analysis, the creditor's proof would in effect represent both the outstanding balance of

the principal debt and the guarantor's right of indemnity. As Professor Goode explains (in *Goode on Legal Problems of Credit and Security* (5th edition) at §8-18):

> "*At first sight it seems surprising that, if the surety pays part of the debt, the creditor should not have to give credit at least for sums received from the surety prior to the bankruptcy. But the rule has a sound policy base. It is a well settled principle of equity that until the creditor has received payment of the guaranteed debt in full the surety cannot prove in the insolvent debtor's estate for a sum paid by him to the creditor … If the creditor were required to give credit for a pre-bankruptcy part payment by the surety, neither of them could prove for the amount of such payment and the general body of creditors would thus be unjustly enriched.*" (emphasis added)[16]

158. The Guarantee Cases deal with this issue. It is fair to note that the Guarantee Cases are internally inconsistent, and the reasoning is often truncated or confused. As Professor Goode explains (*op cit* at §8-16):

> "*If the subject of fixed and floating charges seemed complicated, and the cases difficult to analyse, the going becomes harder still when we come to look at the case law on the impact of bankruptcy on suretyship guarantees. For some reason, conflicting authorities and obscure reasoning seem endemic in the earlier bankruptcy cases, and not infrequently one finds in the literature two quite inconsistent propositions placed one after the other, each being duly supported by authority, yet without a hint in the later case that it marks a departure from the earlier. So anyone going into this field does so at his peril.*"

159. Some of the Guarantee Cases support the view that a part-payment by the guarantor should never be deducted from the creditor's proof in the liquidation of the principal debtor, regardless of when the part-payment was made: see *Re Sass* [1892] 2 QB 12; *Re Houlder* [1929] 1 Ch 205; *Ulster Bank Ltd v Lambe* [1968] NI 161; *Re An Arranging Debtor No.A 1076* [1971] NI 96; *Re Fitness Centre (South East) Ltd* [1986] BCLC 518 at 521; *Westpac Banking Corp v Gollin & Co Ltd* [1988] VR 397 (Supreme Court of Victoria); *Bula v Crowley* (unreported decision of the High Court of Ireland, 20 February 2001); and *Re Sugar Hut Brentwood Ltd* [2008] EWHC 2634 (Ch) at [36].

[16] See also *Rowlatt on Principal and Surety* (6th edition) at §11-08 and *Millett and Andrews* (*op cit*) at §13-010.

160. By contrast, some of the Guarantee Cases support the view that a part-payment by the guarantor should be deducted from the creditor's proof in the liquidation of the principal debtor, unless the part-payment was made after the commencement of the liquidation (in which case it should not be deducted): see *MacKinnon's Trustee v Bank of Scotland* [1915] SC 411 and *Stotter v Equiticorp Australia Ltd* [2002] 2 NZLR 686.

161. Further still, some of the Guarantee Cases support the view that a part-payment by the guarantor should be deducted from the creditor's proof in the liquidation of the principal debtor (even if the part-payment was made after the commencement of the liquidation), unless the part-payment was made after the submission of the creditor's proof (in which case it should not be deducted): see *Re Blakeley* (1892) 9 Morr 173 and *Re Amalgamated Investment and Property Co Ltd* [1985] 1 Ch 349.

162. The Guarantee Cases give rise to the possibility that the creditor could recover more than 100p in the £ (for example, where the dividends paid in the liquidation of the principal debtor and the part-payment by the guarantor are together equal to more than the amount of the underlying debt). If the creditor recovers more than 100p in the £, the creditor must hold the surplus on trust for the guarantor. The surplus can then be applied towards the discharge of the guarantor's right of indemnity. See *Re Sass* [1896] 2 QB 12 at 15: "*if the principal creditor has proved and has received the dividend, and the surety comes and repays the full amount, the principal creditor would then be trustee for the surety of the amount of the dividend which he had so received*". See also *Westpac Banking Corp v Gollin & Co Ltd* [1988] VR 397 at 403. This trust is an incident of the guarantor's right of subrogation: see Millett & Andrews, *The Law of Guarantees* (7th edition) at §13-004.

163. The crucial point, however, is that none of the Guarantee Cases supports the view that the Barclays Proof should be admitted without any deduction for the LBI Payment. This is because there is no relation of suretyship between LBI, LBIE and Barclays. In particular:

(1) LBI is not a guarantor of LBIE's indebtedness to Barclays. The LBI Payment was made pursuant to bespoke contractual arrangements between the parties

(set out in the LBI/LBIE Settlement and the LBI/Barclays Settlement). On any view, those arrangements do not create a relation of suretyship.

(2) LBI has no right of indemnity against LBIE to recover the amount of the LBI Payment. Any such right of indemnity would be totally inconsistent with the compromise set out in the LBI/LBIE Settlement.

(3) Accordingly, the rule that a part-payment by a guarantor should not be deducted from the creditor's proof in the liquidation of the principal debtor has no application. The rationale for that rule depends on the guarantor's right of indemnity against the principal debtor, for which the guarantor cannot prove (by reason of the rule against double proof): see above. The creditor is permitted to prove for the full amount of the debt, representing the outstanding balance due to the creditor and the guarantor's right of indemnity. No such right of indemnity exists in the present case.

(4) The same point can be put in the following way. When a guarantor makes a part-payment to the creditor, the principal debtor's total liability is not truly reduced. The principal debtor's liability is simply redistributed, with part due to the creditor and part due to the guarantor. By contrast, the LBI Payment resulted in a true partial discharge of LBIE's total liabilities in respect of the ETD Trades.

(5) In these circumstances, there is no basis for permitting Barclays to prove for the full amount of a debt which has already been partially discharged. Any such course of action would cause Barclays to receive substantially more than 100p in the £ on its claim, and Barclays rightly accepts that it cannot receive more than 100p in the £. If LBI were a guarantor of LBIE's indebtedness to Barclays, this problem would not arise: the surplus received by Barclays would be held on trust for LBI under its right of subrogation, and applied in discharge of LBI's right of indemnity (see above). But LBI is not a guarantor and has no such right of subrogation or indemnity. Barclays would simply

receive a windfall in LBIE's administration, to the detriment of LBIE's other creditors.[17]

164. The Court has recently declined to apply the Guarantee Cases outside the narrow context of suretyship. In *Re MF Global (UK) Ltd* [2014] 1 WLR 1558, a number of creditors had parallel claims against the client money pool and the company's general estate. Those creditors had received (or were expected to receive) distributions from the client money pool. The issue was whether such distributions should be deducted from the parallel proofs of debt which had previously been submitted against the general estate.

165. It was argued that, by virtue of the Guarantee Cases, any post-proof distributions from the client money pool should not be so deducted. David Richards J rejected this argument. He noted (at [64]-[66]) that there was a special practice "*applicable in the case of guarantees*", citing *Re Amalgamated Investment and Property Co Ltd* [1985] 1 Ch 349. Since CASS7 did not create a relation of suretyship, the Guarantee Cases did not apply:

> "*… I do not consider that the client money rules are intended to create in the CMP a separate estate analogous to those of a principal debtor and guarantor. It would be contrary to the nature and purpose of the client money trust if account were not to be taken of payments made from the CMP after the submission of claims against the general estate in arriving at the amount at which such claims could be proved*."

166. Accordingly, the LBI Payment falls to be deducted from the Barclays Proof.

167. The Administrators are neutral as to which (if any) of the Guarantee Cases remain good law. For the reasons set out above, there is no need for the Court to determine this issue in the present Application. However, to the extent necessary, the Administrators reserve their right to argue that some or all of the Guarantee Cases are no longer good law. The Administrators note that:

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[17] Accordingly, Professor Goode is wrong to state that the rule in the Guarantee Cases also applies "*where the creditor receives payment from a complete stranger*" (*op cit* at §8-18). Further, to the extent that the decision in *Re Amalgamated Investment and Property Co Ltd* [1985] 1 Ch 349 supports a broader principle applicable outside the context of guarantees, that case is wrong and should not be followed.

(1) Rule 2.72(3)(b)(ii) provides that a proof of debt must state "*the total amount of [the creditor's] claim as at the date on which the company entered administration, less any payments that have been made to [the creditor] after that date in respect of [the creditor's] claim*". This provision was first introduced in 1986, after most of the Guarantee Cases had already been decided. There is no direct equivalent in previous insolvency legislation. The Administrators reserve their right to argue that some or all of the Guarantee Cases are inconsistent with Rule 2.72(3)(b)(ii).

(2) The Guarantee Cases were decided before (or, in some cases, without proper regard to) the decision of the Court of Appeal in *MS Fashions v BCCI* [1993] Ch 425 at 448, where Dillon LJ said: "*a creditor cannot sue the principal debtor for an amount of the debt which the creditor has already received from a guarantor*". The Guarantee Cases were also decided before (or, in some cases, without proper regard to) the decision of the Privy Council in *Wight v Eckhardt Marine GmbH* [2004] 1 AC 147.

(3) Most of the Guarantee Cases were decided at a time when there was a strict timeline between the submission of a proof and its determination by the office-holder. For example, rule 117 of the Companies Winding Up Rules 1949 required the liquidator to determine a proof within 28 days of its submission. Now that this timeline has been abolished, the reasoning in certain of the Guarantee Cases (including *Re Amalgamated Investment and Property Co Ltd* [1985] 1 Ch 349 at 385) has no application.

ISSUE 12

Are the Administrators entitled and/or obliged to admit the Barclays Proof for a reduced amount deducting an amount in respect of the LBI Payment (or any part thereof)?

168. The LBI Payment is required to be taken into account for the purposes of valuing and admitting the Barclays Proof (regardless of the value of Barclays' Client Money Entitlement in respect of the ETD Trades): see Issues 10 and 11 above.

ISSUE 13

Does (i) the creation of the Dedicated Reserve; and/or (ii) the LBI Payment; and/or (iii) the Administrators' consent thereto; and/or (iv) any other action relating to the creation of the Dedicated Reserve and payment therefrom, itself constitute (a) an admission to proof; and/or (b) payment of a dividend by the Administrators of part of the Barclays Proof in an amount equal to such payment?

169. The Administrators consider that:

(1) The Barclays Proof has never been admitted in part or in full at any time; and

(2) No dividend has ever been paid in respect of the Barclays Proof at any time.

170. Issue 13 was included in the Application at the request of Barclays. At the present time, the Administrators are unable to identify any basis for arguing that the Barclays Proof has been admitted, or that a dividend has been paid in respect of the Barclays Proof.

171. Since 1861, there has been a "*clear distinction between the submission and the admission of the proof*": see *Re Amalgamated Investment and Property Co Ltd* [1985] Ch 349 at 383 (Vinelott J). The Administrators are the parties responsible for admitting proofs of debt: see Rule 2.77. The Administrators are also responsible for paying dividends on proofs of debt: see Rules 2.95 to 2.99. As noted above, there is no prescribed deadline for the admission of a proof.

172. The Administrators do not consider that they have admitted or paid any dividends on the Barclays Proof. See section 19 of the Appendix to Downs 10, which explains that "*Barclays' unsecured claim has not been admitted – and therefore has not yet been paid – because of the complex issues raised by this Application*". There is no basis on which the Court could second-guess the Administrators' description of their own conduct.

173. The Barclays Proof could not have been admitted at the time of the creation of the Dedicated Reserve. The Dedicated Reserve was created on 21 February 2013, pursuant to section 10 of the LBI/LBIE Settlement. At that time, it remained unclear whether Barclays had in fact taken a valid assignment of LBI's rights in respect of the ETD Trades.[18] The scope of the assignment was only confirmed when the 5 August 2014 decision of the US Court of Appeals for the Second Circuit became final and unappealable in May 2015: see Downs 10 at [34].

174. Reflecting this uncertainty, the LBI/LBIE Settlement expressly prohibits the Administrators from admitting the Barclays Proof except in very restricted circumstances: see section 10.06 (entitled "*Diligent Defense of Barclays LBIE ETD Claims*").

175. Nor could the Barclays Proof have been admitted at the time of the LBI Payment on 2 July 2015. The LBI Payment was made in accordance with the LBI/Barclays Settlement. Paragraph 6 of the LBI/Barclays Settlement provides:

> "*Except for the reduction in, and release of the maximum aggregate undischarged liability of LBIE, and the receipt by Barclays of $777,000,000, with respect to the Barclays LBIE ETD Claims … nothing in this Stipulation shall act as a collateral estoppel, res judicata or judicial estoppel as between Barclays and LBIE, or prejudice the merits of any rights, defenses or arguments of Barclays or LBIE against each other. The Parties intend for LBIE (including the LBIE Client Money Trustee) to be entitled to rely on … this paragraph 6 … as a third party beneficiary thereof.*"

[18] Further, LBIE and Barclays entered into a reconciliation exercise in respect of the ETD Trades, which concluded in January 2013. But the parties did not agree a precise figure: see Downs 10 at [49].

176. The Barclays Proof was submitted for protective purposes only. Indeed, Barclays did not intend for the Barclays Proof to be admitted unless and until the Administrators determined that there was a shortfall in the Client Money Pool. The ETD Annex to the Barclays Proof states:

> "*Barclays is submitting this contingent unsecured claim as a protective matter in the event and to the extent it is determined that (a) there is any shortfall in recoveries from [the Client Money Claim] or other proprietary claim or (b) Barclays' claim in relation to the balances in some or all of the Accounts and/or the LBI Margin Assets is properly characterized as an unsecured claim under applicable law.*"

177. Likewise, the main body of the Barclays Proof states:

> "*Barclays intends to submit a client money and/or client/trust asset claim in relation to the Accounts and the LBI Margin Assets and the proceeds thereof … The amount of any client/trust asset claim has yet to be determined and is subject to further investigation by Barclays. If LBIE makes a client money entitlement determination or a client/trust asset determination, an unsecured claim is submitted equal to the difference between the client money entitlement determination and/or the client/trust asset entitlement determination and the amount of client money and client/trust assets received from the client money pool and client/trust assets distributed by Barclays.*"

178. Irrespective of the language of the Barclays Proof, the LBI Payment plainly cannot be characterised as any form of dividend in the administration of LBIE. See also the Administrators' primary position on Issue 10.

179. For these reasons, the Administrators are currently unable to identify any basis for arguing that the Barclays Proof has been admitted, or that a dividend has been paid on the Barclays Proof.

180. The LBI/LBIE Settlement, the LBI/Barclays Settlement and the June 2015 Order are governed by the law of New York. To the extent necessary, the Administrators will rely on expert evidence of New York law in support of their position on Issue 13.

ISSUE 14

If the Barclays Proof should be admitted without deducting an amount in respect of the LBI Payment (or any part thereof), are the Administrators entitled and/or obliged to give credit for the Sterling Equivalent of the LBI Payment (or any part thereof) when paying dividends in respect of the Barclays Proof?

181. For the reasons set out above (in relation to Issues 11 and 12), the Administrators consider that the Barclays Proof should be admitted for a reduced amount deducting the LBI Payment. If this submission is correct, then Issue 14 does not arise.

182. Issue 14 only arises if (which is denied) the Barclays Proof should be admitted without any deduction in respect of the LBI Payment. In that case, it is necessary to determine whether the Administrators should give credit for the LBI Payment when paying dividends in respect of the Barclays Proof.

183. As a matter of common sense, it would plainly be wrong for the Administrators to pay dividends to Barclays on the full amount of the Barclays Proof. Barclays would otherwise recover more than 100p in the £ and Barclays rightly accepts that it cannot do so. In effect, Barclays would receive USD 777m more than the true amount of its claim.

184. Barclays must therefore identify a legal mechanism by which the Administrators can give credit for the LBI Payment when paying dividends on the Barclays Proof.

185. As the Guarantee Cases reveal, there is a special solution available in a suretyship scenario. Where a creditor submits a proof of debt in the liquidation of a principal debtor after receiving part-payment from a guarantor, the law deploys the concept of subrogation to prevent the creditor from recovering more than 100p in the £. For example, assume that the creditor is owed £1,000 by the principal debtor, and that the guarantor (who is liable for the entire amount) pays £777 to the creditor in part-payment of the debt after the principal debtor enters into liquidation. In that case, the Guarantee Cases suggest that:

(1) The creditor remains entitled to prove for the full amount of £1,000 in the liquidation of the principal debtor.

(2) If the creditor recovers more than 100p in the £, the creditor must hold the surplus on trust for the guarantor. The surplus can then be applied in discharge of the guarantor's right of indemnity. See *Re Sass* [1896] 2 QB 12 at 15: "*if the principal creditor has proved and has received the dividend, and the surety comes and repays the full amount, the principal creditor would then be trustee for the surety of the amount of the dividend which he had so received*". See also *Westpac Banking Corp v Gollin & Co Ltd* [1988] VR 397 at 403. This trust is an incident of the guarantor's right of subrogation: see Millett & Andrews, *The Law of Guarantees* (7th edition) at §13-004.

186. In the present case (which does not involve a guarantee), this solution is not available. It cannot be suggested that Barclays should hold any dividends on trust for LBI, or that LBI has any right of indemnity: see above.

187. Accordingly, Barclays must identify some other mechanism by which the Administrators can give credit for the LBI Payment when paying dividends on the Barclays Proof.

188. In principle, it is difficult to see what this mechanism might be. Rule 2.77(1) provides: "*A proof may be admitted for dividend either for the whole amount claimed by the creditor, or for part of that amount*". A proof can only be admitted <u>for dividend</u>: it cannot be admitted for any other purpose. The Rules do not explain how a dividend could be paid on some amount other than the amount admitted for dividend.

189. In *Re MF Global (UK) Ltd* [2014] 1 WLR 1558, a similar situation arose. A number of creditors had parallel claims against the client money pool and the company's general estate. Those creditors had received (or were expected to receive) distributions from the client money pool. It was argued that the creditors' proofs should be admitted at full face value, but that a 'cap' should be imposed under the law of unjust enrichment to prevent any creditor from recovering more than 100p in the £. This argument was rejected: see the judgment at [59]. Instead, David Richards J held

that the administrators should simply admit each proof for a reduced amount, taking into account any actual or anticipated distributions from the client money pool: see the judgment at [67]-[69].

190. The Administrators therefore adopt the following position on Issue 14:

(1) On the true construction of the Rules, Issue 14 does not arise at all.

(2) If (which is denied) Issue 14 does arise, Barclays must not be permitted to recover more than 100p in the £. The legal mechanism for achieving this result is, however, wholly unclear.

ISSUE 15

In relation to Issues 10 to 14 and Issue 19, how is the amount in respect of the LBI Payment to be calculated? In particular, if it is the Sterling Equivalent that is to be taken into account, should the Sterling Equivalent of the LBI Payment be calculated based on the exchange rate prevailing at:

(1) The Time of Administration;

(2) The time when Barclays received the LBI Payment; or

(3) Some other time?

191. Issue 15 seeks to identify the precise manner in which the LBI Payment falls to be deducted from Barclays' claims against LBIE, having regard to the fact that the LBI Payment is denominated in USD (whereas it might be argued that Barclays' Unsecured Claim is denominated in a different currency).

192. The Administrators' primary position is that the LBI Payment reduced Barclays' Client Money Entitlement in respect of the ETD Trades by USD 777m. (Since the LBI Payment and the Client Money Entitlement are both denominated in USD, no issue of currency conversion arises at this stage of the analysis.[19]) By virtue of the

[19] As to the currency of the Client Money Entitlement, see *Re Lehman Brothers International (Europe)* [2010] 2 BCLC 301 at [396]-[397] (Briggs J). This aspect of Briggs J's judgment was not reversed on appeal.

reduction in Barclays' Client Money Entitlement, the Administrators consider that Barclays' Parallel Unsecured Claim in respect of the ETD Trades was likewise reduced: see Issue 10.

193. If Barclays did not have a Client Money Entitlement of at least USD 777m, the Administrators contend that the LBI Payment nevertheless falls to be applied towards the reduction of Barclays' Unsecured Claim in respect of the ETD Trades: see Issue 10.

194. In both cases, it is necessary to determine the manner in which the USD amount of the LBI Payment falls be deducted from Barclays' Unsecured Claim in respect of the ETD Trades.[20]

195. The answer to Issue 15 depends, in part, on whether Barclays' Unsecured Claim in respect of the ETD Trades (prior to any conversion under Rule 2.86) is denominated in USD or in some other currency. This question is the subject of Issue 16 below.

196. The Administrators consider that:

(1) If Barclays' Unsecured Claim in respect of the ETD Trades is denominated in USD, then:

(a) The USD amount of the LBI Payment should be deducted from the USD amount of Barclays' Unsecured Claim in respect of the ETD Trades (giving the "**Net USD Amount**").

(b) The Net USD Amount should be converted into GBP pursuant to Rule 2.86 (giving the "**Net GBP Amount**").

(c) The Net GBP Amount should be admitted for dividend, and Statutory Interest should be paid on the Net GBP Amount.

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[20] It is irrelevant for the purposes of Issue 15 whether, and to what extent, Barclays' Unsecured Claim in respect of the ETD Trades constitutes a Parallel Unsecured Claim.

(2) If Barclays' Unsecured Claim in respect of the ETD Trades is denominated in a currency other than USD (including GBP) (the "**Foreign Currency**"), then:

(a) The USD amount of the LBI Payment should be converted into the Foreign Currency based on the exchange rates prevailing on the date of the LBI Payment (giving the "**Converted Foreign Currency Amount**").

(b) The Converted Foreign Currency Amount should be deducted from Barclays' Unsecured Claim in respect of the ETD Trades (giving the "**Net Foreign Currency Amount**").

(c) The Net Foreign Currency Amount[21] should be converted into GBP pursuant to Rule 2.86 (giving the "**Net GBP Amount**").

(d) The Net GBP Amount should be admitted for dividend, and Statutory Interest should be paid on the Net GBP Amount.

197. The Administrators do not seek to rely on the concept of the "*Sterling Equivalent of the LBI Payment*" for the purposes of Issue 15. In particular, the Administrators do not consider that the LBI Payment should be converted into GBP at any stage of the analysis. The only amount which falls to be converted into GBP under Rule 2.86 is the Net USD Amount or the Net Foreign Currency Amount (as applicable).

198. Rule 2.86 provides:

> "*(1) For the purpose of proving a debt incurred in or payable in a currency other than sterling, the amount of the debt shall be converted into sterling at the official exchange rate prevailing on the date when the company entered administration …*
>
> *(2) 'The official exchange rate' is the middle exchange rate on the London Foreign Exchange Market at the close of business, as published for the date in*

[21] If not already GBP.

question. In the absence of any such published rate, it is such rate as the court determines."

199. Notwithstanding Rule 2.86, a creditor's claim against an insolvent company retains its original contractual currency throughout administration or liquidation: see *Re Lehman Brothers International (Europe)* [2016] Ch 50 at [136] (Briggs LJ). The claim is converted into GBP under Rule 2.86 only for the purposes of proof: *ibid* at [154].

200. It follows that the LBI Payment reduced Barclays' Unsecured Claim in respect of the ETD Trades in its underlying contractual currency. Only the net amount (defined above as the Net USD Amount or the Net Foreign Currency Amount) falls to be converted into GBP under Rule 2.86. The part of Barclays' Unsecured Claim in respect of the ETD Trades which was discharged by the LBI Payment is not properly provable: see Issues 11 and 12 above. Accordingly, the amount of the Barclays Proof must be reduced by the amount of the LBI Payment before any conversion under Rule 2.86 is calculated.

201. If the currency of Barclays' Unsecured Claim in respect of the ETD Trades is the same as the currency of the LBI Payment (namely USD), the calculation is simple: the USD amount of the LBI Payment should be deducted from the USD amount of Barclays' Unsecured Claim in respect of the ETD Trades, and the net amount can then be converted into GBP.

202. If the currency of Barclays' Unsecured Claim in respect of the ETD Trades is different from the currency of the LBI Payment, then the LBI Payment must be converted into the Foreign Currency (as defined above) and then deducted from Barclays' Unsecured Claim in respect of the ETD Trades. In identifying the appropriate rate of conversion, the normal contractual rules apply: see Rule 263 of *Dicey, Morris & Collins on the Conflict of Laws* (15th edition). Where a debt is paid in a currency different from the contractual unit of account, "*the rate of exchange to be applied is that of the day when the debt is paid*": *ibid*. at §37-054. It follows that the USD amount of the LBI Payment should be converted into the Foreign Currency based on the exchange rates prevailing on the date of the LBI Payment.

PART D: LBIE SURPLUS ENTITLEMENTS

ISSUE 16

If Barclays has an Unsecured Claim in respect of the ETD Trades, in what currency (or currencies) is such Unsecured Claim denominated (prior to any conversion under Rule 2.86)?

203. The Administrators will submit that Barclays' Unsecured Claim(s) in respect of the ETD Trades are denominated in USD (prior to conversion under Rule 2.86). In other words, USD is the 'money of account'.

204. As to the money of account, see *Chitty on Contracts* (32nd edition) at §30-374:

> "*The 'money of account' is the currency in which a debt is expressed or a liability to pay damages is calculated … [and] describes the currency in which the amount due is to be measured. Where the parties have not indicated in the contract itself the particular currency which is the money of account, the relevant currency must be identified by interpreting or construing the contract, the canons of interpretation or construction being those which prevail in the law which governs the contract. If English law is the applicable law, then in the absence of any intention emerging from the contract itself when construed according to English law, the parties will be presumed to have intended the currency of the country with which the contract is most closely connected. This may, but need not necessarily, be the country of the applicable law*."

205. The Administrators rely, in particular, on the following facts and matters:

(1) There does not appear to have been any written contract between LBIE and LBI governing the terms of the ETD Trades (Downs 10 at [60]);

(2) However, the ETD Trades were recorded in an electronic system known as "**RISC**", which has now been transferred to Barclays under the Asset Purchase Agreement (Downs 10 at [57]);

(3) The ETD Trades were divided between 11 accounts in RISC (the "**ETD Accounts**"), containing trades in a variety of currencies (Downs 10 at [52] and [58]);

(4) The overall balance of each ETD Account was expressly recorded in USD (Downs 10 at [58]);

(5) These USD balances were entered into the overall Lehman Group General Ledger; and

(6) The overall Lehman Group General Ledger converted all intercompany balances (both ETD and non-ETD) between LBIE and LBI into USD.

206. Having regard to the course of dealing between the parties, and having regard to the normal principles of contractual interpretation, it is submitted USD serves as the money of account for the ETD Trades.

ISSUE 17

On the true construction of Rule 2.88(7), if the Barclays Proof should be admitted for a reduced amount by deducting an amount in respect of the LBI Payment (or any part thereof), is the debt on which Statutory Interest is payable: (i) the amount admitted to proof; or (ii) the amount that would have been admitted to proof but for such deduction?

207. The Administrators submit that Statutory Interest is payable only on the amount of the Barclays Proof which is admitted for dividend.

(A) LEGAL ANALYSIS

208. The starting point is the language of Rule 2.88(7), which provides as follows:

> "*Any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest on those debts in*

respect of the periods during which they have been outstanding since the relevant date."

209. Thus, Statutory Interest is payable only on the "*debts proved*". There is no mechanism by which Statutory Interest can be paid on any other amount.

210. Since 1824 (when the concept of Statutory Interest was first introduced into insolvency law), Statutory Interest has expressly been confined to the debts proved: see section 132 of the Bankrupts (England) Act 1825 (6 Geo 4, c 16); section 197 of the Bankruptcy Law Consolidation Act 1849 (12 & 13 Vict, c 106); rule 137 of the Bankruptcy Rules 1870; section 40 of the Bankruptcy Act 1883; and section 33 of the Bankruptcy Act 1914 (4 & 5 Geo 5, c 59).

211. As a matter of construction, the "*debts proved*" are the amounts which have been admitted for dividend pursuant to Rule 2.77(1). It follows that Statutory Interest is payable only on the amount for which a proof has been admitted. In particular:

(1) If a proof of debt is rejected in its entirety, then no Statutory Interest is payable to the alleged creditor.

(2) If a proof of debt is admitted in part, then Statutory Interest is payable only on the amount of the proof which has been admitted.

(3) If a proof of debt is admitted in its entirety, then Statutory Interest is payable on the full amount claimed in the proof.

212. This analysis is supported by common sense. If some or all of a proof is rejected, Statutory Interest plainly should not be paid on the rejected amount.

213. Further, the foregoing analysis is directly supported by David Richards J's reasoning in *Re Lehman Brothers International (Europe)* [2016] Bus LR 17. One of the central issues in that case was whether Statutory Interest should be paid on an admitted contingent debt (i) from the commencement of the administration or (ii) from the date (if any) when the relevant contingency occurs.

214. David Richards J held that Statutory Interest should always be paid on the amount of an admitted proof from the commencement of the administration, regardless of when the underlying debt falls due. In reaching this conclusion, the Judge expressly held that the "*debts proved*" in Rule 2.88(7) are the respective amounts of the admitted proofs (rather than the "*underlying debts*").

215. David Richards J explained:

> "[204] … *I turn to the construction of rule 2.88(7). The issue in short is whether in providing that interest is to be paid 'on those debts' in respect of the periods during which they have been 'outstanding' since the company entered administration, the sub-rule is referring to the underlying debts giving rise to the admitted proofs or whether it is referring to the debts as admitted to proof …*
>
> [206] *I do not consider that this is the right approach to rule 2.88(7). The distribution in the administration is being made to creditors pari passu in discharge of their proved debts, not their underlying claims. They are not the same thing, as clearly illustrated by the examples of an estimate of the value of a contingent debt for the purposes of proof and the admission to proof of a sterling sum in place of a debt otherwise due in a foreign currency.*
>
> [207] *The purpose of rule 2.88(7) , as earlier discussed in this judgment, is to provide for interest to be paid to all creditors, irrespective of whether they had any entitlement to interest apart from the administration. What they are being compensated for by the payment of interest under rule 2.88(7) is the delay since the commencement of the administration in the payment of their admitted 'debts', as ascertained or estimated in accordance with the legislation. It is not, in my judgment, compensation for the non-payment of the underlying debt …*
>
> [208] *It is true that in some parts of rule 2.88, references to 'debt' appear to be references to the underlying debt rather than the debt as admitted to proof. For example, rule 2.88(1) provides that "where a debt proved in the administration bears interest, that interest is provable as part of the debt" in respect of pre-administration periods. The "debt" there would appear to be the underlying debt. That is not, however, true of rule 2.88(7). It opens by referring to 'any surplus remaining after payment of the debts proved'. That can only be, in my view, a reference to the debts as admitted to proof*." (emphasis added)

(B) THE EFFECT OF THE LBI/BARCLAYS SETTLEMENT

216. In correspondence, Barclays has sought to rely on paragraph 5 of the LBI/Barclays Settlement. This provision states:

> "*For the avoidance of doubt, nothing herein affects, waives, releases or reduces Barclays' claim against LBIE to interest relating to the $777,000,000 referenced in this Paragraph (or LBIE's defenses thereto) …*"

217. It is submitted that this provision does not require or empower the Administrators to pay Statutory Interest except in accordance with Rule 2.88(7).

218. On its true construction, paragraph 5 of the LBI/Barclays Settlement does not seek contractually to modify the effect of Rule 2.88(7). This would in any event be impossible, for there is a "*general principle that parties cannot contract out of the insolvency legislation*": see *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383 at [1]. It could be said that contractual subordination (whereby a creditor agrees to lower its ranking in the statutory scheme) is an exception to this rule. However, contractual subordination results in a benefit to the insolvent estate as a whole at the expense of the particular creditor whose debt is subordinated: see *Re Maxwell Communications Corp plc (No. 3)* [1993] BCC 369. By contrast, any attempt to modify the statutory scheme in the present case would result in the enrichment of Barclays at the expense of the insolvent estate as a whole. This would be contrary to principle.

219. Rather, the purpose of paragraph 5 is to ensure that the LBI/Barclays Settlement does not affect Barclays' claim for Statutory Interest on the amount of the LBI Payment save to the extent that such effects follow from the mandatory rules of insolvency law. The effect of the LBI/Barclays Settlement is to reduce the amount for which the Barclays Proof is capable of being admitted: see Issues 11 and 12 above. Accordingly, Statutory Interest is payable only on that reduced amount.

220. It follows that paragraph 5 of the LBI/Barclays Settlement does not affect the Administrators' conclusion that Statutory Interest is payable only on the admitted amount of the Barclays Proof.

221. Although the construction and effect of Rule 2.88(7) is governed by English law, the construction of the LBI/Barclays Settlement is governed by the law of New York. To the extent necessary, the Administrators will rely on expert evidence of New York law in support of their position on Issue 17.

ISSUE 18

If the Administrators admit the Barclays Proof for a reduced amount by deducting an amount in respect of the LBI Payment (or any part thereof):

(1) Should the Administrators be directed under the rule in *Re Condon; ex p. James* (1873-74) LR 9 Ch App 609; and/or

(2) Should the Administrators be directed under paragraph 74 of Schedule B1; and/or

(3) Are the Administrators estopped from refusing to pay Statutory Interest on some amount other than the sum admitted to proof? If so, how should such amount be calculated, and from what date should Statutory Interest be paid thereon?

222. The Administrators submit that the Court has no jurisdiction to order them to pay Statutory Interest on any amount other than the sum admitted for dividend in respect of the Barclays Proof. Neither the rule in *Ex parte James*, paragraph 74 of Schedule B1 nor any concept of estoppel confers jurisdiction on the Court to modify the statutory scheme for the payment of Statutory Interest. Even if the Court had such a power, there would be no basis for exercising it in the present case.

(A) EX PARTE JAMES

223. In *Re Lehman Brothers International (Europe)* [2015] EWHC 2270 (Ch) at [174], David Richards J explained:

> "*The principle in Ex parte James has been described as anomalous but it is a well-established principle providing a means by which the court can control the conduct of its officers. Administrators, liquidators in a compulsory winding-up and trustees in bankruptcy are all officers of the court and subject to this jurisdiction. The case to which the principle owes its name, like a number of cases immediately following it, concerned the retention by a*

liquidator or trustee in bankruptcy of money paid under a mistake of law. At that time, money paid under a mistake of law was not recoverable, but the court directed that its officer should not stand on his strict legal rights but should return the funds, notwithstanding that the effect was to deprive the creditors of funds which would otherwise be available for distribution among them. The rationale for the principle was that, although irrecoverable at law, the officer of the court could not in all conscience retain the money, given the circumstances in which it had been paid. It would amount to an unjust enrichment of the estate. Although the principle was first developed and exercised in these circumstances, subsequent cases applied it in other circumstances and it cannot now be said to be confined to particular categories of case."

224. The nature and scope of the rule in *Ex parte James* was authoritatively explained by Lord Neuberger in *RE Nortel GmbH* [2014] AC 209 at [122]-[123]:

> "[122] … *there are a number of cases, starting with Ex p James; In re Condon (1874) LR 9 Ch App 609, in which a principle has been developed and applied to the effect that 'where it would be unfair' for a trustee in bankruptcy 'to take full advantage of his legal rights as such, the court will order him not to do so', to quote Walton J in In re Clark (a bankrupt), Ex p The Trustee v Texaco Ltd [1975] 1 WLR 559, 563. The same point was made by Slade LJ in In re TH Knitwear (Wholesale) Ltd [1988] Ch 275, 287, quoting Salter J in In re Wigzell, Ex p Hart [1921] 2 KB 835, 845: 'where a bankrupt's estate is being administered … under the supervision of a court, that court has a discretionary jurisdiction to disregard legal right', which 'should be exercised wherever the enforcement of legal right would … be contrary to natural justice'. The principle obviously applies to administrators and liquidators: see In re Lune Metal Products Ltd [2007] Bus LR 589, para 34.*
>
> [123] *However, none of these cases begins to justify the contention that an administrator can be ordered to change the ranking of a particular debt simply because the statutory ranking appears unattractive—in this case because it means that a particular debt is ranked lower than other unsecured debts because (as I am assuming) it is not provable according to the statutory formula. Indeed, observations in the Lune Metal case, at paras 35–38, tend to support the notion that the court cannot sanction a course which would be outside an administrator's statutory powers*." (emphasis added)

225. Lord Neuberger concluded (at [125]) that "*it would be wrong for the courts to override the statutory ranking*". Further, "*the mere fact that the court does not think that it is fair that a particular statutory liability should not rank as a provable liability under the relevant statutory provisions is not enough to justify a decision to alter the effect of those provisions*": see the judgment at [126].

226. Statutory Interest occupies a distinctive position in the statutory hierarchy for the distribution of a company's assets in administration. By Rule 2.88(7), "*any surplus remaining after payment of the debts proved shall, before being applied for any purpose, be applied in paying interest on those debts in respect of the periods during which they have been outstanding since the relevant date*" (emphasis added). Thus:

(1) Statutory Interest is only payable in the event that a surplus exists after the payment of all provable claims. If such a surplus exists, it must be used for paying Statutory Interest "*before being applied for any other purpose*".

(2) Rule 2.88(7) provides that Statutory Interest is payable only on the "*debts proved*". The "*debts proved*" are the amounts of the admitted proofs: see Issue 17 above.

227. In light of Lord Neuberger's remarks in *Nortel*, the Court has no jurisdiction to modify the statutory scheme by directing the Administrators to pay Statutory Interest on a different principal sum. The rule in *Ex parte James* has no application in this context.

228. Further (and in any event), there is no basis for suggesting that it would be unfair for the Administrators to pay Statutory Interest on the sum admitted for dividend in respect of the Barclays Proof:

(1) In the absence of the LBI/Barclays Settlement, the LBI Payment would not have been made to Barclays and would have had no effect whatsoever on Barclays' claims against LBIE.

(2) By entering into the LBI/Barclays Settlement, Barclays agreed to apply a third party payment towards the reduction of its claims against LBIE.

(3) Barclays' acceptance of the LBI Payment and agreement to apply it towards the reduction of its claims against LBIE had the effect of reducing the amount of Statutory Interest which Barclays is entitled to receive. It can safely be

assumed that Barclays took the decision to accept the LBI Payment on the basis of legal advice.

(4) Paragraph 5 of the LBI/Barclays Settlement states: "*For the avoidance of doubt, nothing herein affects, waives, releases or reduces Barclays' claim against LBIE to interest relating to the $777,000,000 referenced in this Paragraph (or LBIE's defenses thereto)*". Paragraph 5 does not enable Barclays to contract out of the mandatory effect of Rule 2.88(7): see above.

(5) Had Barclays received USD 777m from the Client Money Pool, it is plain that Statutory Interest would not be payable on that amount. By virtue of the June 2015 Order, Barclays agreed that its Client Money Entitlement would "*automatically, unconditionally and irrevocably be reduced*" by USD 777m. In the circumstances, it is not unfair that Barclays is unable to receive Statutory Interest on the amount of the LBI Payment.

(B) PARAGRAPH 74

229. Paragraph 74 of Schedule B1 provides that the Court may grant relief where:

> "*(a) the administrator is acting or has acted so as unfairly to harm the interests of the applicant (whether alone or in common with some or all other members or creditors), or*
>
> *(b) the administrator proposes to act in a way which would unfairly harm the interests of the applicant (whether alone or in common with some or all other members or creditors).*"

230. Like the rule in *Ex parte James*, an allegation of "*unfairness*" under paragraph 74 cannot be used to undermine the statutory insolvency scheme: see Lord Neuberger's comments in *Nortel* (quoted above). If the Administrators simply propose to act in accordance with the statutory scheme, a challenge under paragraph 74 cannot succeed: see *Re Lehman Brothers International (Europe)* [2009] BCC 632 at [31]-[39] (Blackburne J).

231. It follows that paragraph 74 does not confer jurisdiction on the Court to direct the Administrators to depart from the statutory scheme by paying Statutory Interest on anything other than the "*debts proved*" in accordance with Rule 2.88(7).

232. Further (and in any event), there is no basis for suggesting that Barclays' interests would be "*unfairly harmed*" if the Administrators pay Statutory Interest on the sum admitted for dividend in respect of the Barclays Proof: see paragraph 228 above.

(C) ESTOPPEL

233. The same remarks apply to estoppel (whether by representation, convention or otherwise).

234. It is well established that "*no estoppel by representation will arise if its effect would be to undermine the operation of a statute*": see *The Law of Waiver, Variation and Estoppel* (3rd edition 2012) at §9.131. Otherwise, "*the statute might just as well be erased from the statute book*": see *Re A Bankruptcy Notice (62 of 1924)* [1924] 2 Ch 76 at 98-99 (Atkin LJ).

235. This is a general principle which applies to all forms of estoppel. In *Maritime Electric Co Ltd v General Dairies Ltd* [1937] AC 610 at 620, Lord Maugham said:

> "*… where, as here, the statute imposes a duty of a positive kind, not avoidable by the performance of any formality, for the doing of the very act which the plaintiff seeks to do, it is not open to the defendant to set up an estoppel to prevent it. This conclusion must follow from the circumstance that an estoppel is only a rule of evidence which under certain special circumstances can be invoked by a party to an action; it cannot therefore avail in such a case to release the plaintiff from an obligation to obey such a statute, nor can it enable the defendant to escape from a statutory obligation of such a kind on his part. It is immaterial whether the obligation is onerous or otherwise to the party suing. The duty of each party is to obey the law. To hold … that in such a case estoppel is not precluded, since, if it is admitted, the statute is not evaded, appears to their Lordships, with respect, to approach the problem from the wrong direction; the Court should first of all determine the nature of the obligation imposed by the statute, and then consider whether the admission of an estoppel would nullify the statutory provision*."

236. Likewise, in *Re Exchange Securities and Commodities Ltd* [1988] Ch 46, Harman J held that a liquidator could not be estopped from collecting or distributing assets in accordance with the statutory scheme. He said (at [60]):

> "*… the court must consider the nature of the obligation imposed by the statutory scheme – that is, to distribute such assets as there are rateably amongst the true creditors and then to say, 'Will an estoppel operate in any way to defeat that?' And the answer [in this case] plainly is 'Yes', because it will allow inflated or fictitious creditors to come in and deplete the estate*."

237. It follows that estoppel is incapable of providing a mechanism for the Administrators to pay Statutory Interest on anything other than the "*debts proved*" in accordance with Rule 2.88(7).

238. Further (and in any event), the Administrators are not aware of any facts which would support the existence of an estoppel.

ISSUE 19

If the Barclays Proof should be admitted without deducting an amount in respect of the LBI Payment (or any part thereof), on the true construction of Rule 2.88(7), in calculating the principal sum on which Statutory Interest is payable in respect of the Barclays Proof, should such principal sum be reduced by the Sterling Equivalent of the LBI Payment from the date when Barclays received the LBI Payment (or any other date)?

239. For the reasons set out above (in relation to Issues 11 and 12), the Administrators submit that the Barclays Proof should be admitted for a reduced amount deducting the LBI Payment. If this submission is correct, then Issue 19 does not arise.

240. Issue 19 only arises if the Barclays Proof should be admitted without any deduction in respect of the LBI Payment. In that case, the Administrators accept that Statutory Interest should be paid on the entire amount for which the Barclays Proof is admitted in respect of the period between the Time of Administration and the LBI Payment. As explained above (in relation to Issue 17), Statutory Interest is payable only on the

"*debts proved*". There is no mechanism by which Statutory Interest can be paid on any other amount. The "*debts proved*" are the amounts of the admitted proofs.

241. However, Statutory Interest is only payable on the debts proved "*in respect of the periods during which they have been outstanding*". On the date of the LBI Payment, Barclays' provable claim was reduced by the amount of the LBI Payment: see Issues 10 and 15 above.

242. It follows that no Statutory Interest should be paid on that part of Barclays' provable claim which was discharged as a result of the LBI Payment (from the date thereof), for that amount was no longer "*outstanding*" from such date. This proposition holds true even if (which is denied) the Barclays Proof should be admitted at full face value.

243. The Administrators reserve the right to amend the position they take on Issue 19 in the event that the Court concludes that the dividends payable to Barclays in respect of its proof are payable other than by reference to the full amount of the proof as admitted.

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