IN THE HIGH COURT OF JUSTICE **No. 7942 of 2008**

CHANCERY DIVISION

COMPANIES COURT

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

B E T W E E N

(1) ANTONY VICTOR LOMAS
(2) STEVEN ANTHONY PEARSON
(3) PAUL DAVID COPLEY
(4) RUSSELL DOWNS
(5) JULIAN GUY PARR
(THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION))

Applicants

- and -

(1) BURLINGTON LOAN MANAGEMENT LIMITED
(2) CVI GVF (LUX) MASTER S.A.R.L.
(3) HUTCHINSON INVESTORS, LLC
(4) WENTWORTH SONS SUB-DEBT S.A.R.L.
(5) YORK GLOBAL FINANCE BDH, LLC
(6) GOLDMAN SACHS INTERNATIONAL

Respondents

WATERFALL II DIRECTIONS APPLICATION

SENIOR CREDITOR GROUP'S REPLY SKELETON ARGUMENT: GERMAN MASTER AGREEMENT ISSUES

A. INTRODUCTION

1. This skeleton argument is filed on behalf of Burlington Loan Management Limited, CVI GVF (Lux) Master S.a.r.l, and Hutchinson Investors, LLC (collectively, the "Senior Creditor Group"). It is filed in reply to the skeleton argument of Wentworth dated 26 October 2015 in relation to Issues 20 and 21, dealing with claims under the German Master Agreement (the "WW GMA Skeleton" and the "GMA" respectively).

2. In this skeleton, the Senior Creditor Group seeks to address shortly only a few of the points made in the WW GMA Skeleton, in particular those where it considers clarification and further submissions may assist the Court in advance of hearing from the expert witnesses, and certain new arguments made by Wentworth that were not raised by Dr Fischer in his reports or by Wentworth in its position paper.

3. The remainder of the points raised by Wentworth have either already been addressed in written submissions, or will be addressed further at the hearing if necessary once the expert evidence has been heard. To the extent that the Senior Creditor Group does not reply to any points raised in the WW GMA Skeleton, this should not be taken to imply that such points are accepted.

4. In particular, the WW GMA Skeleton argument contains a number of unjustified and tendentious submissions regarding the manner in which the German law issues have evolved, and evidence has been prepared (see paras 46-53). It is unnecessary for the Court to consider the merits of those points, which are not addressed in this reply skeleton, save that it should be noted that:

   (1) As set out in the Senior Creditor Group's main GMA skeleton (the "SCG GMA Skeleton"), nothing turns on whether a claim for further damages arises under Clause 3(4) of the GMA in conjunction with the provisions of the BGB, or only directly under the provisions of the BGB (Mülbert 3 at paras 21 and 28);

(2) The need for further questions to be posed to the German law experts principally arose because Dr Fischer raised certain issues regarding the need for a default and the impact of German insolvency proceedings that were not covered by the original Agreed Questions or Wentworth's original position paper; and

(3) Wentworth initially insisted that Professor Mülbert should delete, from his column of the Joint Statement, his full reasons for disagreeing with Dr Fischer in relation to the question of when the single compensation claim falls due under Clauses 7-9 of the GMA[1] (and made it clear that Dr Fischer would refuse to sign the Joint Statement if this wording was included) (see paras 50-53 of the WW GMA Skeleton). However, Dr Fischer did not have the right to review or veto anything that Professor Mülbert wished to include in his comments in the Joint Statement (which were intended to assist the Court). Professor Mülbert's comments (as set out in the appendix to the letter dated 23 October 2015 from Freshfields to Kirkland & Ellis and Linklaters) should either be treated as included in his column of the Joint Statement, or as part of his reports to the Court. Wentworth has now belatedly recognised (by letter dated 2 November 2015) that its stance was untenable and has agreed to the inclusion of such material as a supplemental report, albeit contingent on Dr Fischer being permitted to lodge a supplemental report of his own. The Senior Creditor Group has no objection to any such further report provided that it is limited to dealing with Professor Mülbert's additional comments on Clauses 7-9 of the GMA.

B. ISSUE 20

(1) German insolvency law is irrelevant

5. Although there are frequent references to German insolvency law in Dr Fischer's reports, including as to the calculation of the compensation claim under Clauses

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1 Professor Mülbert explained his reasons for disagreeing with Dr Fischer, and referred to various authorities including OLG Frankfurt WM 2012, 2280, 2284.

8 and 9 of the GMA (see paras 61 and 81 et seq of Fischer 1), German insolvency law has no substantive role to play at this trial:

(1) There is no German insolvency proceeding which has been opened in respect of LBIE, and German insolvency law does not apply to the LBIE administration in any way;

(2) Although Dr Fischer continues to seek to refer to German insolvency law as being relevant to, for example, the interpretation of the contractual netting arrangements in the GMA by virtue of Article 25 of Directive 2001/24/EC (see Fischer 3 at paras 55-58), Directive 2001/24/EC did not apply to LBIE as an investment firm in 2008[2];

(3) There is no provision of German law (or English law) which prohibits the occurrence of a default either before or after LBIE entered administration: the dispute between the parties is whether a default cannot occur because of the legal consequences and effect of LBIE entering administration; and

(4) Reliance is now placed by Wentworth on German insolvency law, or German insolvency proceedings, only for the purposes of drawing an analogy (see, for example, Fischer 3 at para 40 [4/12/322], and seeking to explain why, in its view (i) LBIE's English administration has the legal effect which means that a default cannot occur under Section 286 of the BGB (paras 61, 63 and 109(3) of the WW GMA Skeleton); and (ii) a proof of debt in the English administration cannot amount to a warning notice (see para 111(1) of the WW GMA Skeleton). As stated in para 21 of the SCG GMA Skeleton, the Senior Creditor Group does not agree with Wentworth's contentions on either of these points.

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2 See Article 1 of Directive 2001/24/EC, which was extended to investment firms by virtue of Article 117 of the Bank Recovery and Resolution Directive 2014/59/EU (with an implementation date of 1 January 2015). This was given effect in the United Kingdom by The Bank Recovery and Resolution Directive No. 2 Order, made on 18 December 2014. The version of Directive 2001/24/EC in the authorities bundle is the version that was in force in 2008 at the time of the commencement of LBIE's administration.

(2) The source of the right to interest

6. Wentworth repeatedly asserts that any right to further damage under the BGB is equivalent to a foreign judgments act rate (as considered for the purpose of Issue 4) rather than a pre-existing right, and is therefore incapable of forming a rate applicable to the debt for the purpose of Rule 2.88(9) of the Rules: see, for example, paras 15 and 121-133 of the WW GMA Skeleton.

7. This issue was addressed in detail in Section D of the SCG GMA Skeleton. The Senior Creditor Group contends that Wentworth is wrong for the reasons that it has already given, and that there is no logical basis to distinguish between an existing contractual entitlement to interest, and an existing right to interest or other compensation for delayed payment under statute. In particular:

   (1) Both are existing rights as at the date of the Administration[3]; i.e. they are both forms of right which have an existing legal foundation as at the date of administration. The source of that right is irrelevant;

   (2) The fact that, at the date of the Administration, an element of contingency may exist in relation to the determination of the quantum or value of the claim does not prevent it being a rate applicable to the debt for the purpose of Rule 2.88(9): see, by analogy, the position in respect of interest payable on a contingent debt addressed in *Waterfall IIA* at [225];

   (3) The fact that an interest/compensation rate may change during the course of the administration does not prevent it from being treated as the rate applicable to the debt for the purpose of Rule 2.88(9): see, by analogy, the position in respect of variable interest rate as determined in *Waterfall IIA* at [27]-29].

8. The position is perfectly clear where the right has accrued by reason of default occurring prior to or at the point of administration, as the Senior Creditor Group

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3 The Senior Creditor Group adopts the "existing right" analysis used for the purpose of the Court's determination of Issue 4, without prejudice to its appeal against that decision.

contends was the situation in this case, but it also applies where default occurs after administration: the entitlement to damages arising under the BGB applies to the debt proved (i.e. the close-out amount) and is part of a creditor's rights with an existing legal foundation at the commencement of the administration.

(2) Further damages by reference to some other amount

9. Wentworth argues that a claim for further damage is without the necessary properties under German law as would permit its characterisation as a rate applicable to the debt as opposed to a rate referable to some other amount (see WW GMA Skeleton at paras 18, 19 and 132-133).

10. This is incorrect:

(1) The argument is inconsistent with aspects of Wentworth' own expert evidence: see, for example, Fischer 1 at para 88 [4/8/149] where reference is made to the further damages in the form of interest being "*applied to the amount for which the debtor is in default*";

(2) The fact that the rate may be applicable to part of the debt but not all (Fischer 2 at para 19 [4/10/216]) cannot mean that it should not be regarded as applicable to the debt: it may simply mean that the calculation required in order to assess whichever is the greater of the two potentially applicable rates for the purpose of Rule 2.88 will need to take into account the extent to which the rate is applicable to the debt;

(3) In any event, the suggestion that the rate awarded "*is based upon the sum borrowed or which would have been invested and not the amount owed to the claimant*" (see, for example, para 19 of the WW GMA Skeleton) is a distinction without any substance: the rate is applied to the debt which has not been paid. The rate may be calculated based on assumptions as to what would have been necessary to borrow equivalent funds, or by reference to what would have been earned had the sum owed been received. But the rate remains applicable to the debt which has not been paid; and

(4) Nor, for the same reasons, and c/f para 133(2) of the WW GMA Skeleton, does it make any sense to say that there is no necessary connection between the further damage suffered and the unpaid amount: the further damage can only be calculated by reference to the amount of the unpaid debt or such part thereof as is treated as being relevant to the calculation of the further damages.

(3) Serious and definitive refusal of performance

11. Whilst both experts have expressed a view on whether, on the facts of LBIE's administration, the requirements of Section 286(2) No. 3 BGB are satisfied, this is ultimately a question for this Court which depends on the circumstances surrounding LBIE's administration.

12. In that regard, the question is whether the German law concept and requirements for a serious and definitive refusal (which will be addressed by the experts in due course[4]) have been satisfied.

13. Contrary to paras 116 and 117 of the WW GMA Skeleton, there is no useful analogy to be drawn with the English concept of repudiation, and it would be wrong for the Court to be influenced by its understanding of that concept. The issues are issues (respectively) of German law and fact, not English law, and the English cases to which reference is made are irrelevant[5].

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4 In this regard, a number of the alleged requirements for a serious and definitive refusal of performance which are relied upon by Wentworth at para 115 of the WW GMA Skeleton are an inaccurate paraphrasing of its own expert evidence and unjustified. Such matters will be addressed further having heard from the experts.

5 It is for this reason that the Senior Creditor Group did not agree to the inclusion in the administration summary of any statement regarding the impact of an administration on an English law governed contract. Furthermore, as the cases relied upon by Wentworth make clear, the question of repudiation cannot be considered in the abstract, or by reference to simply one factor: it is necessary to look at all of the circumstances (see *Eminence Property Developments Ltd v Kevin Christopher Heaney* [2011] 2 All ER (Comm) 223 at [61]; and, by analogy, *Tolhurst v The Associated Portland Cement Manufacturers* [1902] 2 KB 660 at 671 per Collins MR: "*Liquidation of itself clearly does not involve inability to carry out the contract, though it certainly may, coupled with other circumstances, such as those mentioned in Ex parte Chalmers and Morgan v. Bain, ground an inference that the liquidating company has renounced the contract*"). References to administration not, *per se*, amounting to repudiation are meaningless because repudiation would never be assessed in a vacuum.

C. ISSUE 21

(1) The assignee's claim for further damage as a rate applicable to the debt

14. At paras 23 and 136 of the WW GMA Skeleton, Wentworth contends that even if a claim for further damage by the original counterparty to the GMA could constitute part of the "*rate applicable to the debt apart from the administration*" for the purposes of rule 2.88(9), a claim for further damage by an assignee of rights under GMA could not.

15. Wentworth contends that this is because:

    (1) The assignment of the proved debt has taken place after the commencement of the administration;

    (2) The assignee can assert a claim for further damage only by reference to the period following the assignment[6]; and

    (3) According to Wentworth it is not therefore understood how an assignee's claim for further damage is applicable to the debt proved at the commencement of the administration.

16. This contention is also incorrect:

    (1) A damages interest claim (like any entitlement to interest under sections 288(1) and (2) of the BGB) is capable of constituting part of the "*rate applicable to the debt apart from the administration*" for the purposes of Rule 2.88(9) for the reasons set out at paragraph 25 of the SCG's skeleton argument.

    (2) That is the position for an original counterparty to the GMA. The position of an assignee of the right to the close out amount is (and can be) no different. In particular:

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6 This statement is incorrect. The assignee can also assert a claim for further damages by reference to the period before the assignment if such claim was assigned to the assignee (see para 28 of the Joint Statement at [4/13]).

(a) The rate applicable to the debt apart from the administration is determined by reference to the rights existing at the commencement of the administration: *Waterfall IIA* at [179].

(b) As such, where a damages interest claim constitutes the rate applicable to the debt apart from the administration before an assignment has taken place, it also constitutes the rate applicable to the debt after an assignment has taken place.

(c) This is the case irrespective of whether the rate applicable to the debt increases as a consequence of the assignment (because, for example, the assignee can assert a higher damages interest claim than the assignor).

(d) In those circumstances, the position is the same as the position that exists in relation to any other rate that changes over the period of the administration. For the reasons set out in paragraph 25 of the SCG's Skeleton Argument, a right to interest is capable of constituting the "*rate applicable to the debt apart from the administration*", even though the applicable rate (or value of that right) has not been assessed or fixed as at the date of administration and even though an element of contingency may exist in relation to the determination of the quantum or value of that rate.

(e) In all such cases, the debtor is simply being required to pay what, as a matter of German law, the contract that he entered into requires him to pay and which he agreed to pay.

(2) Substance or procedure

17. In the context of Issue 21(iii) (*"where does the burden of proof lie in establishing a Damages Interest Claim, and what is required to demonstrate that a relevant creditor has or has not met such requirement?"*), it is common ground between the experts that:

(1) The burden of proof lies with whoever asserts the claim (Joint Statement at paras 8 and 33);

(2) Banks may calculate damage in the abstract on the basis of transactions typically conducted (i.e. the typified method of calculation: Joint Statement at para 9; Mülbert 3/56; Fischer 2/27)[7]; and

(3) Under German law, Section 252 sentence 2 of the BGB includes a facilitation (i.e. a simplified method of calculation of damage) concerning the demonstration and amount of damage in cases where lost profits are being claimed (Joint Statement at para 9).

18. As regards this last point:

(1) Professor Mülbert has explained (Mülbert 3 at paras 51-53) that profits which the specific creditor in question could not realize as a consequence of a delayed payment by the debtor are to be considered as damage suffered (i.e. giving rise to a further damages claim) if the profits could probably have been expected to accrue in the normal course of events or in the special circumstances applicable to the particular creditor. The burden would be on the debtor to rebut the presumption of profits made by the creditor in such a case (Mülbert 3 at para 51); and

(2) Both experts agree that the standard of proof for the simplified method of calculation of damages has not been stated consistently (Fischer 2 at para 26). Professor Mülbert highlights the conflicting approaches at para 53 of Mülbert 3. Dr Fischer maintains that the correct standard is on the balance of probabilities i.e. the creditor must prove that it is more probable than not that the profit would have been generated (Fischer 2 at para 26).

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7 There is a dispute between the experts regarding whether the typified method of calculation is available to any entity other than banks (the Senior Creditor Group contends that it is, Wentworth disagrees).

19. Wentworth, for the first time, now takes a new point not foreshadowed in its position papers nor raised when it agreed the questions for the German law experts. It contends (see para 144(3) of the WW GMA Skeleton) that any case pursued for an entitlement to lost profit based on the simplified method of calculation provided for by Section 252 sentence 2 is unjustifiable because:

(1) It is founded squarely on Section 287 of the German Civil Procedure Code; and

(2) Being so founded, is based on a provision of civil procedure which is inapplicable in the English Court (as the forum in which any disputes in relation to the GMA claims would be resolved): see *Hardings v Wealands* [2007] 2 AC 1 and Dicey, Morris & Collins, The Conflict of Laws 15th Ed at 32-154.

20. This approach is confused and, ultimately, wrong.

21. First, the rule of German law entitling a creditor to recover lost profits based on the simplified method of calculation is based on Section 252 2nd sentence of the BGB. Section 252 BGB provides:

> *"The damage to be compensated also includes the lost profits. Those profits are considered lost that in the normal course of events or in the special circumstances, particularly due to the measures and precautions taken, could probably be expected."*

22. Section 252 therefore provides a presumptive rule (akin to a rule of causation) as to the extent of the loss of profits that will be treated as lost and recoverable in any case where compensation includes a claim to lost profits.

23. By contrast, Section 287 of the German Civil Procedure Code does not provide the basis for the entitlement to the simplified calculation. It does not provide any assumption as to the loss which is to be taken to have been suffered. It provides:

> *"Should the issue of whether or not damages have occurred, and the amount of the damages or of the equivalent in money to be reimbursed, be in dispute among the parties, the court shall rule on this issue at its discretion and conviction, based on its evaluation of all circumstances. The court may decide at its discretion whether or not – and if so, in which scope – any taking of evidence should be ordered as applied for, or*

whether or not any experts should be involved to prepare a report. The court may examine the party tendering evidence on the damage or the equivalent in money thereof; the stipulations of section 452(1), first sentence, subsections (2) to(4) shall apply mutatis mutandis.

(2) In the event of pecuniary disputes, the stipulations of subsection (1), sentences 1 and 2, shall apply mutatis mutandis also to other cases, insofar as the amount of a claim is in dispute among the parties and to the extent the full and complete clarification of all circumstances authoritative in this regard entails difficulties that are disproportionate to the significance of the disputed portion of the claim."

24. Any case pursued in relation to loss of profits where reliance is placed on the simplified calculation is not therefore "*founded squarely*" on Section 287: it is founded principally on Section 252 2nd sentence of the BGB.

25. Second, the Court is concerned with identifying the rate applicable to the debt apart from the administration for the purpose of Rule 2.88(9) of the Rules. For that purpose, the traditional distinction between substance and procedure in English private international law is irrelevant. If the Court concludes that, apart from the administration, the creditor would have been entitled to recover damages (expressed in the form of a rate) pursuant to Section 288(4) of the BGB including damages for loss of profit, and that the extent of the loss of profits which are recoverable is determined in accordance with Section 252 2nd sentence, those damages should be regarded as capable of being the rate otherwise applicable for the purpose of Rule 2.88(9) of the Rules, irrespective of whether the rules establishing the creditor's rights would be classified as substantive or procedural as a matter of private international law.

26. Third, if, contrary to the above, the distinction is of relevance for the purpose of Rule 2.88(9), it is not a distinction that operates in the manner that Wentworth contends. To the extent that Wentworth is categorising the rule contained in Section 252 2nd sentence of the BGB as a procedural rule rather than a substantive rule, that is incorrect:

    (1) The question of categorisation of a foreign statutory provision as substantive or procedural is a question of English law: *Allen v Depuy International Limited [2015] EWHC 926* (QB) at [28]; referring to Dicey, Morris and Collins, 15th Ed at para 7-004. Matters of procedure are

governed by the law of the forum in order to "*obviate the inconvenience of conducting the trial of a case containing foreign elements in a manner with which the Court is unfamiliar. In principle, therefore, if it is possible to apply a foreign rule without causing any such inconvenience, those rules should not necessarily, for the purpose of this rule, be classified as procedural.*" (ibid).

(2) In *Harding v Wealands* [2007] 2 AC 1, the Supreme Court affirmed the traditional distinction between questions of actionability or liability (substantive) and questions of quantification and assessment which went to the availability and extent of the remedy (procedural). At [24], and in the context of claims in tort, Lord Hoffmann (with whom all of the other members of the House agreed) emphasised that those rules which are concerned with the identification of actionable damage "*are an integral part of the rules which determine liability*", and are to be contrasted with those which are concerned with the type of remedy and, if damages are to be awarded, the quantum of the remedy. As was noted in *Boys v Chaplin* [1971] AC 356 per Lord Hodge at 379, the law relating to damages is partly procedural and partly substantive, and it is the actual quantification of damages which is procedural only.

(3) In *Cox v Ergo Versicherung* [2014] AC 1379, the Supreme Court affirmed the distinction drawn in Harding, albeit querying whether the classification of certain of the provisions in that case as procedural was necessarily correct (see in particular at [15] per Lord Sumption regarding exclusion of economic loss, and [43] per Lord Mance). The distinction to be drawn is between provisions which deal with what is recoverable (substantive) and questions of assessment (procedural): Lord Sumption at [14]. Provisions which determine "*the extent of the loss for which the defendant ought fairly, reasonably or justly be held liable*" are substantive: Lord Sumption at [17].

27. The rule contained in Section 252 of the BGB identifies both that loss of profit falls within the recoverable heads of loss, and the extent of the loss of profit that is to be treated as part of the recoverable or actionable damage. It is an integral part of the rules determining the extent of liability (Harding at [17]; Cox at [17]),

akin to a rule of causation or remoteness (see by analogy Cox at [17] and [41]). It is not concerned with the procedural quantification of damage in the relevant sense.

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4 November 2015

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