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

Respondents

SENIOR CREDITOR GROUP'S SKELETON ARGUMENT FOR 9 MARCH 2015 CMC

Time estimate: up to 1 day

Suggested pre-reading if time permits: as per the Administrators' suggested reading list, and Browning 2 [1/19] in addition.

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") for the purpose of the CMC relating to Parts B and C of the Administrators' application for directions.

PART B

(1) COMPLIANCE WITH PRIOR DIRECTIONS

2. Part B of the Application currently concerns Questions 9 (whether accession to the CRA affects the answers to Questions 7 and 8), 34-36 (the effect of post-administration contracts on non-provable claims) and 38 (whether Part VII of the CRA is capable of giving rise to Currency Conversion Claims).

3. Since the last CMC:

   (1) The Administrators have filed two further witness statements (Pearson 7 [1/15]) and Copley 1 [1/16]) in compliance with paragraph 4 of the 21.11.14 Order (the "Order") [1/3];

   (2) The Senior Creditor Group has filed and served factual evidence in reply to that served by the Administrators (Browning 2 at [1/19]) in compliance with paragraph 5 of the Order; and

   (3) Wentworth has filed and served factual evidence in reply to that served by the Administrators and the other Respondents (Goldschmid 1 and Ryan 1 at [1/17] and [1/18] respectively) in compliance with paragraph 5 of the Order.

4. Paragraph 6 of the Order required the Administrators to provide a draft scenarios paper to the Respondents "*describing realistic and potentially relevant factual scenarios with the intention of formulating a series of alternative assumed facts*" on the basis of which the Court would be invited to determine Questions 34 and 35 (and 36, subject to the Court's further directions). The Administrators have decided not to

produce such scenarios for the reasons set out in their letter of 6 February 2015 [2/29].

5. As set out in the Senior Creditor Group's letter of 27 February 2015 [2/61], in light of the proposed limitation on the scope of Question 36 for the purpose of the Part B hearing (see further below), it does not seem to the Senior Creditor Group that the creation of assumed factual scenarios is likely to be of real utility.

6. This raises, however, the question of what if any further directions are appropriate or necessary at this time in order to enable Questions 34, 35 and 36 (in its more limited form, and assuming that the Court is content to proceed in the manner suggested below) to be taken to trial. This question is addressed in paragraphs 12-45 below.

(2) QUESTIONS 31-33

7. As the Court will recall, Questions 31 to 33 were to be determined as part of the Part A hearing. The question of whether those questions can or should be determined as part of the Application was adjourned to this CMC.

8. On 27 February 2015, the Senior Creditor Group wrote to the Administrators and set out its position in relation to Questions 31 and 32: see [2/66]. In short:

   (1) Questions 31 and 32 ask whether Currency Conversion Claims can arise, including in respect of the contractual Base Currency, under certain agreements;

   (2) The Senior Creditor Group and Wentworth agree that they can arise, either by reason of a contractual debt obligation payable in a foreign currency or because damages may be payable in a foreign currency if that currency most truly expresses the claimant's loss;

   (3) Unless the Administrators disagree, the Senior Creditor Group does not understand that there is an issue in respect of Questions 31 and 32 that requires resolution by the Court;

(4) The suggestion by Wentworth at the Part A hearing that a Currency Conversion Claim arising from a contractual debt claim may, depending on the factual circumstances, not be in the same currency as a Currency Conversion Claim arising from a contractual damages claim is a different question to those currently posed by Questions 31 or 32. The Senior Creditor Group does not understand whether that distinction is considered by Wentworth or the Administrators to be relevant or of general importance to the administration and, if so, why; and

(5) Absent further clarification from the Administrators or Wentworth (and, in particular, details of the factual matrix), it was in any event unclear to the Senior Creditor Group how the questions (in particular, Question 31) could sensibly be determined as part of the Application.

9. Further correspondence has passed between the parties. It would now seem to be agreed that Questions 32 and 33 cannot be determined as part of the Application (see the Administrators' letter of 3 March 2015 at [2/69], Wentworth's letter of 4 March 2015 at [2/88]; York's letter of 4 March 2015 at [2/83]).

10. The position in relation to Question 31 remains at large: the Administrators have asked Wentworth to confirm how Question 31 can be determined, and why it is considered to be of general importance. Wentworth asserts that it has already set out its position in its Part A skeleton and that it is now for the Administrators to confirm whether the issue is of material significance in the administration.

11. The Senior Creditor Group's position remains as set out in its letter of 27 February 2015 i.e. that Question 31 should no longer form part of the Application.

(3) QUESTIONS 34-36 GENERALLY

12. The principal issue to be determined at this CMC in respect of Questions 34-36 is the scope of Question 36 for the purpose of the hearing of Part B of the Application.

13. In its letter of 26 February 2015, the Senior Creditor Group proposed that:

(1) The part of Question 36 that raises the general issue of whether the Administrators should, in any event, be directed not to enforce any release of non-provable claims by reason of, or by analogy with, the rule in *Ex parte James* should be determined as part of the hearing of Part B of the Application, and

(2) The part of Question 36 which involved other issues such as rectification, mistake, estoppel etc. which are likely to depend on facts specific to creditors, should not, and should be adjourned to be considered only if necessary after determination of Part B of the Application.

14. There appears to be broad agreement with this approach:

(1) The Administrators have indicated that, in principle, such an approach is sensible and pragmatic, and one with which they would therefore agree provided that the parameters of what is in issue in relation to Question 36 are clear: see [2/69 at 72-73];

(2) York agrees with the Senior Creditor Group's proposed approach: see [2/83];

(3) Wentworth also appears to agree that the proposed approach is sensible and pragmatic, albeit subject to reserving its position to contend later that there is no issue in respect of Question 36 that can be resolved at a general level and seeking various directions aimed at clarifying the basis on which Questions 34-36 are to be determined: see [2/88 at 91-94].

15. The following sections of this skeleton argument seek to explain for the benefit of the Court the nature of the dispute and issues that are perceived to arise in relation to Questions 34-36, and the basis on which the proposed narrowing of Question 36 has been agreed. If the Court is content with the agreed approach, the only outstanding issue as regards Questions 34-36 is likely to be the ancillary

directions necessary to progress these questions to trial (as to which see paragraphs 44 – 45 below).

(4) QUESTIONS 34 AND 35

16. It is helpful to start by summarising the nature and scope of the exercise that will be required to determine Questions 34-35 and the relationship of that exercise to the issue raised Question 36.

17. Questions 34-35 concern the construction and effect of the CDDs and the CRA. The construction of the CDDs and the CRA will involve consideration of their wording in the light of the background facts[1].

18. The background to the various CDDs and the CRA has been addressed at length in the witness statements filed:

    (1) on behalf of the Administrators (those of Mr Lomas (Lomas 9, 10 and 11), Mr Pearson (Pearson 7) and Mr Copley (Copley 1));

    (2) on behalf of the Senior Creditor Group (Garvey 1, Zambelli 1, Browning 1 and 2); and

    (3) on behalf of Wentworth (Goldschmidt 1 and Ryan 1).

19. It does not appear that there is likely to be a substantial dispute regarding the relevant underlying facts, albeit the characterisation of the underlying facts may differ and the Senior Creditor Group is still reviewing the evidence recently served on behalf of Wentworth on 3 March 2015.

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1 The Administrators have indicated that they wish to amend Question 34 in order to make reference to non-provable claims generally (letter of 3 March 2015). The Senior Creditor Group asked for clarification of the type of non-provable claim that the Administrators contemplate being in issue (letter of 4 March 2015 at [2/85 at 86]), which was provided by letter of 5 March 2015. In light of the response provided, the Senior Creditor Group is considering whether the proposed amendment requires any further amendments to the position papers or further evidence. It will update the Court as to its position at the hearing.

20. The background facts that the Court will have to consider when construing the CDDs and the CRA will include matters such as the purpose of the administration, the Administrators' duties and role within the administration, the purpose of the various CDDs and the CRA (and the release clauses included therein), the circumstances in which the form of the CDDs evolved and creditors were required to enter into them, and the lack of any original expectation of a surplus.

21. In that regard, although it is obviously not appropriate on this application to try and provide a comprehensive summary of the evidence served, the background to the CDDs and CRA includes the following matters:

(1) The CDDs and CRA are instruments drafted by the Administrators, and produced for a particular purpose in the context of LBIE's administration. They are in large part standard form agreements entered into with creditors in order to facilitate the process of the administration, and avoid the lengthy and costly delay that the Administrators anticipated might arise if the standard mechanism for dealing with proofs was adopted.

(2) The CDD process arose following recognition by the Administrators that it was desirable to create an alternative process for determining unsecured creditors' claims i.e. an alternative to the standard statutory proof of debt regime: Lomas 10 at [33]. The Administrators believed that such an approach would facilitate the making of distributions to unsecured creditors within a more expeditious timeframe (Lomas 10 at [34]).

(3) The purpose of the CDDs was to enable the Administrators to determine the size of the provable claims against LBIE to the extent possible, and enable them to make distributions in respect of provable claims. They "*are the documents used by the Joint Administrators for the purpose of agreeing the quantum of certain claims*" (Lomas 9 at [61]) and "*provide an efficient process for agreeing the amount of unsecured and client money claims and to document the releases, ongoing rights and obligations of LBIE and the creditor*": Lomas 10 at [47]. The creation of the CDD was instrumental to admitting claims for dividend at

a time when, according to the Fourth Progress Report, the focus of the administration was in "*agreeing balances provable*": Garvey 3 at [9(i)].

(4) A broad release provision was included in the CDDs "*with the intention that the amount of the Agreed Claim or Admitted Claim (as the case may be) would not need to be revisited once it had been agreed in a CDD*" (Lomas 10 at [59], which also sets out the terms of the standard CDD release). The waivers and releases were "*designed to give LBIE and the Joint Administrators certainty in respect of the creditor's claims so as to facilitate making interim distributions*": Lomas 9 at [64.3] (emphasis added).

(5) From 2010 until early 2014, creditors were informed by the Administrators that entry into a CDD was a condition for admittance of provable claims and participation in distributions by LBIE in respect of provable claims. Creditors were therefore required to sign CDDs in order to participate in distributions by LBIE in respect of provable claims.

(6) Approximately 1600 CDDs and 460 Client Money Supplemental Deeds have been entered into: Lomas 11 at [64]. There will have been a wide variety of creditors, with different sizes of claim and levels of sophistication.

(7) The CDDs have evolved over the period 2010 to 2014 (including those used in conjunction with the CRA). The different forms are described in Appendix A to Lomas 10. In particular, when it was subsequently appreciated that there might be a surplus and an issue arose as to whether the effect of the existing form of CDDs might be to release claims to Statutory Interest or other non-provable claims, amendments were made to the standard templates to include language which expressly preserved Statutory Interest and Currency Conversion Claims.

(8) Creditors were informed and understood that, if they did not enter into CDDs as part of the Administrators' proposed "*consensual approach*" (whereby, in order to streamline the process of creditors agreeing their provable claim amounts, the Administrators provided a creditor with an

offer of an amount in respect of its provable claims against LBIE which was to be accepted or rejected), they would have to enter into individual negotiations with the Administrators at an unspecified future date and the payments of distributions to them would therefore be delayed (potentially for a very significant period and potentially for a lesser sum): Lomas 10 at [45].

(9) Creditors were informed by LBIE when provided with a CDD that (i) the amount at which LBIE proposed to agree and/or admit each creditors' provable claim (which was typically communicated in the currency of contractual entitlement) by the CDD; and (ii) the form of the CDD, were non-negotiable (Lomas 10 at [45] and [56]).

(10) Although in some circumstances certain provisions in the CDD were ultimately amended for certain creditors (Lomas 10 at [57] and [58]), the Release Clause was not the subject of material amendment and was and is regarded by the Administrators as being in materially the same form in all types of CDD save for those dealing with CRA Trust Property (Lomas 10 at [61])[2].

(11) On 29 December 2009, LBIE entered into the CRA with a large number of LBIE's trust beneficiaries. The return of trust property necessitated an assessment both of a party's entitlement to Trust Property and its unsecured position vis-à-vis LBIE (Lomas 10, at [16.1]). The CRA was proposed for collective approval and was not subject of negotiation or amendment (Lomas 10 at [27]). It pre-dated the CDDs both in concept and in fact.

(12) A key aspect of the CRA (in order to enable the return of Trust Assets) was the valuation and agreement of unsecured financial claims in order that, when distributions were made in due course, the valuation of the

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2 The release provisions in Aggregator CDDs are in a different form from the standard form release in that they provide for the release of the claims of the original creditor that were assigned to the aggregator i.e. those who acquired claims in the secondary market: Lomas 10 at [62].

"new" claim (i.e. the agreed net balance payable under the relevant financial contracts) could simply be "fed into" the distribution process: Pearson 7 at [23], [24] and [75]. The CRA provided an alternative mechanism for agreeing claims and determining their value so as to establish an ascertained unsecured claim against LBIE for the purpose of future distributions from the general estate: Pearson 7 at [30], [99.1] and [128]. Accession to the CRA thus gave LBIE a degree of certainty as to the unsecured claims arising from Financial Contracts: Lomas 10, at [19(b)].

(13) Although not necessary in order to have their unsecured claims agreed and admitted, the Administrators' and LBIE's policy became to request that creditors who entered into the CRA also entered into a CDD (Lomas 10 at [63]). This was because *"[a] CDD is considered to be a more straightforward and less time-consuming way of documenting the claim instead of issuing the various notices required under the CRA*": Lomas 10 at [63].

22. All of the above matters occurred in circumstances where, until April 2013, the Administrators' Progress Reports indicated that LBIE would, even in the projected best case "*high end*" scenario, be unable to pay provable claims in full (having contained no projections at all as to payments in respect of provable claims until April 2011): Copley 1 at [18], Pearson 7 at [33.1] and [33.2]. i.e. the Administrators did not expect a surplus would emerge even in the most optimistic of scenarios at the time when the CRA, and then many of the CDDs, were entered into by the creditors in order to admit their debts to participate in dividends .

23. It is common ground that, if the Administrators had adopted the usual process of ascertaining claims and distributing the assets, no question of waiving or releasing rights to Statutory Interest or other non-provable claims would or could have arisen.

24. As set out in more detail in its Position Papers, the Senior Creditor Group contends that, on the true construction of the relevant documents, none had the effect of releasing or waiving non-provable claims such as Statutory Interest or

Currency Conversion Claims. In short, the purpose of the CRA was to enable trust assets to be returned. The quantifying of claims was a product of that purpose. The purpose of the CDDs was to assist with the efficient distribution of the assets by providing an alternative method of quantifying claims as compared to the standard process of proof. Construed in their relevant context, it was no part of the purpose of such documents to deprive creditors of a right to Statutory Interest or other non-provable claims in the event of a surplus. The release of non-provable claims was not necessary, nor was it consistent with achieving the purpose of the administration or fulfilling the Administrators' duties. In fact, it is clear on the evidence that, as one would expect, the Administrators did not intend to deprive creditors of such rights: see paragraph 33 below.

25. Wentworth's position on Questions 34 and 35 is however that certain of the CDDs and/or CRA (in conjunction with the CDDs) did deprive creditors of such rights, although others did not. Thus:

Statutory interest

(1) Wentworth's position is that the CDDs which include the Release Clause did not waive or release a creditor's claim to Statutory Interest at the Judgments Act Rate. However, it contends that, in the absence of express wording preserving claims, all CDDs waived or released a creditor's right under rule 2.88(9) to Statutory Interest at the rate applicable to the debt apart from the administration (Position Paper at [163] and [164]);

(2) Wentworth contends that the CRA had the same effect (i.e. Statutory Interest is limited to interest at the Judgments Act Rate) because any contractual right that the creditor might have had to a rate higher than the Judgments Act Rate was released pursuant to the terms of the CRA (Position Paper at [164]);

Currency Conversion Claims

(3) Wentworth's position is that a Foreign Currency CDD[3] which includes the Release Clause did not waive or release the creditor's right to assert a currency conversion claim, provided that the foreign currency specified in the CDD was the same as the underlying contractual currency of entitlement (Position Paper at [155], Reply Position Paper at [63]);

(4) However, Wentworth's position is that a Sterling CDD[4] which includes the Release Clause did waive or release the creditor's right to assert a currency conversion claim unless there was express language preserving such a right (Position Paper at [157]);

(5) Wentworth position is that the CRA did not waive or release a creditor's right to assert a currency conversion claim, provided that the foreign currency specified in the CRA was the same as the underlying contractual currency of entitlement. However, it contends that a CRA CDD (provided that it was a form of Sterling CDD) did, in conjunction with the CRA, waive or release the creditor's right to assert a currency conversion claim unless there was express language preserving such a right (Position Paper at [161]).

26. The Senior Creditor Group's response is that this cannot sensibly have been the objectively intended effect of such documents. The purpose of the CDDs and CRA did not require the release of non-provable claims. The effect of Wentworth's case is that different creditors are dealt with differently, depending on which standardised document they entered into, for reasons which are irrelevant in this context. The reasons for the different versions of CDDs had nothing to do with preserving or waiving and releasing rights to Statutory Interest or non-provable claims. The estate, and the shareholders as a result, on

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3 As defined in the Application – which is likely in the main to be certain of the Agreed Claim CDDs (all of which the Senior Creditor Group understands to reflect the underlying currency of entitlement) but may also include some of the other forms of CDD.

4 Which is, in practice, likely to be Admitted Claim CDDs (because all Admitted Claim CDDs are understood to record the creditor's claim in sterling irrespective of the original currency of entitlement), but possibly includes some of the other forms of CDD.

Wentworth's case, receives a very substantial benefit that it would not have received but for the entry into the CDDs and CRA, which benefit was not intended by the Administrators.

27. Wentworth has, to date, reserved its position on the admissibility of the evidence filed for the purpose of Question 34 and 35. In its letter of 4 March 2015, it appears to indicate that it considers parts of the Administrators' and the Senior Creditor Group's (and indeed its own) evidence as strictly inadmissible to questions of construction (although it has not sought to identify which particular paragraphs in the evidence are inadmissible).

28. In this regard, the Senior Creditor Group contends that the Court should adopt the usual approach: the assessment of the relevance and admissibility of evidence should be left to trial (*Beazer Homes Ltd v Stroude* [2005] EWCA Civ 265 at [9] and [41]) where its potential relevance and admissibility (or irrelevance and inadmissibility) is likely to become clearer; *Standard Life Assurance v Oak Dedicated Ltd* [2008] 1 CLC 59 at [12] and [13]. As set out below, it is content to provide an updated position paper in which it will set out the principal facts upon which it relies.

29. In this case, it also needs to be borne in mind that:

    (1) Notwithstanding the wide language of a general release, the context in which the release is given is key. Certain claims or aspects of claims may not, on the true construction of the agreement, have been released: see, for example, *BCCI SA v Ali* [2002] 1 AC 251.

    (2) The Court will not presume that a party intends to achieve a result which is contrary to the law or the purpose for which his powers have been conferred. The purpose of the administration, and the duties to which the Administrators were subject when entering into the CDDs and CRA are a relevant part of the factual matrix, and may be such as to lead the Court to conclude that it cannot attribute a particular intention to the officeholder: see, for example, *Re WW Duncan* [1905] 1 Ch 307. It was no part of the purpose of the administration or the function of the

Administrators that they would release non-provable claims, and the agreements should not be interpreted in a manner that attributes to them such an intention (particularly where, as here, to do so would be to attribute to them an intention that they did not in fact have).

(3) Although evidence of previous negotiations or outward expressions of intention may be inadmissible for the purpose of explaining or drawing inferences about what a particular term means, such evidence may be used to establish that a fact relevant as background was known to the parties, or to establish the commercial nature and object of the contract: see, for example *The Bank of New York Mellon v Truvo NV* [2013] EWHC 136 (Comm) at 43(b) and (c), applying *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101.

30. No practical difficulty is likely to be caused by adopting this approach, which is particularly appropriate where, as here, any evidence that is inadmissible on the question of construction is likely to be admissible and relevant to Question 36 (see below).

(5) QUESTION 36

31. Question 36 arises if the Senior Creditor Group is wrong as a matter of construction as to the effect of the CDDs and CRA. It involves consideration of the same or a similar set of facts, but the application of different legal principles.

32. There is no suggestion (or basis to suggest) that it was necessary for the CDDs or the CRA (by itself or taken in conjunction with any relevant CDD) to release non-provable claims as part of the process of determining the quantum of claims, or otherwise in order to achieve the purpose of the administration.

33. On the contrary, the Administrators have confirmed in evidence that:

(1) "*[I]t was never our intention that creditors would waive their right to Statutory Interest by virtue of the Release Clause*": Lomas 10 at [69];

(2) Prior to March 2013, the Administrators were not aware of the concept of a Currency Conversion Claim as a non-provable claim, and had not considered the notion that such a claim could exist: Copley 1 at [19]. Such claims (and indeed non-provable claims generally) were simply not in the contemplation of the Administrators prior to that time when, for example, the CRA was implemented: Pearson 7 at [33.3] and [122];

(3) The Administrators' view (as expressed to at least certain creditors in October 2013 by Mr Copley, the Administrator charged with the process of agreeing CDDs during the relevant period) was that (Copley 1 at [25], [27], [28]):

(a) The CDDs (without express preservation language) did <u>not</u> have the effect of releasing Currency Conversion Claim;

(b) It had not been the intention of the Administrators that creditors waive their right to Currency Conversion Claims;

(c) Had the Administrators known about the existence of Currency Conversion Claims at the time that the Release Clause was drafted, they would have sought to have them carved out from the effect of the Release Clause if it were necessary to do so in order to preserve them.

34. In this regard, it is notable that the Administrators also discussed their understanding of the effect of the CDDs, and their intention, with creditors. Thus, for example, Mr Copley says at [25] and [28]:

> *"Shortly after the PTR, I mentioned to various creditors, including CarVal and Baupost, that (subject to obtaining legal advice that supported this course of action), my preference would be to make a publicly-available statement on the section of the PwC website dedicated to the Administration to the effect that it was the Joint Administrators' view that CDDs did not have the effect of releasing Currency Conversion Claims and that it had not been the intention of the Joint Administrators that creditors waive their right to Currency Conversion Claims. I recall making this comment to a small number of significant creditors on calls and in meetings. In making these comments relating to the Joint Administrators' intentions, at the time the Release Clause in the template CDDs was originally drafted, specifically to release creditors' rights in relation to Currency Conversion Claims, in circumstances where, so far as I*

was aware, prior to 2013, the possibility of Currency Conversion Claims being made (or, indeed, existing) had not been considered by the Joint Administrators.

…

In my discussions with creditors from mid-2013 onwards (including the discussions that followed the PTR that I have referred to above), I also stated that, had I known (which I did not) about the existence of such claims at the time the Release Clause was drafted to be included in the CDDs in 2010, I would have sought to have them carved out from the effect of the Release Clause if it were necessary to do so in order to preserve them. The reason for my making such a statement was that, had I known at the time the CDDs were drafted that a Currency Conversion Claim would be available as a non-provable claim in the event there was a surplus, I believe that my own preference at that time would have been to carve them out."

35. The Administrators and LBIE have not suggested any rationale or justification for the various forms of CDD (separately or in conjunction with the CRA) having a different effect on the rights of different creditors with respect to non-provable claims, nor suggested that it was the Administrators' intention that such CDDs would have a different effect on the rights of different creditors with respect to such claims depending on the form used (which varied as a consequence of the passage of time).

36. In such circumstances, if, which is denied, the Release Clause as a matter of construction releases non-provable claims, the Senior Creditor Group will contend that the Administrators should be directed not to enforce it. The Senior Creditor Group's position is set out in more detail in its Position Papers, and in its letter of 27 February 2015. In short:

(1) The purpose of the administration required the Administrators to perform their functions with the objective of, amongst other matters, achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration);

(2) The Administrators were required to perform their functions in the interests of the company's creditors as a whole;

(3) Requiring certain creditors, as a condition to the admission of their provable claims, to give releases which (assuming the construction issue against the Senior Creditor Group) waived or released legitimate rights to

Statutory Interest or non-provable claims was not necessary, nor was it consistent with achieving the purpose of the administration or fulfilling the administrators' duties;

(4) Obtaining such releases was no part of the purpose of the CDDs or CRA, and could not have reflected (and did not reflect) the Administrators' intentions, as set out in the evidence filed;

(5) That is particularly so when the releases were sought at a time when there was no indication from the Administrators to the creditors that LBIE was likely to be solvent and able to pay interest to compensate creditors for delay in the payment of proved debts, let alone the payment of non-provable claims such as Currency Conversion Claims; and

(6) The effect of enforcing any release of rights to Statutory Interest or Currency Conversion Claims would be to benefit, at unsecured creditors' expense, the estate and, in due course, provide a windfall to those ranking below such creditors.

37. The direction not to enforce the Release Clause as regards Statutory Interest and other non-provable claims should be given because it is appropriate to regulate the conduct of the Administrators in order to ensure the proper conduct of the administration in accordance with its purpose and the Administrators' duties. The situation requires the application of, or is analogous with, the rule in *ex parte James, Re Condon* (1874) LR 9 Ch App 609 i.e. per Lord Neuberger in *Re the Nortel Companies* [2014] AC 209 at [122]:

> *"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."*

38. In broad terms, the Senior Creditor Group will therefore contend that, in the circumstances of this case, enforcement in full of the legal consequences of transactions initiated by the Administrators for the benefit of the general body of the estate would be regarded by a reasonable member of the public, knowing all of the facts, as unfair, and would confer an unfair benefit or enrichment on the estate and a windfall on the subordinated creditors and shareholders: see, for example, *Re Multi-Guarantee Co Ltd* [1987] BCLC 257 at [29] and *In Re Wigzell, Ex Parte Hart* [1921] 2 KB 835 per Younger LJ at 869.

39. For the avoidance of doubt, the Senior Creditor Group is not suggesting that the Administrators or their advisors knowingly or wilfully acted in a manner inconsistent with the purpose of the administration, or their duties. It is not necessary for them to do so in order to bring themselves within the scope of the rule as described above.

40. The argument applies to all CDDs, but may as time passes become even more stark where, for example, CDDs were entered into after the Administrators become aware of the potential existence of Currency Conversion Claims or where (see Lomas 10, at [66]-[73]; Copley 1 at [24]):

    (1) CDDs with release language were entered into between early 2012 and August/September 2012 i.e. after the Administrators had explained their view that the inclusion of language to preserve a creditor's right to Statutory Interest was unnecessary; and/or

    (2) CDDs were entered into after September 2012 and after the introduction of standard Statutory Interest preservation language, in a form which did not include such language; and/or

    (3) CDDs were entered into after October 2013 and after the introduction of standard Currency Conversion Claim preservation language, in a form which did not include such language.

41. Question 36 as posed in the Application also potentially raises wider issues, such as rectification, mistake and estoppel (see the Senior Creditor Group's letter of 11

July 2014). However, in light of the evidence served, and the Court's indication at the last CMC that consideration should be given to identifying which issues within Question 36 were generic and reasonably self-contained, the Senior Creditor Group has indicated (see its letter of 27 February 2015) that it is content that consideration of Question 36 at the hearing of Part B of the Application is limited in the manner set out above. Subject to the Court, that approach appears in principle to be agreeable to all parties subject to the giving of any directions necessary to ensure that the issues and evidence are clearly identified. The remainder of Question 36 can, if necessary, be considered further in due course by the parties and the Court (including the appropriate format of proceedings to determining any outstanding issues).

42. Framed in this way, Question 36 is as generic as the questions posed by Questions 34 and 35, and should be dealt with in the Part B hearing. It is hoped that this will ultimately save time and expense and enable an earlier determination of the issues and distribution of the surplus. The arguments raised by the Senior Creditor Group on Questions 34, 35 and 36 are of general application to LBIE creditors and are for the benefit of the population of senior unsecured creditors who entered into various forms of CDD during the administration, many of whom held comparatively small claims against LBIE and were therefore unlikely to have had the benefit of sophisticated legal advice when entering into CDDs.

43. There may, of course, be additional facts and matters on which a particular creditor may rely, by way of factual background, which may give it additional arguments on construction or in relation to the application of the rule in *ex parte James*. But this is a general issue that applies to Questions 34-36 and a consequence of trying to decide these issues otherwise than by reference to specific agreements between specific parties. Obviously any determination of either issue is not intended to and will not prejudice creditors in that respect.

(6) ANCILLARY DIRECTIONS

44. So far as further directions are concerned:

(1) The Senior Creditor Group is content (as indicated in its letter of 4 March 2015) to update its position paper in light of the evidence filed both as regards Questions 34-35 and Question 36. This will enable the parties to identify the key arguments and facts relied upon by the Senior Creditor Group as part of the factual matrix, and in relation to Questions 34-36 (albeit the Senior Creditor Group will rely on the evidence served as a whole at the hearing of this matter). The Senior Creditor Group has stated that it would need until 14 April 2015 to produce an updated Position Paper in light of the commitments of its legal team arising in the interim relating to the Waterfall I appeal.

(2) The Administrators and the other Respondents should then reply to the updated Position Paper, and indicate which, if any, of the key facts are disputed for the purpose of resolving Questions 34-36.

45. It is hoped that, if draft directions are circulated by the Administrators, the position may be capable of agreement in large part before the hearing.

PART C

(1) COMPLIANCE WITH PRIOR DIRECTIONS

46. Part C concerns Questions 10 to 27, being issues arising from the terms of various Master Agreements.

47. The Senior Creditor Group has filed and served evidence explaining the basis or bases upon which it considers that it is entitled to advance for payment pursuant to Rule 2.88(7) of actual claims to interest at a rate in excess of the Judgments Act Rate, with sufficient particulars to substantiate such claims to interest and assist any experts instructed in due course: see McKee 1 at [1/14] (in compliance with paragraph 10 of the Order).

48. The parties were required to use best endeavours to agree the questions to be posed to the foreign law experts (paragraph 14 of the Order). This has occurred and the questions have now been agreed. The Senior Creditor Group has recently written to the other parties to suggest a slight extension of the timetable for the

delivery of the foreign law expert reports (which will not impact on the hearing timetable). It is hoped that this can be agreed between the parties. It is not thought to be necessary to address foreign law issues any further in this skeleton.

49. The principal issue in relation to Part C concerns the expert evidence relating to Cost of Funding. In that regard, the parties have been unable to agree the areas of expertise.

(2) EXPERT EVIDENCE ON COST OF FUNDING

50. Paragraph 11 of the Order required the Senior Creditor Group, Wentworth and the Administrators to use their best endeavours to agree, by 6 February 2015, the areas of expertise in respect of which permission to adduce expert evidence will be sought, the questions to be addressed by the expert witnesses in relation to Questions 11-13 and the identity of the expert witnesses on whose evidence they seek to rely.

51. Unfortunately, as at the date of this skeleton argument, the Senior Creditor Group and Wentworth have been unable to agree the questions for the experts in relation to Questions 11-13. The position at present appears to be that:

(1) Wentworth considers that the only expert evidence required in relation to Questions 11-13 relates to whether or not there is a generally understood meaning of the expression "*cost….if it were to fund or of funding*". Wentworth's position, in this regard, is that those words have a generally understood meaning in the banking derivatives market and it wishes to adduce expert evidence in order to support its position. On this issue, the Senior Creditor Group contends that there is no such generally understood meaning in the banking derivatives market and that the words "*cost….if it were to fund or of funding*" should be given their natural and ordinary meaning. It agrees that expert evidence is required on this issue.

(2) The Senior Creditor Group considers that expert evidence in the field of corporate finance is also required to identify the nature and extent of the costs of funding incurred by an entity and the "*costs*" which that entity

might rationally and in good faith certify that it has or would incur "*if it were to fund or of funding"* the relevant amount. Such evidence will assist the court to provide guidance to the Administrators as to whether particular categories of costs or bases for claims are "*costs*" within the meaning of the Default Rate and such that a creditor may be able in good faith and rationally to claim. Wentworth's position appears to be that such evidence is irrelevant to the issues raised by Questions 11–13.

52. The questions which the Senior Creditor Group considers should be addressed to the expert(s) are set out in Appendix A to this skeleton argument.

53. Further, at present the Senior Creditor Group does not understand the scope or terms of the "*generally understood meaning*" asserted by Wentworth. It is necessary and desirable for Wentworth to clarify this aspect of its case for the parties to understand Wentworth's position and to enable the parties' experts to be properly instructed.

54. In a letter dated 5 February 2015, Linklaters indicated that the Administrators were of the view that expert evidence in the field of corporate finance would be in accordance with the expectations expressed during the November CMC: see the correspondence at [2/17].

(3) WENTWORTH'S ALLEGED GENERALLY ACCEPTED MEANING

55. The Default Rate as contained in the ISDA Master Agreement is defined as "*a rate per annum equal to the cost (without proof or evidence of any actual cost) to the relevant payee (as certified by it) if it were to fund or of funding the relevant amount plus 1% per annum*". Questions 11-13 are concerned with determining the ambit and scope of the definition of "Default Rate".

56. One of the issues raised by Questions 11 - 13 concerns the construction of the phrase "*the cost…if it were to fund or of funding the relevant amount"*. As to this:

(1) Wentworth contends that the expression has a generally understood meaning in the banking derivatives market (i.e. among bank

counterparties to ISDA Master Agreements) as referring to the bank's own "*cost of funds*". Wentworth contends that the phrase "*cost of funds*" is itself a concept generally understood in the banking market to mean the weighted average of the interest payable on all borrowings divided by their total notional amount (see its Position Paper at [70]).

(2) The Senior Creditor Group, by contrast, contends that there is no such generally understood meaning and that the expression should be construed by reference to the natural and ordinary meaning of the words used and depends on the facts. On that basis, the Senior Creditor Group contends (see its Position Paper at [11(1)]) that the expression refers to or is capable of including any cost that would or have in fact been incurred or sustained by the relevant payee in raising an incremental sum of money (whether by debt or equity or a combination of the two) equivalent to the relevant amount or is incurred or sustained by the relevant payee as a result of being forced to fund, in the sense of extending credit to, the defaulting party in the sum of the relevant amount as a result of the defaulting party's non-payment of that amount.

57. Wentworth and the Senior Creditor Group agree that expert evidence is required on the question of whether the Default Rate has the generally accepted meaning in the banking derivatives market for which Wentworth contends. Subject to Wentworth clarifying the scope of the alleged "*generally understood meaning*" (as to which, see further below), the Senior Creditor Group agrees with the questions proposed by Wentworth on this issue.

(4) THE NATURE AND EXTENT OF RELEVANT "COSTS"

58. Another issue raised by Questions 11 – 13 concerns the potential nature and scope of the "costs" encompassed by the phrase *"the cost…if it were to fund or of funding the relevant amount"*.

59. There is agreement between the parties that a relevant payee's certification of its cost of funding is not conclusive but is "*susceptible to challenge on the basis that it is irrational, in bad faith,* ***or does not relate to a "cost"***" (Administrators' Position

Paper at [62.1], emphasis added. See also Wentworth's Position Paper at [86], Senior Creditor Group's Reply Position Paper at [14(2)]). However, there is disagreement between the parties as to the scope of such "costs".

60. If the Court determines that the phrase "*the cost…if it were to fund or of funding the relevant amount"* does not have the generally understood meaning for which Wentworth contends or, in relation to those entities to which the supposed trade usage does not apply in the event the court determines the phrase does have a generally understood meaning, the Senior Creditor Group will contend that the "*cost"* to the relevant payee "*of funding the relevant amount"* includes or is capable of including:

(1) all costs associated with raising a sum of money equal to the relevant amount; and/or

(2) all costs associated with being forced to fund the defaulting party in a sum equal to the relevant amount.

61. The Senior Creditor Group's position in this regard is summarised in McKee 3, which was filed pursuant to paragraph 10 of the Order and which explains the bases on which the Senior Creditor Group considers that it is entitled to advance actual claims to interest at a rate in excess of the Judgments Act Rate. By way of illustration, and as explained in greater detail in McKee 3:

(1) Where a company introduces a liability onto its balance sheet (e.g. by borrowing an sum equal to the relevant amount), it exposes shareholders to a greater risk which increases the cost of equity (Reply Position Paper at [14(4)(a)]). Looking only at, for example, the coupon and fees associated with borrowing therefore understates the true cost to the relevant payee of funding the relevant amount through raising debt.

(2) The true cost to the relevant payee of being forced to fund, in the sense of extending credit to, the defaulting party in the sum of the relevant amount is, in accordance with the Modigliani-Miller theorem, independent of the funding mix used.

62. For the avoidance of doubt, Mr McKee's evidence does not, and is not intended to, set out the only bases on which any LBIE counterparty could rationally and in good faith certify the cost to it if it were to fund the relevant amount. For example, it may be that certain financial institutions which are subject to capital maintenance requirements could rationally and in good faith certify their cost of funding in an amount which reflects their cost of equity capital. To the extent that this is the case, the Senior Creditor Group assumes that this will be addressed by the Administrators.

63. It is necessary and desirable for the Court to have the benefit of expert evidence in the field of corporate finance to explain the concept of a cost of funding as it is used in that context and the full extent of the costs which the Senior Creditor Group contends are incurred by an entity in raising a sum of money equal to the relevant amount or being forced to fund the defaulting party in a sum equal to the relevant amount[5].

64. Such evidence is required to assist the Court and in due course the Administrators to determine which, if any, of those costs are capable of being properly included in a valid certification of a relevant payee's "cost" of funding:

(1) An expert in the field of corporate finance would assist the Court in understanding how entities can and do calculate their funding costs.

(2) An expert in the field of corporate finance would assist the Court in understanding the conceptual bases for the Senior Creditor Group's case that the cost of borrowing is not limited simply to the interest on any loan and fees.

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5 The Senior Creditor Group's position in this regard reflects the comments made by David Richards J at the last CMC in connection with this issue. In particular, his Lordship's observation (which Wentworth's counsel agreed with) that "*people need to identify their case namely fund* [sic], *the cost of funding within the meaning of the relevant clause includes these categories and then you get to that ultimately as a question of, perhaps of construction, but aided, you say, by expert evidence"* (Transcript, page 70 line 22 – page 71 line 4. See, similarly, page 76 line 25 – page 71 lines 1-5 (cited above)).

(3) An expert in the field of corporate finance would assist the Court in understanding the various ways in which the true cost of raising an incremental sum of money (whether by debt or equity or by a combination of the two) can and should be measured and why (as the Senior Creditor Group contends) such costs can be roughly equated with an enterprise's weighted average cost of capital (being the cost of funding a portfolio of all the enterprise's existing investments or "WACC"[6]);

(4) An expert in the field of corporate finance would assist the court in understanding the ways in which the true costs associated with being forced to fund the defaulting party in a sum equal to the relevant amount can and should be measured and why (as the Senior Creditor Group contends) such costs are dependent primarily on the nature of the asset being funded (in this case, the defaulted LBIE receivable) and not on enterprise-specific factors[7].

65. The fact that the scope of the funding "costs" encompassed by the phrase *"the cost…if it were to fund or of funding the relevant amount"* is an issue raised by Question 11 – 13 was expressly acknowledged by Wentworth's counsel on a number of occasions during the course of the November CMC. For example:

> "*DAVID RICHARDS J: what we are concerned with is the meaning of the phrase "cost of funding". So that will include certain things and not include other things. So certain people will be saying it includes X, Y and Z and other people may disagree with that. That is the basic issue there, is that fair or not?*
>
> *MR ZACAROLI: that is correct…In a sense, this perhaps relates to the more broad evidence about corporate finance experts as my learned friend wishes to put in."*

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6 For a more detailed explanation of an enterprise's WACC and its relevance in this context see McKee 3 [19] – [20].

7 For a more detailed explanation of why this is the case, see McKee 3 [10] – [17]. It is plain that these issues are properly the subject of expert evidence. The Modigliani-Miller Theorem, for example, which Mr McKee refers to in his witness statement, was the result of the work of Franco Modigliani and Merton Miller. Franco Modigliani was awarded the 1985 Nobel Prize in Economics for his contribution to the theorem. Merton Miller won the 1990 Nobel Prize for Economics for his work in the theory of financial economics and fundamental contributions to the theory of corporate finance.

(Transcript p.76 line 25 – p.77 line 5[8])

66. The questions which the Senior Creditor Group considers should be addressed to the expert(s) in the field of corporate finance are also set out in Appendix A to this skeleton argument.

67. In accordance with the requirement for the parties to use best endeavours to agree, among other things, the areas of expertise and the questions to be addressed by the witnesses in relation to Question 11 – 13, the Senior Creditor Group wrote to Wentworth on 27 January 2015 identifying questions for experts. Those questions fell into two categories, namely:

    (1) Questions relevant to identifying whether or not there is a generally understood meaning in the banking derivatives market of the expression "*cost….if it were to fund or of funding"* as it is used in the ISDA Master Agreement.

    (2) Questions relevant to identifying, by reference to principles of corporate finance, the full extent of the costs incurred by an entity in raising a sum of money equal to the relevant amount and / or being forced to fund the defaulting party in a sum equal to the relevant amount; and

68. Wentworth subsequently responded by letter dated 30 January 2015 objecting to the inclusion of any questions in the second category of questions identified above.

69. Wentworth's position, as it appears from the correspondence, appears to be that the only issue raised by Questions 11–13 is whether there is generally understood meaning of the phrase "*cost…if it were to fund or of funding the relevant amount"* in any particular context and that this is the only issue on which expert evidence is therefore potentially relevant. Copies of the relevant correspondence are at [2/4-6 and 9-13].

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8 See also p.70 line 22 – p.71 line 4.

70. While that is plainly one possible issue on which expert evidence may be relevant, it is not the only one. As set out above, a further issue concerns the scope of the "costs" encompassed by the phrase *"the cost…if it were to fund or of funding the relevant amount"*. That issue arises irrespective of and is independent from the question of whether the phrase *"the cost…if it were to fund or of funding the relevant amount"* has a particular trade usage or generally understood meaning, whether in the area of corporate finance the banking derivatives market or otherwise. But in any event, the way in which entities can and do calculate their funding costs is a potentially relevant part of the context in which the ordinary and natural meaning of the phrase "*the cost…if it were to fund or of funding the relevant amount"* should be construed.

(5) THE SCOPE OF WENTWORTH'S "GENERALLY UNDERSTOOD MEANING"

71. Wentworth's position is that the phrase "*the cost…if it were to fund or of funding the relevant amount"* has a "*generally understood meaning among financial institutions that actively participate (whether as broker or dealer) in the derivatives markets"* and that expert evidence is relevant in order to demonstrate such generally understood meaning.

72. At present the Senior Creditor Group does not understand, however, the scope or terms of the "*generally understood meaning*" asserted by Wentworth. In particular:

(1) On several occasions[9], the Senior Creditor Group has requested Wentworth to clarify what it means by its use of the term "*banking derivatives market*" and "*banking market*". As at the date of this Skeleton Argument, no response has been received.

(2) Question 1 of the proposed questions circulated under cover of Wentworth's letter of 3 March 2015 contains six subsidiary questions (labelled 1(a) – 1(f)) which it appears are intended to identify the precise scope and terms of the market usage contended for by Wentworth.

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9 In letters dated 4, 13 and 24 February 2015.

(3) The Senior Creditor Group does not however know what Wentworth's case is in relation to any of these subsidiary issues, none of which have been addressed in Wentworth's Position Papers or in correspondence.

73. Wentworth's position in this regard is all the more unclear in light of the various and inconsistent ways in which the "*generally understood meaning*" has been expressed. In particular:

(1) In its Position Paper, Wentworth contended that the expression "*cost…if it were to fund…the relevant amount"* had a generally understood meaning in relation to "*Credit Institutions and Financial Institutions*" (Position Paper at [71]) but that, with respect to "*funds and corporate entities"* the term referred to the lowest amount which the counterparty would be required to pay over the relevant period (Position Paper at [69], [72(1)]).

(2) By contrast, in a mark up of questions for the proposed expert attached to Kirkland and Ellis' letter of 30 January 2015 Wentworth appeared to suggest that the "generally understood meaning" applied only to a "bank". In particular, the mark-up referred to a "*generally understood meaning in the banking derivatives market"* which it defined as "*an entity that is a bank that is an active participant (by amount and frequency of transaction) in the derivatives market whether as broker or dealer".*

(3) This is in further contrast to the proposed questions attached to Kirkland and Ellis' letter of 3 March 2015, which refers to a generally understood meaning "*among financial institutions that actively participate (whether as broker or dealer) in the derivatives market*". It is not clear whether "financial institutions" refers to (i) banks active in the market, (ii) all financial institutions active in the market or (iii) all counterparties.

74. The Senior Creditor Group considers that it is necessary and desirable for Wentworth to clarify this aspect of its case to enable the parties to understand its position and to ensure that the experts are properly instructed.

(6) OTHER MATTERS RELATING TO COST OF FUNDING EXPERTS

75. At the November CMC the parties considered that two experts would be required. The Senior Creditor Group's position in this regard has not changed and it considers that provision should be made for the parties to instruct up to two experts each. Directions in due course will also be required as to timing of expert reports.

(7) WENTWORTH'S MOST RECENT POSITION ON TRANCHE C

76. In a letter dated 4 March 2015 [2/88 at 94], Wentworth suggested for the first time that "*with the exception of Issue 10, and such party of Issue 11 that is a pure question of construction of the ISDA Master Agreement, the Issues that remain in contention between the parties in Tranche C are unlikely to be capable of resolution at a generic level*" and have suggested that it would be "*helpful for the parties to identify and agree one or more representative cases where cost of funding has been certified at a rate in excess of the Judgments Act Rate which can stand as test cases*".

77. The Senior Creditor Group does not understand the basis for this suggestion:

(1) The need for representative illustrations of claims under ISDA Master Agreements to interest in excess of the Judgments Act Rate was debated at length at the November CMC. The Court ordered the Senior Creditor Group to file evidence explaining the bases on which they consider that they are entitled to advance actual claims for interest in excess of the Judgments Act Rate.

(2) On 15 January 2015 the Senior Creditor Group filed McKee 3, which met the requirements of the order and included three anonymised examples of actual certifications which could be made.

(3) Subsequently, in a letter dated 3 March 2015, Wentworth stated that the factors contended for to demonstrate the full extent of the costs of funding which may be incurred "*are adequately explained in Mr McKee's evidence*".

(4) The recent suggestion by Wentworth that creditors should be asked to submit a certificate of their cost of funding with a view to "*selecting them as a test case*" for the court then to finally determine whether such creditor was acting in good faith and rationally will add substantially to the cost and expense of the exercise and be unlikely to provide any more general assistance to the Administrators.

AGREED ISSUES

78. Finally, the Senior Creditor Group notes that the Administrators have circulated a note identifying the questions where the parties have adopted an agreed position and requesting declarations from the Court in respect of those questions.

79. To the extent necessary, the Senior Creditor Group will provide comments before the hearing or raise them at the hearing. Whilst it is a matter for the Court as to whether it is prepared to make declarations at this time, and in what form, the Senior Creditor Group dos not object to the Administrators suggestions, save that it would query whether it is necessary or desirable to make a declaration regarding Question 3 at this stage given the interplay between Questions 2 and 3.

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6 March 2015

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