No. 7942 of 2008

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

B E T W E E N:

(1) ANTHONY VICTOR LOMAS
(2) STEVEN ANTHONY PEARSON
(3) PAUL DAVID COPLEY
(4) RUSSELL DOWNS
(5) JULIAN GUY PARR
(as joint administrators of the above named company)

Applicants

- and -

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

Respondents

WENTWORTH'S SKELETON ARGUMENT FOR CMC ON 9 MARCH 2015

INTRODUCTION

1. This skeleton argument sets out Wentworth's position on the case management of Parts B and C of the Waterfall 2 Application. It also sets out its position in relation to the matters which remain outstanding from the Part A hearing.

PART B

2. The Part B hearing is listed to commence on 19 May 2015. Pursuant to the directions given at the CMC on 21 November 2015, the Part B hearing comprises Issues 9, 34, 35 and 38. The question of whether Issue 36 should form part of the Part B hearing was reserved to this CMC.

3. No further directions are required in respect of Issues 9 and 38. The following paragraphs consider the further directions that are required in respect of Issues 34, 35 and 36.

4. Two matters arise for consideration in relation to Issues 34 and 35:

   (1) the proposed reformulation of Issue 34 so as to extend to non-provable claims generally; and

   (2) the evidence that is admissible as an aid to construing the CRA and the CDDs.

Proposed reformulation of Issue 34

5. Issue 34, as presently drafted, is framed to include only the question of whether Currency Conversion Claims have been released by the CRA or the CDDs. The Administrators have proposed that it be reformulated so as to include any "*other non-provable claims*" that might exist.

6. Wentworth agrees that it would be advisable to reformulate Issue 34 so that it extends to any non-provable claims that might exist, in particular (if and to the extent that the Court concludes that they exist) non-provable claims for such contractual rights as creditors may have to interest which are not satisfied by Statutory Interest. Any such claims are as much

capable of being affected by the releases as Currency Conversion Claims and it would be burdensome for the Administrators and a cause of further delay to have to revisit such issues after the trial of Part B. The formulation of Issue 36 already includes reference to "*other non-provable claims*".

7. Wentworth agrees with the Administrators that the reformulation of Issue 34 does not require the parties to produce amended position papers.

Evidence that is admissible as an aid to construction

8. Issues 34 and 35 raise issues of the construction of the release provisions contained in the CRA and the CDDs.

9. The Court made clear, at the CMC on 21 November 2014, that evidence which goes beyond any relevant factual matrix evidence was inadmissible in relation to Issues 34 and 35. It is trite law that the subjective intentions of the parties are not admissible as an aid to construction.

10. In the event that there should be a dispute as to admissibility for the purpose of construing the CRA and the CDDs, Wentworth summarises the key relevant principles as follows:

    (1) In construing a commercial document, such as a CDD or the CRA, the starting point is the language used. The Court will also look at the particular factual matrix to determine how a reasonable person in the position of the parties would interpret the language. The question is what a reasonable person having all the background knowledge which would have been available to the parties would have understood the words to mean using the language in the contract: *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1998] 1 WLR 896, 912G-913E; *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101, at 1112.

    (2) The scope of that enquiry does not admit matters which a reasonable man would not have regarded as relevant to the way the document would have been understood: *BCCI v Ali* [2002] 1 AC 251, at 269

(3) Such background does not include evidence of the parties' respective subjective intentions, and, as matter of legal policy, does not include evidence of pre-contractual negotiations for the purpose of drawing inferences about what the contract meant: *A & J Inglis v John Buttery & Co* (1878) 3 App Cas 552, 577; *Prenn v Simmonds* [1971] 1 WLR 1381, 1384; and *Chartbrook Ltd v Persimmon Homes Ltd* [2009] 1 AC 1101, at 1115-21.

(4) Further, the parties to a contract cannot legitimately use as an aid to its construction anything which the parties said or did after it was made save where their conduct amounts to a variation of that contract: *James Miller & Partners v Whitworth Street Estates (Manchester) Ltd* [1970] AC 683, 603B-F.

11. Much of the evidence filed to date on behalf of the SCG is either inadmissible as a matter of law (because it is evidence of the subjective beliefs of particular creditors, or because it is evidence of facts subsequent to the execution of the relevant agreement or agreements), or creditor-specific, in the sense of referring to *ex post facto* conversations between particular creditors and the Administrators. A large amount of the evidence filed by the Administrators is similarly inadmissible. For example:

(1) The evidence filed by the SCG is replete with references to the subjective intentions of the deponent; the deponent's opinion on the effect of the release provisions in the CRA and the CDDs; and a description of ex-post facto statements that are said to have been made by Mr Copley. These matters are inadmissible on Issues 34 and 35.

(2) The Administrators' evidence includes evidence as to the development of the later versions of the CDDs; evidence of the subjective intentions of Mr Copley; and evidence of ex-post facto statements made by Mr Copley.

12. The intention in seeking the Court's decision on Issues 34 and 35 is that the decision will be at least highly persuasive (if not substantively binding) in respect of each CDD or CRA entered into between a creditor and the Administrators, except where there are facts peculiar to that creditor relevant and admissible on the question of construction which mean that the Court's decision could be distinguished.

13. In order to achieve that result, it is necessary that the precise ambit of the relevant and

admissible matrix of facts on which the Court's decision is based, is clearly identified. In that way, it will be easier for a creditor who might wish to contend that the decision is distinguishable to see whether its facts are materially different from those on which the court's decision was based.

14. Wentworth accordingly suggests that the parties are directed to produce an agreed statement of those facts contained in the evidence filed to date relevant to Issues 34 and 35 which are of general application to creditors and admissible as an aid to construction of the CRA and the CDDs. The argument, and the Court's conclusion, can then proceed on the basis of these facts alone.

Issue 36

15. The SCG has confirmed (by Freshfields' letter dated 27 February 2015) that questions of rectification, estoppel and mistake are fact sensitive and should not form part of the Part B hearing. Wentworth agrees.

16. The SCG nonetheless suggests retaining, as part of the Part B hearing, one aspect of Issue 36, namely whether the principle in *Ex parte James* (1874) LR 9 Ch App 609 applies such that the Court should direct that the Administrators should not be permitted to rely upon LBIE's strict legal rights in enforcing the contractual releases contained in the CRA and the CDDs. In response, the Administrators have proposed bifurcating Issue 36, so that Issue 36(A) contains this limited *ex parte James* point, with the remainder (Issue 36(B)) left for later determination.

17. Wentworth makes the following observations on the proposed Issue 36(A):

    (1) At the CMC on 21 November 2014, the Judge expressed the view that it would be better to deal with Issues 34 and 35 first and then, in the light of that, consider how to address Issue 36.

    (2) The rule in *Ex parte James* would require the relevant creditor to demonstrate dishonourable behaviour or a threat of dishonourable behaviour on the part of the Administrators, by taking an unfair advantage of the creditor. It is a discretionary

remedy which is necessarily heavily fact sensitive.

(3) Wentworth disagrees with Freshfields' characterisation of the evidence of the Administrators as being that they had no intention to release the claims which form the subject matter of Issues 34 and 35. It is clear from Mr Copley's statement that the Administrators did not at the time give any consideration to whether claims such as those which form the subject matter of Issues 34 and 35 existed at all (see, for example, paragraph 19 of Mr Copley's witness statement). Their positive intention to be gleaned from the express terms of the relevant CDDs was to waive *any* claim "*whether or not in the contemplation of the creditor and/or the company and/or the Administrators at the date hereof*".

(4) Wentworth moreover disagrees with the assertion by Freshfields that the Administrators had no proper reason to procure the release of the claims which form the subject matter of Issues 34 and 35. The Administrators' evidence in relation to the failed Scheme, the CRA and the CDDs makes clear that it was plainly in the interests of both LBIE and its creditors generally for the Administrators to enter into the various forms of compromises now at issue in Part B of the Application. The wide release, as part of any compromise, would ensure certainty and avoid potentially time consuming and expensive litigation of any other claims in the future.

(5) The fact that sophisticated parties with access to legal advice might not have been conscious in all respects of the meaning and effect of their agreement has never been a reason not to enforce the terms of that agreement as objectively construed.

(6) Moreover, there is nothing wrong or unfair in holding sophisticated creditors to the terms of their bargain, and that position is not altered because other creditors compromised their claims at a later stage pursuant to agreements which expressly preserved the claims which were released under the earlier versions of the CRA and the CDDs.

18. Nevertheless, Wentworth considers that the suggested bi-furcation of Issue 36 which the Administrators now propose may provide a means for the determination of the SCG's case on *ex parte James* at the Part B hearing. This is, however, subject to the following points:

(1) It is important that any directions for Issue 36(A) properly identify the scope of the issue: Wentworth understands that the case the SCG wish to advance at the Part B hearing is limited to whether the principle in *ex parte James* should preclude the Administrators from relying upon LBIE's strict legal rights in enforcing the contractual releases contained in CRA and the CDDs.

(2) Wentworth remains sceptical that even this issue can be determined at a generic level, given the discretionary and highly fact sensitive nature of the *ex parte James* remedy. Wentworth's agreement to any directions is without prejudice to its ability to contend, following the exchange of position papers, that there is in fact no issue that can be resolved at a general level at the Part B hearing.

(3) Moreover, any decision by the Court on this issue would necessarily have to be confined to the particular facts placed before it, and on the assumption that there was nothing else in the circumstances that would affect its decision on those facts. For similar reasons as set out above in relation to Issues 34 and 35, in order for any decision which the Court might reach on Issue 36(A) to be of wider use, it is important that the facts which the Court takes into account in reaching such decision are clearly identified, so that in any particular case it can be seen whether the circumstances existing as between the Administrators and the relevant creditor distinguish that case from any decision reached by the court on Issue 36(A).

(4) It is also important that the facts that are relied on by the Court in relation to Issue 36(A) are contained in a separate document from the facts it relies on in relation to Issues 34 and 35, so that the boundaries between the two are kept clear. The evidence for Issues 34 and 35 is now complete pursuant to the directions given at the CMC in November 2014. Any further evidence should be limited to such matters as are said to be relevant to Issue 36(A).

19. Wentworth set out the above position by letter dated 4 March and proposed the following directions for Issue 36(A):

(1) The SCG and York each produce by 24 March:

(a) A position paper in relation to Issue 36(A) articulating in detail why they contend, if the releases are held to be effective under Issues 34 and 35, that the principle in *ex parte James* should preclude the Administrators from relying upon LBIE's strict legal rights in enforcing such releases; and

(b) A statement setting out each and every relevant fact which is of general application to creditors and upon which they intend to rely in their arguments on Issue 36(A).

(2) Wentworth produces by 14 April 2015:

(a) A reply position paper in relation to Issue 36(A); and

(b) Comments on the facts which the SCG and York intend to rely upon in respect of Issue 36(A), noting those facts which Wentworth accepts and any additional facts of general application to creditors on which it intends to rely.

(3) The Administrators produce by 28 April 2015:

(a) (If so advised) a position paper on Issue 36(A); and

(b) A consolidated document identifying those facts of general application to creditors for Issue 36(A) on which the Respondents and the Administrators are in agreement.

20. Wentworth respectfully invites the Court to give these directions.

PART C

21. The Part C hearing comprises Issues 10 to 27. The following matters arise for consideration in relation to the Part C hearing:

(1) the listing of the Part C hearing and the amendment of the current timetable;

(2) the expert evidence to be filed for the Part C hearing:

(a) the expert evidence of foreign law;

(b) Wentworth's request for permission to adduce expert evidence as to the meaning of the term Default Rate in the ISDA Master Agreement; and

(c) the SCG's request for permission to adduce expert evidence on corporate finance theory and practice.

(3) the possibility of test cases; and

(4) the new sub-issue raised by the Administrators.

Listing Part C and amendment of the current timetable

22. The trial of Part C should be listed for the first available date after 1 October 2015. Following the fixture of that date, a revision to the timetable can be agreed for the filing of any evidence of fact and the exchange of expert evidence. At present, the timetable for Part C is unnecessarily front-loaded and will require substantial expert reports to be prepared and exchanged in April at a time when the parties' respective legal representatives are preparing for the trial of Part B.

Expert Evidence

23. The Court has to consider two questions when considering whether to grant permission to adduce expert evidence:

(1) Whether the evidence is admissible as expert evidence?

(2) Whether the Court should admit it as being relevant to any decision which the Court has to arrive at, that is, helpful to the Court for that purpose?

See *Barings plc v Coopers & Lybrand (No 2)* [2001] Lloyd's Rep Bank 85 at [44].

Expert evidence of foreign law

24. The Court directed, at the November CMC, that the parties have permission to adduce expert evidence of New York, German and French law. The Court further directed that the parties should take steps to agree the questions to be put to the experts.

25. The parties have, subject to the Court, agreed the formulation of the questions for the experts.

Wentworth's request for permission to adduce expert evidence as to the meaning of cost of funding in the banking derivatives market

26. The relevant issue is Issue 11. This raises the true construction of the phrase "*cost ... if it were to fund or of funding the relevant amount*" in the definition of Default Rate in the ISDA Master Agreement.

27. It is Wentworth's case, as set out at paragraph 71(1) of its Position Paper, that this phrase has a generally understood meaning among financial institutions that actively participate (whether as broker or dealer) in the derivatives markets:

> "In relation to Credit Institutions and Financial Institutions (which will be referred to generically as "banks" in the following sub-paragraphs):
>
> (1) The expression "*cost… if it were to fund… the relevant amount*" has a generally understood meaning in the banking derivatives market (i.e. among bank counterparties to ISDA Master Agreements), namely that it means the bank's own 'cost of funds'.
>
> (2) The phrase 'cost of funds' is 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.
>
> (3) A bank, whose business it is to lend and borrow money, will usually not fund a particular asset with a particular item of borrowing. On the contrary, it will regard any liability incurred as a proportionate part of its overall borrowing required to fund the whole of its asset base. Accordingly, the cost "*if it were to fund*" the relevant amount would not be the cost of the next incremental increase in its lending up to the value of the relevant amount, but would be the same as its 'cost of funds' as that term is defined above.

(4) In the rare case where a bank actually does go out and borrow funds to match the particular relevant amount for which its counterparty is in default, then Wentworth accepts that the "*cost… to… it… of funding the relevant amount*" would be the actual cost incurred (subject to the definition of 'cost' referred to in paragraph [69] of Wentworth's Position Paper).

(5) The fact that there is a generally understood meaning among banks as to the cost of funding is reflected in empirical evidence of the cost of funding which banks have generally claimed in the insolvency of various Lehman entities: see the witness statement of Robert Sabin Bingham exhibiting information compiled by Zolfo Cooper LLC as to the cost of funding claimed in respect of certain ISDA Master Agreement claims in relation to the insolvent estates of Lehman Brothers Holding Inc and Lehman Brothers Special Financing Inc.

(6) Wentworth will rely on expert evidence of banking practice in support of the above sub-paragraphs."

28. Accordingly, Wentworth seeks permission to adduce expert evidence as to the fact of that practice and understanding and its content.

29. It is respectfully submitted that it is appropriate to permit the parties to adduce expert evidence on this issue:

(1) The evidence is relevant to Issue 11 as it is evidence as to a market practice or understanding that Wentworth contends has been incorporated into the ISDA Master Agreement: see Phipson on Evidence 18th edition at 7-26 to 7-28 and 33-83.

(2) The fact that the parties might disagree as to the existence or content of a practice or understanding is not a reason to refuse permission to adduce expert evidence. If there is a disagreement on what a market practice or is, then the Judge must decide whether a particular market practice exists or not: *Crema v Cenkos Securities plc* [2010] EWCA Civ 1444 at [46].

(3) In the present case, the Court will require such evidence to provide guidance to the Administrators who will otherwise lack full directions to distribute the surplus. Many of LBIE's counterparties were banks and, as such, a market practice or understanding as between banks active in the derivative market will be relevant to a number of claims in the administration.

<u>The SCG's request for permission to adduce expert evidence of cost of funding as a matter of</u>

corporate finance theory and practice

30. Wentworth opposes the SCG's application for permission to adduce evidence of corporate finance theory and practice as regards the cost of funding. The SCG does not contend that such evidence amounts to a market practice or understanding as to the meaning of any of the relevant words in the ISDA Master Agreement.

31. The highest the SCG would appear to put its case as regards the relevance of such evidence is that adjudication upon one or other aspects of corporate finance practice or theory would identify *possible* methods by which a relevant payee might calculate and certify its cost of funding the relevant amount.

32. So put, the SCG's case does not justify adducing expert evidence:

    (1) The constraints upon a relevant payee's power to calculate and certify its cost of funding the relevant amount are:

        (a) the meaning of the words "*cost … if it were to fund or of funding the relevant amount*" within the definition of the Default Rate; and

        (b) the standard by which the power to certify is to be exercised. It is common ground that the standard is that of rationality and good faith.

    (2) The first constraint is a question of construction. The SCG does not advance any case in its position papers that expert evidence of corporate finance theory and practice is relevant to construction.

    (3) To the extent that the SCG contends that particular methods of calculation are within the meaning of the words properly so construed, such methods are adequately described in the exhibit to Mr McKee's statement. Indeed, that was the objective pursuant to which that statement was filed, as recorded in **McKee 3, paragraph 3** ("*evidence explaining **the basis or bases** upon which they or their affiliates consider that they are entitled to advance, for payment pursuant to Rule 2.88(7) of the Insolvency Rules 1986, actual claims to interest at a rate in excess of the Judgments*

Act Rate, together with ***sufficient particulars to substantiate such claims*** *to interest"* (emphasis added)). Expert evidence of corporate finance theory and practice will not assist the court in adjudicating whether either of these bases are within the meaning of the words in the definition of Default Rate.

(4) In the latest draft of the proposed question for 'cost of funding' experts provided by the SCG on 6 March 2015, it is proposed to ask the experts whether various matters are within the scope of "cost … if it were to fund or of funding". That is a question, however, of interpretation, which is for the Court and not an expert witness to determine.

(5) The second constraint – the applicable standard – is fact specific in its application. It is not possible, at a generic level, to define what method of calculation would either satisfy, or fail, that test, since it depends upon the circumstances peculiar to each relevant payee.

33. Accordingly, Wentworth respectfully submits that the SCG has not met the requisite threshold to adduce expert evidence on cost of funding as a matter of corporate finance theory and practice.

34. Moreover, it is to be noted that the suggested scope of expert evidence relating to corporate finance is so wide ranging as to admit of no sensible limitation by the Court: the questions proposed by the SCG extend to all the ways in which a company or fund might incur cost in funding a particular receivable, the ways in which corporate finance theory and practice would enable such cost to be calculated, including the theoretical justification for any such calculation. Admission of such evidence would be likely to result in the litigation of Part C becoming unwieldy as well as unproductive.

The utility of a test case or test cases

35. As explained above, it is unlikely to be a fruitful exercise for the Court to determine whether a particular methodology for calculating cost of funding is within, or outside, the test, at a general level, because it will invariably depend on the particular circumstances of the relevant payee.

36. In these circumstances, but cognizant of the fact that it is in the parties' interests that effective guidance from the Court is obtained so far as possible on the questions raised, Wentworth considers that it would be most helpful for the parties to identify a selection of 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.

37. Accordingly, Wentworth invites the Administrators and the Court to give consideration to inviting certain creditors from within the SCG group to submit a certificate of their cost of funding, with a view to reaching agreement between the parties as to the selection of a representative test case or cases. Although it is unlikely that the circumstances of any two cases will be precisely the same, Wentworth anticipates that, with an appropriate selection of test cases, the Court's conclusions on them will provide guidance across a large number of claims in the estate.

OTHER ISSUES

Issues 31-33

38. Issues 31-33 were originally scheduled to be determined as part of the Part A hearing. They were adjourned for further consideration at this CMC.

39. Wentworth has set out its position at paragraphs 229 to 230 of its skeleton argument for the Part A hearing on Issue 31 and how it should be determined in this Application. Wentworth understands that Issue 31 is of wide application and thus of material significance in the context of LBIE's administration. It is, however, for the Administrators to confirm whether this issue does, in fact, arise in respect of a sufficient number of claims across the LBIE estate such that it should be determined in the current proceedings. Wentworth awaits the Administrators' considered views on this question.

40. Wentworth is content for the Administrators to notify the Court that Issue 32 is no longer to form part of the Application because it is fact sensitive.

41. So far as Issue 33 is concerned, although Wentworth continues to believe that there are examples of cases where the holder of a claim denominated in a foreign currency has

assigned to an assignee merely the right to prove in respect of that claim and not ant non-provable Currency Conversion Claim, it has been unable, bearing in mind issues of confidentiality, to identify an example. Accordingly, Wentworth accepts that Issue 33 can be removed from the application. Wentworth notes, however, that as and when non-provable claims are submitted, the Administrators should be careful to ensure that (a) insofar as the claim is pursued by an assignee of the original creditor, the right to assert the non-provable claim has been assigned; and (b) if a non-provable claim is asserted by an original creditor, such creditor has not entered into an assignor letter (as referred to at paragraph 235 of Wentworth's skeleton argument for the trial of Part A) and thus waived any such claim. If, after the Court's conclusions in respect of Issues 34-36, there remains in any case doubt about the effect of an assignor letter on a non-provable claim which was not effectively assigned, then such case may have to be referred to the Court for determination.

Issues in Part A requiring further submissions

42. Wentworth does not consider that there are any additional sub-issues to be considered at the CMC unless the Judge invites oral submissions on, for example, the sub-issue relating to calendar years in respect of Issue 1 from York and the Joint Administrators. Wentworth note the Joint Administrators intend to file some further short submissions on this point and have no objection to this.

43. In relation to Issue 37, Wentworth understands that Linklaters will provide draft directions for the consideration of the parties in advance of the CMC which are based on the agreed position as set out at paragraphs 230 to 232 of the Administrators' skeleton argument for the Part A hearing.

44. In relation to the application of *Sempra Metals* to Issue 39, in light of the Judge's comments on day seven of the hearing, Wentworth do not consider further submissions are necessary, unless the Court should positively invite further submissions.

CONCLUSION

45. The Court is respectfully invited to grant the directions proposed by Wentworth.

ANTONY ZACAROLI QC

DAVID ALLISON QC

ADAM AL ATTAR

SOUTH SQUARE

6 MARCH 2015