Waterfall II Application

No 7942 of 2008

IN THE HIGH COURT OF JUSTICE

CHANCERY DIVISION

COMPANIES COURT

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

(1) ANTHONY VICTOR LOMAS

(2) STEVEN ANTHONY PEARSON

(3) PAUL DAVID COPLEY

(4) RUSSELL DOWNS

(5) JULIAN GUY PARR

(as the joint administrators of the above named company)

Applicants

- and -

(1) BURLINGTON LOAN MANAGEMENT LIMITED

(2) CVI GVF (LUX) MASTER S.À R.L

(3) HUTCHINSON INVESTORS LLC

(4) WENTWORTH SONS SUB-DEBT S.À R.L

(5) YORK GLOBAL FINANCE BDH, LLC

Respondents

- and -

GOLDMAN SACHS INTERNATIONAL

Applicant

SKELETON ARGUMENT ON BEHALF OF THE FOURTH RESPONDENT

Suggested pre-reading: the parties' written submissions; the witness statements of John Kelly (**"Kelly 1"**) **[A/5]** dated 8 May 2015 and Johannes Weber dated 18 June 2015 (**"Weber 1"**) **[A/6A]**

1. These submissions are filed by the Fourth Respondent ("**Wentworth**") in response to the application for joinder issued by Goldman Sachs International ("**GSI**"). Wentworth does not agree to the joinder of GSI to the trial of Part C of the Application, which concerns the various cost of funding issues, because:

   (1) GSI has not identified any new issue which requires it to be joined; and

   (2) GSI has not identified any arguments it would advance at trial not duplicative of the arguments to be advanced by the Senior Creditor Group ("**SCG**").

2. Wentworth has requested that GSI address the above points on a number of occasions, as set out below. GSI has failed to do so. In the absence of such explanation, Wentworth does not agree that GSI has made out a case for joinder under CPR r 19.2.

3. CPR r 19.2(2) permits joinder where it is desirable to resolve all matters in dispute or where there is an issue between the new party and the existing party which makes joinder desirable to resolve that issue.

4. In terms of the trial of Part C of the Application, GSI must accordingly identify a new issue to be resolved relevant to the distribution of the surplus, or it must otherwise identify an argument in relation to the existing issues that is it not merely duplicative of the arguments to be advanced by the SCG. Absent identification of such, the joinder of GSI will necessarily add to the litigation only in terms of time and costs and without any desirable benefit.

5. Issues 11-12 as currently formulated were settled on the basis of the arguments which the SCG wishes to advance as to the construction of the definition of Default Rate in the ISDA Master Agreement. The SCG reformulated the issues on the basis of the various sources of funding and bases upon which the cost of funding might be measured articulated in the report exhibited to Mr McKee's third witness statement (**"McKee 3"**). GSI accepts in its skeleton argument that no new issue needs to be introduced. Thus it is not being suggested by GSI that it intends to rely upon any different basis of calculation or source of funding, other than those which are already

relied on by the SCG. GSI has, in particular, not identified any position on the issues that is different from that of the SCG.

6. The SCG is motivated to pursue such arguments, in relation to Issues 11-12, that would maximise the rates of interest that could be certified by counterparties, so that the "*rate apart from administration*" within the meaning of Rule 2.88(9) is greater than the Judgments Act rate. It is to be expected, therefore, that the SCG will advance any and all available arguments as to the construction of the definition of Default Rate, which would achieve that end. GSI's presence is accordingly not required in order to ensure that relevant arguments are made in support of that position.

7. Wentworth has repeatedly asked GSI to identify any new issue and any non-duplicative arguments which GSI wishes to advance at the trial of Part C: see Weber 1/9 **[A/6A]** and JW1/10-14 **[A/6B]** and the letters from Kirkland & Ellis International LLP dated, 6 May, 27 May, 8 June and 16 June 2015. Neither GSI nor its solicitors, Cleary Gottlieb Steen & Hamilton LLP, has provided any substantive response.

8. Kelly 1 merely states:

> "*In particular, Goldman Sachs wishes to address the specific and limited question of whether the definition of Default Rate encompasses all sources of funding, including equity, rather than being restricted to the cost of borrowing*": Kelly 1/8

9. Whether the cost of funding language in the ISDA Master Agreement is confined to the cost of borrowing and, if not, whether it includes the cost of equity is already in dispute between Wentworth and the SCG: see paragraph 11 of the SCG's position paper **[A/7]** and paragraphs 15 and 19 of the report exhibited by McKee 3 **[B/12]**.

10. Further GSI has not identified any non-duplicative arguments which would bear on that issue or other issues. GSI's evidence simply says:

> "*In particular, Goldman Sachs is concerned that Financial Institutions be entitled to recover their cost of funding the relevant amounts, including costs incurred through equity funding.*
>
> ...

In particular, Financial Institutions are compelled by regulation and/or the market to fund their assets with a portion of equity, and in some cases they may be compelled to respond to losses by raising additional equity, or may simply deem it prudent to do so

…

Goldman Sachs is well placed to put relevant factual evidence before the court on the importance of equity finance to Financial Institutions, which forms part of the factual matrix that must be considered in interpreting the definition of "Default Rate". Likewise, Goldman Sachs is well placed to assist the court in understanding the conditions applying to Financial Institutions in the 1990s and 2000s when the ISDA Master Agreements between LBIE and Financial Institutions were concluded and at the time when the LBIE default occurred.": Kelly 1/11, 11A and 12B **[A/5]**

11. None of this is relevant to any question of construction of the ISDA Master Agreement:

    (1) There is no connection between the evidence described in Kelly 1 and the construction of the ISDA Master Agreement:

        (a) The ISDA Master Agreement does not apply only to Financial Institutions.

        (b) GSI does not contend that the definition of Default Rate is to be construed differently insofar as it applies to Financial Institutions.

        (c) The dealings between a particular Financial Institution, such as GSI, and LBIE, and especially post-default dealings, cannot inform the construction of the Default Rate, the language of which is standard.

        (d) GSI does not identify any market practice as regards Financial Institutions concerning the ISDA Master Agreement as might connect a practice notorious to them to the construction of that agreement. That was the only basis upon which Wentworth did (and could have) formerly pursued an argument specific to Financial Institutions. GSI does not make any such connection between any evidence it wishes to adduce and the questions of construction for the Court.

(2) The evidence described in Kelly 1 moreover neither identifies nor suggests any non-duplicative argument. It in fact suggests that equity might be raised for many reasons unconnected with any default under the ISDA Master Agreement. Kelly 1 goes so far as to describe equity issued in response to "*the market*" or simply because it is "*prudent*".

(3) The fact that GSI is a regulated bank that routinely uses the ISDA Master Agreement does not bear on the question of construction and, of itself, provides no sufficient interest for joinder. Were GSI to be joined simply because it is a routine user of a standard agreement then any bank could, in theory, seek to join in any litigation related to the ISDA Master Agreement because the construction of that agreement will foreseeably affect its use of that agreement. That is however simply a consequence of the litigation of a standard form contract.

12. To the extent that GSI contends that its presence is necessary in order to ensure that a different perspective – i.e. that of a Financial Institution – is presented on the construction arguments that will otherwise be advanced by the SCG, the premise of that contention is that such perspective is one which supports a construction of the cost of funding language as might permit a claim to Statutory Interest in excess of 8%. Wentworth has, however, identified publically available financial information which suggests that GSI does not in fact share such "perspective". As set out in Weber 1 **[A/6A]**:

(1) GSI has filed claims in the estates of LBHI (as guarantor of a claim against LBIE under an ISDA Master Agreement) and LBSF which indicate that its cost of funding was approximately 0.07% and 3.78% as asserted by the respective claims. The claims submitted were not on the basis of the Default Rate but on the basis of the Termination Rate. However, as regards the costs of funding language, the Termination Rate is identical to the Default Rate save that it does not add 1%. Even with the addition of 1%, GSI's cost of funding as in fact claimed is nowhere near the threshold, which allowing for compounding, would exceed 8% under the Judgments Act over the relevant period. The threshold is about 6.6% compounded daily.

(2) GSI's low cost of funding claimed from LBHI and LBSF is unsurprising:

(a) It is in accordance with its costs of funding as stated by S&P Capital IQ which:

(i) in the period Q3 2008 to Q1 2015, did not exceed 3.1% (using the quarterly chart); and

(ii) in the period 2008 to 2015 did not exceed 3.2% in 2008 (using the annual chart) and was for most of this period below 1%.

(b) It is also in accordance with the conversion of GSI's parent, GSGI, to a "bank holding company" after the collapse of Lehman Brothers, which allowed GSGI and GSI to access cheap funding from the Federal Reserve Bank of New York, as stated in GSGI's press release and the Federal Reserve's press release both dated 21 September 2008. There were a number of facilities available, for example:

(i) the primary credit facility for depositary institutions allowed borrowing at rates between 2.25% and 0.5% in the period 15 September 2008 to February 2010, with the rate being 0.75% thereafter;

(ii) the primary dealer credit facility ("**PDCF**") allowed borrowing at rates between 2.25% and 0.5% in the period 15 September 2008 to 18 February 2010; and

(iii) the single-tranche term repurchase programme allowed borrowing via a series of repo transaction at rates that range between 1.10% and 0.01%.

13. The entirety of the amounts borrowed by GSGI and GSI and other affiliates is not known to Wentworth. The amounts, dates and rates borrowed under the repurchase programme are exhibited at JW1/55 **[A/6B]**: in the period October to December 2008, GSGI and GSI borrowed a sum of about US$41bn at rates of between 1.10% to 0.01%.

14. On 16 June 2015, Kirkland & Ellis wrote to Cleary Gottlieb explaining Wentworth's concerns as to GSI's suitability to be joined in the light of its very low cost of funding: JW1/10-12 **[A/6B]**. As at the date of filing this skeleton, no response has been received from Cleary Gottlieb or GSI.

15. For these reasons Wentworth is not in a position to agree to the joinder of GSI which has, despite repeat requests, failed to identify an issue, argument or perspective which would make its joinder desirable.

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19 June 2015

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