Introduction

1. This note has been prepared by the Administrators of Lehman Brothers International (Europe) ("**LBIE**") (the "**Administrators**") to inform creditors as to the approach the Administrators are taking in respect of the matters which have, until now, been before the Court as Issue 37 of the Waterfall II Application (the "**Application**").

2. The matters with which Issue 37 was concerned are of particular practical importance to the Administrators since they arise in a significant number of cases where a CDD (or any other agreement pursuant to which an unsecured claim is agreed or admitted) comprises a number of claims.

3. Issue 37, which was included as part of Tranche A of the Application, was covered fully in the parties' skeleton arguments before the Court. However, it was only addressed cursorily in the course of oral submissions during the Tranche A hearing. Accordingly, in order to assist the Court, the parties to the Application sought to agree what was the correct legal and practical approach to Issue 37. Specifically, the parties sought to agree a "Note on Issue 37" with an accompanying draft order which the Court could make if it was satisfied with the position as agreed among the parties.

4. It has not been possible to reach agreement among the parties to the Application as to the precise terms of the Note on Issue 37 and accompanying order to be put before the Court. However the process has nonetheless assisted the Administrators in finalising the approach they ought to take in the circumstances with which Issue 37 is concerned.

5. This note sets out the following matters:

    (1) What the relevant Issue and sub-issues are;

    (2) What the Administrators consider the answers to the Issue and sub-issues are; and

    (3) the approach the Administrators are taking in the circumstances with which Issue 37 is concerned.

Issue 37

(a) The Issue and sub-issues

6. In broad terms, Issue 37 arises where a creditor and LBIE entered into a CDD (or other agreement with similar effect) and:

(1) The CDD compromised a number of underlying claims (as set out in the creditor's proof of debt); and

(2) The CDD did not record the extent to which and how the amount of the claim admitted by the CDD (the "**Agreed Claim**") derived from the underlying claims.

7. The Administrators have, as part of the Waterfall II proceedings, filed evidence to illustrate the kinds of context in which Issue 37 arises. See Section K of Mr Lomas's 11th witness statement.

8. Issue 37 was set out in the Application as follows[1]:

> *How are claims to be calculated where a CDD (or any other agreement pursuant to which an unsecured claim is agreed or admitted) compromises a number of claims, with differing rates of interest applicable or in different currencies, without indicating how the agreed or admitted claim amount in the CDD (or any other agreement) derives from and relates to those underlying claims?*

9. Further, at paragraph 74 of Lomas 11 two additional sub-issues were identified, namely:

(1) Where an Agreed Claim amount reflects the existence of an underlying receivable owing from the creditor to LBIE (which has therefore been set off against the creditor's claims against LBIE), at what date and against which underlying component(s) of the claim that receivable is to be treated as having been set off; and

(2) Where an Agreed Claim amount included (or may have included) an amount of client money and that part of the claim has been assigned by the creditor to Laurifer (the company set up for the purpose by LBIE), how the assignment affects the attribution of the Agreed Claim amount across the remaining elements of the claim.

10. The Administrators consider that the answer to the main issue arising under Issue 37, being how, for the purposes of calculating non-provable claims and/or claims to statutory interest, the Administrators are to determine which of a creditor's multiple

[1] The question of whether the comparison required for the purposes of Rule 2.88(9) is to be performed for each underlying component claim or across all claims is addressed at paragraphs 15 to 18 of the Note on Agreed Issues in relation to Tranche A of the Waterfall II Application.

underlying claims were admitted, and in what proportions they were admitted, under a CDD or other agreement, is as follows[2]:

(1) Where (on an objective analysis) the Administrators and that creditor have agreed which of the latter's underlying claims are admitted under a CDD or other relevant agreement and in what proportions they were admitted, then their agreement prevails in establishing how the Agreed Claim amount derives from and relates to those underlying claims.

(2) Where no such agreement has been concluded between the Administrators and a creditor, the Agreed Claim amount is to be disaggregated based upon what claims the Administrators did in fact admit and in what proportions they admitted them, to be determined by reference to relevant information as described at paragraph 15(3) below.

(3) Where it is not possible, on the basis of the Administrators' records and other available relevant information, to determine what claims the Administrators did in fact admit and in what proportions they admitted them, the Agreed Claim amount is to be disaggregated:

a. where the Agreed Claim amount is less than the total value of the claims set out in the creditor's proof of debt, *pro rata* by reference to the underlying claims set out in the creditor's proof of debt (save for any elements in that proof of debt which are obvious errors or relate to non-provable amounts including trust claims, which are to be ignored for this purpose); and

b. where the Agreed Claim amount is the same as the total value of the claim set out in the creditor's proof of debt, by reference to the underlying claims set out in the creditor's proof of debt.

11. Further, the Administrators consider that the same analysis as set out at sub-paragraphs (1) to (3) of the paragraph above is also applicable where the Administrators admitted, otherwise than by way of a CDD (or other agreement), an unsecured claim which compromised a number of claims, with differing rates of interest applicable or in different currencies, without indicating how the amount of the claim derives from and relates to those multiple underlying claims.

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[2] Although Issue 37 as set out in the Application (see paragraph 9 above) asks a broader question, the Administrators now consider that the precise issue on which the Court's guidance was required is how, for the purposes of calculating non-provable claims and claims to statutory interest, the Administrators are to determine which of a creditor's multiple underlying claims were admitted, and in what proportions they admitted them, under a CDD or other agreement.

12. The Administrators consider that the answers to the two sub-issues arising under Issue 37, as identified at paragraph 9 above, are as follows:

(1) Where an Agreed Claim amount reflects the existence of an underlying receivable owing from the creditor to LBIE (which has therefore been set off against the creditor's claims against LBIE):

a) set-off, in accordance with Rule 2.85(3) of the Insolvency Rules 1986 (the "**Rules**"), applies[3]:

i. as at the date on which the notice of intention to distribute was given under Rule 2.95 of the Rules; and

ii. *pro rata* across all of an original creditor's admitted claims (as determined in accordance with paragraph 10 above)[4]; and

b) where the set-off is applied against a sum owed to or by a creditor in a foreign currency, the foreign currency claim and the foreign currency receivable (as applicable) are converted into sterling at the exchange rate prevailing on the date on which LBIE entered into administration.

(2) Where an Agreed Claim amount included (or may have included) an amount of client money and that part of the claim has been assigned by the creditor to Laurifer (the company set up for the purpose by LBIE), the attribution of the Agreed Claim amount across the remaining elements of the claim is to be determined on the basis of the approach set out at paragraph 10 above.

13. The Administrators' approach to disaggregation of claims and calculation of creditors' entitlements arising from such disaggregation, as set out in paragraphs 10 and 11 above, will also apply (insofar as relevant) to the calculation of the effect of set-off in accordance with paragraph 12 above.

14. The Administrators have sent to creditors unsecured claim certificates setting out the Administrators' calculation – on the basis of the approach set out in paragraphs 10 to 13 above – of the disaggregation of each creditor's Agreed Claim amount ("**UCCs**"). Those statements will, subject to what follows, form the basis for the Administrators' distribution of the surplus in respect of Statutory Interest and non-provable claims.

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[3] Subject to the application (where relevant) of netting arrangements under the Financial Collateral Arrangements (No. 2 Regulations 2003 ("**FCARs**")

[4] The Administrators are aware of certain cases in which *pro rata* set off was applied across the claims admitted by a CDD or similar agreement, but the creditor later had a further claim admitted (with the result that it was not in practice possible to recalculate, if relevant, the impact of set-off in the original CDD or similar agreement). In some such cases, the relevant admitted claims are no longer all held by a single creditor. The Administrators intend to deal with queries arising from such circumstances under the process set out at paragraph 15.

15. The Administrators recognise that some creditors may have questions on, or ultimately wish to challenge, the Administrators' calculations. However, the Administrators are concerned to ensure that the process of determining creditors' claims and, for that purpose, assessing the constituent elements of their claims, is as efficient as possible and does not result in undue uncertainty, dispute or delay. Accordingly, the Administrators intend to proceed as follows:

(1) The Administrators have sent to each creditor UCCs setting out the Administrators' calculation of the constituent elements making up the creditor's Agreed Claim. That calculation follows the approach set out in paragraphs 10 to 13 above.

(2) Creditors have been invited to comment upon and will in time be invited to agree the UCCs. Where the creditor agrees the UCCs, the Administrators will make distributions (in due course and subject to the outcome of the remaining part of this Application, any appeals in respect of this Application or the Waterfall I application and any further directions sought from the Court) of the surplus in accordance with those agreed UCCs.

(3) Where the creditor disagrees with (or has questions on) the calculations set out in the UCCs and/or their impact on its claim(s), it should provide any material it considers is relevant to the proper disaggregation of its Agreed Claim in accordance with the approach in paragraphs 10 to 13 above. The Administrators will review the material submitted in support of the creditor's views, although only insofar as such material, or relevant information recorded in it, at the time of the admission of the creditor's claim, (i) had been provided by the creditor or (ii) was otherwise available to the Administrators in respect of the Agreed Claim. It is important to limit the material that is considered relevant to that which properly goes to whether the UCCs have been compiled correctly in accordance with the approach set out in paragraphs 10 to 13 above. It should not be open to a creditor in the context of this process to seek to argue that its claim should be admitted in a different total amount (not least given that the Agreed Claim is ordinarily recorded in a CDD), nor that the Administrators, where they in fact admitted a claim on the basis of particular constituent sums making up the claim, should in fact have decided to admit different claims[5].

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[5] The Administrators accept that there may be instances, for instance in the small minority of cases where an admitted claim was not agreed by way of CDD or other agreement, where the creditor might seek later to increase its claim or otherwise vary its proof (see Insolvency Rules 1986, rr.2.79 and 2.101). The approach set out in this note is not intended to cut across the extent (if any) to which the creditor's proof, or the different claims making up the proof might, in such instance, fall to be considered.

(4) Following review and consideration of any relevant material (as set out above), the Administrators will make such amendments to the UCCs as, in the reasonable view of the Administrators, are required to correct any error contained in the latest version provided to the creditor, and provide a revised version thereof to the creditor.

(5) It is the Administrators' hope and expectation that the process outlined above will lead to agreement on the disaggregation of creditors' Agreed Claims. Insofar as agreement cannot be reached or disputes over the proper calculation of the constituent elements arise, the Administrators accept that such disputes may need to be resolved.