



Neutral Citation Number: [2010] EWHC 3372 (Ch)

Case No: 7942 of 2008

IN THE
HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

Royal Courts of Justice
Strand, London, WC2A 2LL
Date: 21/12/2010

Before:

MR JUSTICE BRIGGS

Between:

- (1) ANTONY VICTOR LOMAS
- (2) STEVEN ANTHONY PEARSON
- (3) MICHAEL JOHN ANDREW JERVIS
- (4) DAN YORAM SCHWARZMANN
- (5) DERECK ANTHONY HOWELL

(together the Joint Administrators of Lehman Brothers International
(Europe) (in administration))

Applicants

- and -

- (1) JFB FIRTH RIXSON, INC
- (2) FR ACQUISITIONS CORPORATION (EUROPE) LIMITED
- (3) BEIG MIDCO LIMITED
- (4) KP GERMANY ZWEITE GMBH

Respondents

-and-

**THE INTERNATIONAL SWAPS AND DERIVATIVES ASSOCIATION
INC.**

Intervenor

Mr William Trower QC and Mr Daniel Bayfield (instructed by **Linklaters LLP**) for the Administrators
Mr Mark Haggood QC and Mr Henry Forbes Smith (instructed by **Macfarlanes**) for the First and Second Respondents
Mr Robin Dicker QC and Ms Joanna Perkins (instructed by **Clifford Chance**) for the Third Respondent
Mr Richard Fisher (instructed by **Freshfields Bruckhaus Deringer LLP**) for the Fourth Respondent
Mr Antony Zacaroli QC and Mr Jeremy Goldring (instructed by **Allen & Overy LLP**) for the Intervenor

Hearing dates: 6th – 9th December 2010

Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

.....

Mr Justice Briggs

Mr Justice Briggs :

1. This is an application by the Joint Administrators of Lehman Brothers International Europe (“LBIE”) for directions as to the true construction and effect of five interest rate swap agreements (“the Swaps”) pursuant to which LBIE was, when it went into administration on 15th September 2008, the floating rate payer. Each Swap incorporated the terms of one or the other of the 1992 or 2002 versions of the ISDA Master Agreement (“the Master Agreement”), pursuant to which LBIE’s entry into administration was an Event of Default as therein defined.
2. LBIE’s fixed rate paying counterparties under each of the Swaps have since that date relied upon Section 2(a)(iii) of the Master Agreement as the basis for a refusal to make payments which would otherwise have fallen due to LBIE on subsequent payment dates. Section 2(a)(iii) provides that a party’s payment obligations are subject (*inter alia*) to the condition precedent that there is no continuing Event of Default with respect to the other party.
3. As at 15th September 2008 LBIE was “in the money” in relation to two of the five Swaps, both denominated in US dollars. In relation to the remaining three (denominated in sterling or euros), LBIE was on that date out of the money. Due to a substantial fall in the relevant floating interest rates thereafter, LBIE would have been, but for the Event of Default, very substantially in the money under all five Swaps from about the end of 2008 until now, and it appears very likely that LBIE would have continued to be substantially in the money, in relation to those Swaps which have yet to reach the end of their term, for a significant further period. By “in the money” I mean that, because on any particular payment date the floating rate payable by LBIE was less than the fixed rate payable by the counterparty, a net sum was (or but for the Event of Default would have been) payable on that date by the counterparty to LBIE, pursuant to netting provisions in Section 2(c) of the Master Agreement.
4. The Administrators calculate that, if their Swap counterparties are entitled to refuse to pay as they have done, then LBIE’s creditors will by reason of the Event of Default constituted by LBIE’s going into administration be worse off, in relation to these five Swaps alone, by the aggregate of approximately £20.6 million, US\$57.3 million and €5.3 million. Noting in passing that the interpretation of the Master Agreement relied upon by its counterparties under these Swaps has not been pursued by any of LBIE’s other counterparties under the thousands of other swaps open as at the onset of its administration, the Administrators challenge these counterparties’ interpretation of the Master Agreement under four broad headings. First, they submit that it is a commercially absurd or at least unreasonable interpretation which must therefore yield to implied terms to the contrary, for which they advance three alternatives. Secondly, the Administrators submit that, if the Master Agreement means what the counterparties assert, then it offends against the anti-deprivation principle, because its adverse effects upon LBIE and its creditors are triggered by the onset of LBIE’s administration. Thirdly, they assert that the counterparties’ interpretation gives rise to a penalty. Finally, they assert that it constitutes a forfeiture, against which the court can and should grant relief.
5. In order to obtain a speedy determination of the issues raised by those alternative allegations, all of which are matters of law which arise upon substantially agreed

facts, the Administrators have applied for directions under paragraph 63 of Schedule B1 of the Insolvency Act 1986, and joined each of the Swap counterparties as respondents. In addition, the International Swaps and Derivatives Association Inc. (“ISDA”) has sought and been permitted to intervene, out of an understandable concern that any decision on this application about the interpretation of the Master Agreement may have potentially wide-ranging implications for the derivatives markets generally, in which the Master Agreement is an extremely widely used standard form. ISDA claims (and it is not challenged) that the Master Agreement serves as the contractual foundation for more than 90% of over-the-counter derivatives transactions globally.

THE FACTS

6. Although the outcome of this application is not fact specific, and the facts are largely agreed, it is necessary to provide an outline of the factual background in order to make intelligible both the arguments and my determination of the issues.

ISDA and the Master Agreement

7. ISDA is a not-for-profit corporation incorporated in the state of New York, having been formed in 1985, shortly after the emergence of a recognised derivatives market. It has over 820 member institutions, including most of the world’s major institutions that deal in OTC derivatives, as well as businesses, government entities and other end users that rely on derivatives to manage the risks inherent in their core economic activities. Its primary purpose is to encourage the prudent and efficient development of privately negotiated derivatives business. For that purpose it has developed standard contractual wording and transaction architecture for market participants. This first occurred, historically, in relation to swaps. Since 1992 its standard terms have been used for numerous other types of derivatives, including pure contracts for differences, caps and floors. Thus, interest rate swaps are a sub-class of an original and still very important class of derivatives for which ISDA’s standard forms, and the Master Agreement in particular, are routinely used.
8. The 1992 version of the Master Agreement was the first to be designed in a form applicable to derivatives other than just swaps, and to accommodate both financially and physically settled transactions. The 2002 Master Agreement replicates, for the most part word for word, the provisions of the 1992 version, but with adjustments based upon lessons learnt since 1992, in particular from experience of periods of market turmoil in the late 1990s. Nonetheless, the publication of the 2002 Master Agreement did not lead to its invariable use in preference to its predecessor. For example, three of the five Swaps presently in issue incorporated the 1992 version, although all five were entered into in and after 2006. Generally speaking, it appears that the continued use of the 1992 version may have been more the result of comfortable familiarity than a specific preference based upon a detailed comparison between the two. In this judgment I shall base myself upon the 1992 version, save where different provisions in the 2002 version require specific treatment.
9. As expressly contemplated in its recital, the Master Agreement is designed to operate between its parties by providing contractually agreed standard terms and conditions designed to form part, but not the whole, of the terms of any particular transaction. Thus, a particular transaction is generally governed by the terms of a Confirmation,

the Master Agreement and any Schedule appended to the Master Agreement. By Section 1(b) of the Master Agreement, inconsistencies are to be resolved by affording priority first to the Confirmation, secondly to the Schedule and lastly to the Master Agreement itself. In practice, parties which are content with the Master Agreement may choose not to incorporate a Schedule, but every transaction will be the subject of a Confirmation.

10. In relation at least to interest rate swaps, each Confirmation will identify a series of dates upon which the parties are or may be obliged to make payments to each other, and will contain the formulae necessary to identify the amounts to be paid. The fixed rate payable will simply be specified. The floating rate will generally be identified by reference to a particular market formula, such as three months sterling LIBOR.
11. Section 2 of the Master Agreement headed "Obligations" then provides as follows:

“(a) *General Conditions*

(i) Each party will make each payment or delivery specified in each Confirmation to be made by it, subject to the other provisions of this Agreement.

(ii) Payments under this Agreement will be made on the due date for value on that date in the place of the account specified in the relevant Confirmation or otherwise pursuant to this Agreement, ...

(iii) Each obligation of each party under Section 2(a)(i) is subject to (1) the condition precedent that no Event of Default or Potential Event of Default with respect to the other party has occurred and is continuing, (2) the condition precedent that no Early Termination Date in respect of the relevant transaction has occurred or been effectively designated and (3) each other applicable condition precedent specified in this Agreement.

(b) ...

(c) *Netting*. If on any date amounts would otherwise be payable:-

(i) in the same currency; and

(ii) in respect of the same Transaction,

by each party to the other, then, on such date, each party's obligation to make payment of any such amount will be automatically satisfied and discharged and, if the aggregate amount that would otherwise have been payable by one party exceeds the aggregate amount that would otherwise have been payable by the other party, replaced by an obligation upon the party by whom the larger aggregate amount would have been

payable to pay to the other party the excess of the larger aggregate amount over the smaller aggregate amount.”

There follows provision for netting across multiple Transactions, where the parties so elect. No such elections were made in relation to any of the Swaps.

12. The phrase “Event of Default” is defined in Section 5(a) of the Master Agreement, although the definitions clause in Section 14 contemplates that it may be altered or added to by the Schedule (if any). Section 5(a) sets out eight separate classes of default, under the general heading:

“Events of Default. The occurrence at any time with respect to a party or, if applicable, any Credit Support Provider of such party or any Specified Entity of such party of any of the following events constitutes an event of default (an “Event of Default”) with respect to such party:—”

The eight classes include failure to pay (or to deliver), breach of the agreement, Credit Support Default (see below), misrepresentation, and, most importantly, Bankruptcy.

13. Section 5(a)(vii) provides no less than nine separate classes of Bankruptcy Event of Default, and the opening words provide that Bankruptcy is an Event of Default suffered either by a party, or by a Credit Support Provider of a party. Class (6) arises where the party (or its Credit Support Provider):

“Seeks or becomes subject to the appointment of an administrator, provisional liquidator, conservator, receiver, trustee, custodian or other similar official for it or for all or substantially all of its assets;”

It is common ground that going into Chapter 11 Bankruptcy in the USA is also a Bankruptcy Event of Default. By Section 14, “Credit Support Provider” is an expression which takes on meaning only from a Schedule. I shall return to its meaning when setting out the terms of the single Swap with a Schedule which included such a provision.

14. A number of the Events of Default in Section 5(a) are defined so as to occur only after the combination of a relevant happening (such as non-payment or some other breach) and the giving of notice by the Non-defaulting Party, followed by the passing of a further specified period of time. Thus, for example, Section 5(a)(i) provides:

“Failure to Pay or Deliver. Failure by the party to make, when due, any payment under this Agreement or delivery under Section 2(a)(i) or 2(e) required to be made by it if such failure is not remedied on or before the third Local Business Day after notice of such failure is given to the party;”

Section 2(e) makes provision for payment of interest during any period between default in the performance of a payment obligation and Early Termination in respect of a particular Transaction.

Section 14 defines “Potential Event of Default” as meaning:

“any event which, with the giving of notice or the lapse of time or both, would constitute an Event of Default.”

15. Section 5(b) provides for a series of what are called “Termination Events” which, although not Events of Default, nonetheless give rise, on election or notification, to what is called “Early Termination”. It is unnecessary to describe them.
16. Early Termination is dealt with in Section 6. It begins as follows:

“(a) *Right to Terminate Following Event of Default.* If at any time an Event of Default with respect to a party (the “Defaulting Party”) has occurred and is then continuing, the other party (the “Non-defaulting Party”) may, by not more than 20 days notice to the Defaulting Party specifying the relevant Event of Default, designate a day not earlier than the date such notice is effective as an Early Termination Date in respect of all outstanding Transactions.”

Subsection (a) then continues by providing that parties may specify what is called “Automatic Early Termination” in the Schedule so that, with respect to specified types of Event of Bankruptcy Event of Default, Early Termination follows as a matter of course, rather than by election. In none of the Swaps was Automatic Early Termination specified in a Schedule. Section 6(b) deals with the right to terminate following a Termination Event.

17. The remainder of Section 6 deals with the consequences of Early Termination. Section 6(c), headed “*Effect of Designation.*”, provides that:

“(i) If notice designating an Early Termination Date is given under Section 6(a) or (b), the Early Termination Event will occur on the date so designated, whether or not the relevant Event of Default or Termination Event is then continuing.

(ii) Upon the occurrence of effective designation or an Early Termination Date, no further payments or deliveries under Section 2(a)(i) or 2(e) in respect of the Terminated Transactions will be required to be made, but without prejudice to the other conditions of this Agreement. The amount, if any, payable in respect of an Early Termination Date shall be determined pursuant to Section 6(e).”

Section 6(d) sets out a procedure for calculating the amount to be paid on Early Termination. Section 6(e) sets out a detailed set of alternative formulae for the purpose of determining (by reference to calculation and/or valuation) the amounts to be paid. There is no dispute as to the meaning of these provisions, which are supplemented in Section 14 by various lengthy definitions. In summary, Section 6(e) makes different provision as between Early Termination following Events of Default, and Early Termination following Termination Events. In relation to Events of Default, four alternative formulae are specified, one of which, namely “Second

Method and Market Quotation” is applicable in default of any selection to the contrary. No alternative selection was made in the three Swaps which incorporated the 1992 Master Agreement. It is, however, material to note that two of the four formulae (being alternative versions of the First Method) cannot produce a net outcome under which the payee is the Defaulting Party. By contrast, the default formula (and the “Second Method and Loss” variation upon it) may lead to outcomes under which either the Defaulting Party or the Non-defaulting Party is the net payee.

18. It is common ground that the broad objective of the default formula (Second Method and Market Quotation) is -to produce, as far as possible but in an accelerated form, the same economic outcome for the parties as if there had been neither an Event of Default nor an Early Termination. The formula requires two sums to be identified and then the second subtracted from the first. The first is called “the sum of the Settlement Amount, (determined by the Non-defaulting Party) in respect of the Terminated Transactions and the Termination Currency Equivalent of the Unpaid Amounts owing to the Non-defaulting Party”. The second is called “the Termination Currency Equivalent of the Unpaid Amounts owing to the Defaulting Party”. The resulting amount is expressly described as being capable of being a positive or negative number. If positive, it is to be paid to the Non-defaulting Party. If negative, it is to be paid to the Defaulting Party. In relation to Transactions settled by payment rather than delivery, “Unpaid Amounts” owing to any party are defined by Section 14 as meaning:

“with respect to an Early Termination Date, the aggregate of (a) in respect of all Terminated Transactions, the amounts that became payable (or that would have become payable but for Section 2(a)(iii)) to such party under Section 2(a)(i) on or prior to such Early Termination Date and which remain unpaid as at such Early Termination Date.”

Thus, that part of the formula contemplates that, where payment obligations may not have arisen because of an unsatisfied condition precedent in Section 2(a)(iii), their aggregate amount will be part of that which has to be paid on Early Termination, under the default formula.

19. The Settlement Amount (which is to be determined by the Non-defaulting Party) is identifiable primarily by reference to market quotations obtained, as at the Early Termination Date, of the amount which would be payable by (or to) the Non-defaulting Party as the premium (or reverse premium) for the setting up of a replacement transaction, on precisely the same terms as the Terminated Transaction for the remainder of its natural term. In relation to an interest rate swap for an original period of two years which suffered Early Termination after one year, this contemplates the obtaining from the market of a quote for a new one year swap for the residue of the two year term, at the same fixed and floating rates. Since market perceptions would have changed since the obtaining of the (by then) terminated swap, a premium would be payable or receivable in relation to its substitute. In practice (although this is an over-simplification), a market perception that the Non-defaulting Party would be likely to be in the money for the duration of the period would lead to a premium being payable by that party for the hypothetical new swap. By contrast, if the market perception was that the Non-defaulting Party would be likely to be out of the money, then the market counterparty would be likely to be prepared to pay a

reverse premium for the right to receive the anticipated net income stream under the hypothetical new swap.

20. One effect of that formula (leaving aside the Unpaid Amounts element) is that the Defaulting Party would be liable on Early Termination to pay the Non-defaulting Party the cost of putting in place a replacement swap for the remainder of the original term, whereas if the Non-defaulting Party would be likely to obtain a reverse premium by doing so, the Defaulting Party would obtain that premium as the Settlement Amount.
21. Taken as a whole, the default formula therefore contemplates that the Defaulting Party would not be penalised or rewarded either for its default, or for the Early Termination arising out of its default. For completeness, it is to be noted that the Settlement Amount part of the default formula contains a fallback to an essentially loss-based calculation in the event that no commercially reasonable Market Quotations are available.
22. Pausing there, it is to be noted that the default formula sets out to provide full theoretical protection to a Non-defaulting Party which elects for Early Termination, where (as in relation to some of the Swaps) the Non-defaulting Party is a fixed rate payer which either wishes, or is obliged, to re-hedge its floating interest rate exposure by obtaining an identical replacement interest rate swap for the outstanding part of the original term. But where the Early Termination follows a Bankruptcy Event of Default, a Non-defaulting Party of that kind will nonetheless remain fully exposed to the Defaulting Party's insolvency, since the Early Termination payment obligation of the bankrupt defaulter confers upon the Non-defaulting Party the status only of an unsecured creditor.
23. Section 7 of the Master Agreement, headed "Transfer", generally prevents transfer either of the Agreement or of any interest or obligation under it (whether by way of security or otherwise) without the prior written consent of the other party, subject to certain exceptions, which include a transfer of the Agreement pursuant to certain types of consolidation, amalgamation or merger, and a transfer of an Early Termination Amount payable by a Defaulting Party under Section 6(e).
24. Section 9, headed "Miscellaneous", contains at subsection (a) a typical entire agreement clause. Subsection (c), about which there was considerable debate between counsel, provides as follows:

"Survival of Obligations. Without prejudice to Sections 2(a)(iii) and 6(c)(ii), the obligations of the parties under this Agreement will survive the termination of any Transaction."
25. Section 13(a) provides for the parties to specify their chosen governing law in the Schedule. All the Swaps in issue are governed by English law.
26. Having thus far described the relevant provisions of the 1992 Master Agreement, I must briefly refer to significant differences in the 2002 version. First, certain changes were made to the detailed specification of Bankruptcy Events of Default but none of them are material for present purposes. Secondly, Section 6(c)(ii) is slightly reworded so as to cross-refer to a reworked provision about interest, moved from the old

Section 2(e) to a new Section 9(h), but with no consequential difference in effect. Thirdly, the formulae for payments on Early Termination are, in Section 6(e), completely reworked, so as to omit most of the 1992 alternative formulae. The one which survives is broadly equivalent to the 1992 default formula albeit reworded. It was not submitted that its effect was significantly different.

27. Fourthly, and most importantly, the 2002 Master Agreement contains, at Section 9(h)(i)(3) the following provision for what is described as “Interest on Deferred Payments”:

“If:-

(A) A party does not pay any amount that, but for Section 2(a)(iii), would have been payable, it will, to the extent permitted by applicable law and subject to Section 6(c) and clauses (B) and (C) below, pay interest (before as well as after judgment) on that amount to the other party on demand (after such amount becomes payable) in the same currency as that amount, for the period from (and including) the date the amount would, but for Section 2(a)(iii), have been payable to (but excluding) the date the amount actually becomes payable, at the Applicable Deferral Rate;”

As will appear, it became common ground that this obscure provision resolved, for the purposes of the 2002 Master Agreement, a major issue of construction as to the nature and effect of the condition precedent in Section 2(a)(iii). In short, it clearly contemplates that a payment which, because of an Event of Default which is continuing on the date prescribed for payment in the Confirmation, fails then to become payable under Section 2(a)(i), may nonetheless become payable at a later date, when the relevant Event of Default ceases, so that the condition precedent under Section 2(a)(iii) is for the first time satisfied. No equivalent provision appears in the 1992 Master Agreement.

LBIE

28. LBIE was, until the collapse of the worldwide Lehman Brothers group, the principal group trading company in Europe, based in London. Its ultimate parent company was Lehman Brothers Holdings Inc (“LBHI”), incorporated in Delaware, USA.
29. Immediately prior to the collapse, LBIE had a substantial derivatives book, and I was informed by counsel that its interest rate swaps book was broadly balanced at that time, even though it was the floating rate payer under each of the Swaps in issue on this application. The Administrators’ evidence was that, as at 15th September 2008, LBIE was party to some 2,000 derivative transactions which incorporated the Master Agreement, of which some 1,693 have since been closed out, in many cases by Early Termination, and in some cases in circumstances which gave rise to Early Termination payments to, rather than from, LBIE.
30. I am invited to assume (in relation to a timing issue arising out of one of the Swaps) that LBIE went into administration at or about 7.56 a.m. on the morning of 15th

September 2008, and that LBHI filed for Chapter 11 bankruptcy protection in the United States Bankruptcy Court of the South District of New York at 6.45 a.m. (London time) on the same day. While it is common ground that both of those events constituted Events of Default under the Swap in respect of which LBHI was a Credit Support Provider, there remain timing issues which I am not asked to decide, so that I am invited to deal with the matter as between the Administrators and the relevant Swap counterparty on the basis that the Bankruptcy Event of Default relating to LBHI occurred either before, alternatively at the same time as, or alternatively after, the Bankruptcy Event of Default relating to LBIE.

THE SWAPS

31. The following summary of the five Swap transactions is taken from the Statement of Agreed Facts, supplemented by evidence from each of LBIE's swap counterparties, none of which was challenged. LBIE was the floating rate payer under each Swap.

The Firth Rixson Transactions

32. The first Firth Rixson Transaction was a sterling interest rate swap made on 13th November 2007 between LBIE and FR Acquisitions Corporation (Europe) Limited ("FRAC"), and evidenced by a Confirmation of that date which was amended by an Amendment Confirmation dated 28th April 2008. It incorporated the 1992 Master Agreement without any Schedule. It was based upon a notional amount of £95 million and provided for quarterly payments beginning on 20th March 2008 and ending on 20th December 2010. The fixed rate was 5.555% and the floating was rate three months sterling LIBOR.
33. The second Firth Rixson Transaction was a US\$ interest rate swap made on the same day between the same parties and with the same dates for payment. Although originally incorporating the 1992 Master Agreement, it was novated by FRAC to JFB Firth Rixson Inc. ("JFB") on 29th August 2008, pursuant to a Novation Confirmation which incorporated the 2002 Master Agreement without any Schedule. It was based upon a notional amount of \$US650 million. The fixed rate was 4.3655% and the floating rate was US\$ LIBOR BBA.
34. The Firth Rixson group is a global manufacturer and supplier of specialist metal products, primarily to aerospace engine manufacturers. The Firth Rixson Transactions were entered into pursuant to obligations undertaken by FRAC in floating rate financing agreements with lenders which included, and were represented by, Lehman Brothers. These two Swaps were therefore designed to convert FRAC's floating rate obligations under the Financing Agreements into fixed rate obligations, and thereby to hedge FRAC's interest rate risk. The documentation for the two Swaps was chosen and prepared by LBIE.
35. On the first two payment dates for the sterling Swap (20th March and 20th June 2008) FRAC was slightly in the money, receiving a little over £100,000 from LBIE on each occasion. FRAC remained in the money on the next two payment dates (22nd September and 22nd December 2008) but, since these followed the collapse of the Lehman group, LBIE did not pay the amounts owing. On all subsequent payment dates LBIE has been increasingly in the money, but FRAC has declined to pay the

amounts due, running at a little over £1 million per quarter from September 2009, relying on the Event of Default constituted by LBIE going into administration.

36. Under the US\$ Swap FRAC was in the money only on the first payment date (20th March 2008) in an amount of a little less than US\$1 million. Thereafter, the fall in US\$ floating rates meant that FRAC (and, from August 2008, JFB) were increasingly out of the money, by amounts ranging between just under US\$2 million and US\$6.7 million per quarter. Just over US\$3 million was paid to LBIE in June 2008 and JFB then relied upon LBIE's administration as an Event of Default, making no payments thereafter.
37. Following LBIE's administration, FRAC and JFB re-hedged with Lloyds TSB, but in both cases at lower fixed rates. Nonetheless FRAC and JFB have paid out some £6.6 million and US\$29.3 million under the replacement swaps which were necessitated by LBIE's insolvency.

The BEIG Transaction

38. This consisted of a sterling interest rate swap made between LBIE and BEIG Midco Ltd ("BEIG") on 29th September 2006 by a Confirmation incorporating the 2002 Master Agreement. LBIE's obligations thereunder were guaranteed by LBHI as Credit Support Provider. The Swap was based upon a notional amount of £300,987,600. The fixed rate was 5.1705% and the floating rate was sterling LIBOR BBA. The Confirmation specified payment dates in November and December 2006, followed by half yearly payments at the end of December and June from December 2006 until December 2010 inclusive.
39. BEIG was slightly out of the money on the first two payment dates, in the money from 29th December 2006 to 31st December 2008, and has been heavily out of the money thereafter, in amounts ranging between £3.3 million and £5.8 million on each payment date. The evidence was prepared before the final payment due on 31st December 2010, but it will be another large sum payable to LBIE. Following the group's collapse LBIE did not pay the 31st December 2008 payment of £1.5 million odd to BEIG and, relying upon LBIE's administration as an Event of Default, BEIG has not made any of the substantial payments which would otherwise have fallen due from June 2009 onwards.
40. BEIG is an English company which forms part of the Birds Eye Iglo group of companies, producing, marketing and distributing branded frozen food products in Western Europe. It entered into the BEIG Transaction in order to hedge floating rate risks incurred in connection with financing the acquisition of a business. The evidence did not show whether, following LBIE's collapse, BEIG re-hedged for the remainder of the term of the BEIG Transaction.

The KPGZ Transactions

41. KP Germany Zweite GmbH ("KPGZ") made a euro interest rate swap with LBIE on 26th June 2007 by a Confirmation incorporating the 1992 Master Agreement, together with a Schedule.

42. The notional amount under this Swap was €120.5 million. The fixed rate was 4.695% and the floating rate was the euro-Euribor-telerate. The payment dates were half yearly at the end of December and June, beginning in December 2007 and ending in June 2012.
43. KPGZ and LBIE made a US\$ interest rate swap on 26th June 2007, again incorporating the 1992 Master Agreement and the same Schedule. The notional amount was US\$100,875,000. The fixed rate was 5.485% and the floating rate US\$ LIBOR BBA. The payment dates were the same as under the KPGZ euro Transaction.
44. The Schedule governing both the KPGZ Transactions contained provisions designed to amend the 1992 Master Agreement in various respects for the purpose of harmonising those two Swaps with a complex multi-currency financing transaction. The purpose of the Swaps was to hedge KPGZ's floating rate risks under that transaction. LBIE was, again, a participant in the related financing transaction
45. The KPGZ euro transaction was out of the money for KPGZ in December 2007, in the money in 2008, and out of the money thereafter. It is of course uncertain whether KPGZ will be in or out of the money from June 2011 until the end of the term in June 2012.
46. As for the KPGZ US\$ transaction, KPGZ has been out of the money from its commencement until now. No payments were made by either party to the other under either transaction after the commencement of LBIE's administration. Again, the question whether KPGZ will remain out of the money for the rest of the term of the US\$ Swap is uncertain. At current interest rates, LBIE would, but for its administration, be receiving in excess of €2 million and US\$2 million on each payment date, under each transaction.
47. KPGZ is part of the KP Group, which is a leading manufacturer in the plastics industry, originally founded and still headquartered in Germany, but with manufacturing and distribution facilities in ten countries. The multi-currency financing agreement for which these two Swaps formed a floating rate hedge was entered into in connection with the acquisition of the KP Group by the Blackstone Group in 2007. KPGZ has not re-hedged its floating rate risk under the multi-currency financing transaction since LBIE's default.

Common Features

48. It will be apparent from the above summary that all of the five Swaps were entered into by commercial manufacturing and/or trading companies for the purpose of hedging floating interest rate risk arising from their borrowings. None of the Swaps was, from the perspective of LBIE's counterparties, in any way speculative.
49. The effect of LBIE's collapse in September 2008 was therefore to leave each of those counterparties exposed to interest rate fluctuations. Although, in the event, the floating rate has for most of 2009 and all of 2010 been significantly less than the agreed fixed rates, the fact remains that each of LBIE's counterparties has been without the hedging protection against the risk of a rise in the relevant floating rates for which it contracted.

50. Other common features worthy of note are, first, that in none of the Swaps was Automatic Early Termination selected. Secondly, all the Swaps based on the 1992 Agreement adopted (either expressly or by default) the Second Method and Market Quotation formula for Early Termination payments and, thirdly, none of LBIE's counterparties were members of ISDA.

THE ISSUES

51. The Administrators' application for directions raised some six questions for determination, two of which divided into four further sub-questions. During the process of the exchange of evidence and position papers, the parties (including for this purpose ISDA) eventually agreed a list of some fourteen issues, many of which included sub-issues. The case was argued on the basis of the agreed list. The list uses the headings Construction, Anti-deprivation, Penalty/relief from forfeiture, and Proving. In the event, the issues raised under the last heading turned out to be additional questions of construction (rather than insolvency law).

CONSTRUCTION

52. It is convenient to deal with construction first, and the agreed issues as to Construction and Proving form a helpful introduction. They are as follows:

“Construction

1. Whether (as the Administrators contend), either as a matter of construction or by way of an implied term, the first limb of Section 2(a)(iii) operates only for ‘a reasonable period’.

2. If the answer to Issue 1 above is affirmative:

(1) Is the ‘reasonable period’ there referred to such period as may be reasonable to allow the Non-defaulting Party: (i) in the case of a Potential Event of Default, to establish whether the Potential Event of Default leads to an Event of Default; and (ii) in the case of an Event of Default, to consider whether its interests are best served by designating an Early Termination Date and, if so, to designate an Early Termination Date; or (iii) some other and if so what period?

(2) Has the reasonable period now elapsed in relation to the swap agreements which are the subject matter of these proceedings and, if it has elapsed, when did it elapse?

(3) At the end of the reasonable period, if an Early Termination Date has not been designated by the Non-defaulting Party, does the first limb of Section 2(a)(iii) cease to operate so that the amounts which were previously not payable by reason of the first limb of Section 2(a)(iii) become payable under Section 2(a)(i) (with or without netting)?

3. Alternatively, whether (as the Administrators contend), either as a matter of construction or by way of an implied term, the first limb of Section 2(a)(iii) only operates with respect to obligations under a particular transaction until the last date for performance in respect of, or the date of termination by effluxion of time of, the transaction (or, alternatively, all of the transactions governed by the Master Agreement), at which point the Non-defaulting Party is obliged to designate that date as the Early Termination Date or, alternatively, the obligations of the parties are netted off.

4. Alternatively, whether (as the Respondents variously contend), if an Event of Default or Potential Event of Default exists at a scheduled payment date, on the true construction of the first limb of Section 2(a)(iii):

(1) No payment obligation ever arises on the part of the Non-defaulting Party in respect of the amount which would otherwise have been payable on that scheduled payment date; alternatively

(2) No such payment obligation ever arises if the Event of Default or Potential Event of Default continues until the last date for performance in respect of, or the date of termination by effluxion of time of, the transaction (or, alternatively, all of the transactions governed by the Master Agreement); alternatively

(3) (As ISDA contends) obligations under Section 2(a)(i) (which have not arisen by reason of an Event of Default or Potential Event of Default at the date for performance of the relevant obligation) arise only when there is no longer continuing an Event of Default or Potential Event of Default (whether or not the last date for performance in respect of, or the date of termination by effluxion of time of, the transaction (or alternatively all of the transactions governed by the Master Agreement) has passed).

Proving

14. If the answer to Issue 4 above is affirmative, where a Non-defaulting Party proves in the administration of the Defaulting Party, is the Non-defaulting Party entitled to prove in respect of the entirety of the Defaulting Party's payment and/or delivery obligations:

(1) Where the Non-defaulting Party has not met those obligations which would have fallen due under the transaction but for the first limb of Section 2(a)(iii); and/or

(2) Without giving credit for obligations which would have arisen but for the first limb of Section 2(a)(iii)?"

53. It is necessary to begin with some preliminary observations about the correct approach to construction. The ISDA Master Agreement is one of the most widely used forms of agreement in the world. It is probably the most important standard market agreement used in the financial world. English law is one of the two systems of law most commonly chosen for the interpretation of the Master Agreement, the other being New York law. It is axiomatic that it should, as far as possible, be interpreted in a way that serves the objectives of clarity, certainty and predictability, so that the very large number of parties using it should know where they stand: see Scandinavian Trading Tanker Co, v. Flota Petrolera Ecuatoriana [1983] 1 QB 529 (“the Scaptrade”) per Robert Goff LJ at 540.
54. Nonetheless, the Master Agreement does not ordinarily constitute the entirety of the parties’ bargain in relation to a particular transaction. As illustrated by the foregoing summary of the Swaps, each Transaction will be regulated by the terms of the Master Agreement itself, any accompanying Schedule and a Confirmation which is Transaction specific. Both the Schedule and the Confirmation prevail over the Master Agreement in the event of any inconsistency: see Section 1(b). Furthermore, as already described, the Master Agreement is used for a wide variety of different types of derivatives transaction, not limited to swaps. Mr Zacaroli QC for ISDA was at pains to emphasise, for example, that even the detailed effect of the general conditions in Section 2(a) may be different, as between different types of derivatives to which the Master Agreement is commonly applied. As will appear, this aspect of the way in which the Master Agreement is used is of particular importance in relation to the issue arising under the heading “Proving” in the agreed list of issues.
55. More generally, I was treated to lengthy submissions (both in writing and orally) as to the effect upon the well-settled principles for the identification of implied terms of the Privy Council’s judgment in Attorney General of Belize v. Belize Telecom Ltd [2009] UKPC 11, at paragraph 16 to 27, and in particular the following passage at paragraph 21:
- “It follows that in every case in which it is said that some provision ought to be implied in an instrument, the question for the court is whether such a provision would spell out in express words what the instrument, read against the relevant background, would reasonably be understood to mean. It will be noticed from Lord Pearson’s speech that this question can be reformulated in various ways which a court may find helpful in providing an answer – the implied term must “go without saying”, it must “be necessary to give business efficacy to the contract” and so on – but these are not in the Board’s opinion to be treated as different or additional tests. There is only one question: is that what the agreement, read as a whole against the relevant background, would reasonably be understood to mean?”
56. Lord Hoffmann was there referring to a passage in Lord Pearson’s speech in Trollope & Colls v. Northwest Metropolitan Regional Hospital Board [1973] 1 WLR 601 at 609, as follows:

“The court does not make a contract for the parties. The court will not even improve the contract which the parties have made themselves, however desirable the improvement might be. The court’s function is to interpret and apply the contract which the parties have made for themselves. If the express terms are perfectly clear and free from ambiguity, there is no choice to be made between different possible meanings: the clear terms must be applied even if the court thinks some other terms would have been more suitable. An unexpressed term can be implied if and only if the court finds that the parties must have intended that term to form part of their contract: it is not enough for the court to find that such a term would have been adopted by the parties as reasonable men if it had been suggested to them: it must have been a term that went without saying, a term *necessary* to give business efficacy to the contract, a term which, though tacit, formed part of the contract which the parties made for themselves.”

57. There is in my judgment no conflict, or even tension, between those two passages. The insight provided by the Belize case is that the process of implication is not something separate and distinct from construction. It is part of the process of construction, which:

“arises when the instrument does not expressly provide for what is to happen when some event occurs. The most usual inference in such a case is that nothing is to happen. If the parties had intended something to happen, the instrument would have said so. Otherwise the express provisions of the instrument are to continue to operate undisturbed. If the event has caused loss to one or other of the parties, the loss lies where it falls.

In some cases, however, the reasonable addressee would understand the instrument to mean something else. He would consider that the only meaning consistent with the other provisions of the instrument, read against the relevant background, is that something is to happen. The event in question is to affect the rights of the parties. The instrument may not have expressly said so, but this is what it must mean. In such a case, it is said that the court implies a term as to what will happen if the event in question occurs. But the implication of the term is not an addition to the instrument. It only spells out what the instrument means.” (paragraphs 17-18)

58. The difficulties in the present case arise from the fact that the express terms of Section 2(a)(iii) of the Master Agreement leave significant matters unsaid about the condition precedent to any payment obligation, namely that no Event of Default of Potential Event of Default with respect to the other party has occurred and is continuing.
59. The starting point in each of the respondents’ submissions was that the Master Agreement was a clearly and precisely drafted document, developed over many years,

into which the implication of terms was unnecessary and undesirable, both because of the clarity of its meaning, and because of the various options provided by ISDA whereby parties could, by additional provisions in the Schedule or in any Confirmation, make specific provision about particular matters. Unfortunately, the respondents' attempt to make that starting point good led them into protracted disagreements between themselves as to the meaning and effect of the condition precedent in Section 2(a)(iii) which, in the end, took up nearly as much time in oral argument as did the construction issues which separated them, viewed collectively, from the Administrators. Since those differences related to the express terms of the Master Agreement, whereas the Administrators were mainly concerned to identify an appropriate implied term, it is convenient to address the internal differences between the respondents' submissions first.

Gross/Net

60. The question raised by issue 14 in the Agreed List of Issues, under the heading "Proving", is whether a Non-defaulting Party wishing to take advantage of condition (1) in Section 2(a)(iii) by not making a payment specified in a Confirmation while the counterparty is in default, may nonetheless enforce the Defaulting Party's obligation in full. In the context of an interest rate swap, where the floating rate payer is in default, the question is whether the fixed rate payer is entitled to receive the whole of the floating rate payment from the Defaulting Party, without giving credit for its fixed rate payment obligation due on the same payment date.
61. In Marine Trade SA v. Pioneer Freight Futures Co Ltd BVI [2009] EWHC 2656 (Comm) [2010] 1 Lloyd's Rep 631, Flaux J held that the Non-defaulting Party did not have to give credit: see paragraphs 19 to 27. His view was that the clear language, in particular of Section 2(c), meant that credit only had to be given, by way of netting, for an amount that was payable, and not for an amount that, because of an unfulfilled condition precedent under Section 2(a)(iii), was not payable.
62. At the time of delivery of skeleton arguments, all the respondents except KPGZ submitted that the Swaps in issue in these proceedings should not be so construed. At an early stage in the hearing, Mr Fisher for KPGZ came off the fence and aligned his client with the position of the other respondents. While acknowledging that the 1992 Master Agreement incorporated in the transactions considered in Marine Trade was in all relevant respects the same as the Master Agreements in the present case, the respondents sought to distinguish Marine Trade by reference to the fact that, whereas the Forward Freight Agreements there reviewed were simple contracts for differences, the interest rate swaps in the present case contained simultaneous inter-dependent payment obligations. It was suggested that the Non-defaulting Party could not therefore enforce the Defaulting Party's payment obligation without having its own reverse payment obligation taken into account.
63. For their part, the Administrators were content to go along with the respondents' eventually unanimous approach to this issue. I therefore found myself being invited not to follow Marine Trade on this point, by the unanimous consent of all parties to the Swaps. ISDA submitted that it might be distinguishable.
64. If the matter had been contentious, I might have found it difficult to regard Flaux J's reasoning in Marine Trade as inapplicable to the same issue, under the same Master

Agreement, in relation to interest rate swap transactions. Nonetheless, if all parties to an agreement before the court assent to its having a particular meaning, I consider that no issue arises for the court to decide, even though their convention as to its meaning is different from that which, left alone, the court might otherwise have determined. The parties to these Swaps are, as it seems to me, all before the court and will be estopped by convention if nothing else from resiling from their common answer to the Gross/Net question, should it arise between them on any subsequent occasion. In adopting it myself, I therefore intend to cast no doubt, and to express no view one way or the other, upon Flaux J's contrary conclusion in Marine Trade.

65. I have thus far addressed this issue purely by reference to payment obligations arising on the same date. Mr Dicker for BEIG submitted that it was equally applicable to the question whether a Non-defaulting Party which was entitled to a net payment from the Defaulting Party by reference to a particular payment date, was obliged to give credit for payment obligations which would, but for Section 2(a)(iii), have arisen in favour of the Defaulting Party on some other payment date during a period of continuing default. Again, he submitted that credit would have to be given in those circumstances, and no other party demurred from his analysis. I shall therefore adopt it, as part of the convention between the parties to these Swaps.

Once and for All v Suspension

66. There was a multi-faceted dispute between the respondents about the precise effect of the default condition precedent in Section 2(a)(iii)(1) under the 1992 Master Agreement, and a narrower dispute in relation to the same question under the 2002 Master Agreement. Taking the 1992 version first, Mr Hapgood QC and Mr Fisher (for the Firth Rixson companies and KPGZ respectively) both submitted that if an Event of Default or Potential Event of Default had occurred and was continuing on a particular date for payment by the Non-defaulting Party, then that payment obligation never arose, and would not thereafter arise in the event that the default was cured. Mr Zacaroli QC for ISDA submitted that the effect of a continuing Default (or Potential Default) on a particular payment date was only to suspend the coming into effect of the payment obligation until the default was cured and the condition precedent thereby satisfied. In answer to the obvious question, for how long might that payment obligation remain in suspense, he submitted that it might do so, at least in theory, indefinitely.
67. In relation to the 2002 Master Agreement, Mr Hapgood was constrained to accept (because of Section 9(h)(i)(3)(A)) that he could not maintain his once and for all submission, since that provision expressly contemplated that an amount might become payable due to the satisfaction of the Section 2(a)(iii) condition precedent after a payment date. Nonetheless, he and Mr Dicker for BEIG both submitted that an amount could not become payable by reason of the satisfaction of a condition precedent after the Swap had run its term: i.e. after the last date for payment specified in the relevant Confirmation. If the relevant Event of Default (actual or potential) was continuing on that date, then the Non-defaulting Party was forever freed from any risk that it might become payable thereafter.
68. Again, this issue was also raised in Marine Trade (*supra*), but only in relation to the 1992 Master Agreement. Since by the time of the trial the Defaulting Party (Pioneer)

had not remedied its default, Flaux J expressed only an *obiter* view about it. His conclusion, at paragraph 61 was that:

“There is nothing in the wording of the provisions of the contract to suggest that if the condition precedent is fulfilled at some later date, some obligation to pay then springs up.”

69. Flaux J was not referred to the earlier *dictum* to the contrary of Austin J in the New South Wales Supreme Court in Enron Australia v. TXU Electricity [2003] NSW SC 1169, at paragraph 12:

“Since these two conditions are conditions precedent to the payment obligations of the counterparties, if either condition has not been met at any given time there is no payment obligation under any of the trades that have been made under the Agreement. However, a payment obligation will spring up under a pre-existing trade once the relevant condition is satisfied, and in that sense it might be said (with only approximate accuracy) that the payment obligation is “suspended” while the condition remains unfulfilled, and that amounts “accrue” notwithstanding that the condition is unfulfilled.”

It does not appear that Austin J’s conclusion was the result of adversarial argument on the point. Rather, it appears to have been his assumption as to the way in which Section 2(a)(iii) of the 1992 Master Agreement worked.

70. Flaux J was referred to, but disagreed with, the opinion in Firth on Derivatives: Law and Practice, that the condition precedent in Section 2(a)(iii) was suspensory rather than once and for all in its effect. Mr Firth has nonetheless maintained that opinion in the 2010 edition, on the basis that the once and for all construction produces an extremely uncommercial result, in particular in cases of a short-lived default for which the Defaulting Party bore no responsibility, such as the presentation by a vexatious litigant of a winding up petition.
71. The question whether Section 2(a)(iii) has a once and for all or suspensory effect is of minimal practical relevance in the present context, since there is no realistic prospect that LBIE will ever cease to be in default. Nonetheless it is squarely raised by the agreed issues, and I consider that a proper understanding of the way in which the condition precedent in Section 2(a)(iii) works is a pre-requisite to a reliable analysis of the Administrators’ case, based as it is essentially on implication.
72. Taking the 1992 Master Agreement first, there are persuasive reasons in favour of the once and for all approach. It is in my view more consistent with the language of Section 2(a), and it has the undoubted merit of simplicity and certainty. If a payment does not fall due on a particular payment date because the condition precedent is not satisfied, then the payer need make no provision against the risk of it falling due in the future. Furthermore, there is real force in Flaux J’s conclusion that the absence of any express provision that a payment obligation should arise at a later date if the condition precedent is satisfied points to the absence of any such outcome. Using Lord Hoffmann’s analysis in Belize, subsequent satisfaction of the condition is an event for

which the contract makes no express provision, so that the starting assumption is that none was intended.

73. I have however come on a fairly narrow balance to the conclusion that Austin J's suspensory construction is to be preferred. My main reason is the first of those given by Mr Firth, namely that the once and for all construction would produce a pointlessly draconian outcome, in the event of a minor and momentary default. Secondly, the condition precedent is unsatisfied even if there is merely a Potential Event of Default, which never matures into an Event of Default, sufficient to trigger Early Termination at the Non-defaulting Party's election. The permanent destruction of a payment obligation in those circumstances is even more surprising.
74. Thirdly, there is I consider some force (despite Flaux J's rejection of it) in the point that, even under the 1992 Master Agreement, the election for an Early Termination would trigger a termination payment which included all Unpaid Amounts; i.e. amounts which would have been payable but for an earlier default. The essence of the once and for all approach is that, if a payment obligation on a particular date is nullified by an outstanding condition precedent, it can be forgotten about for all time. It is at least counterintuitive then to find that, quite possibly due to some much later default, an Early Termination brings that payment obligation back to life.
75. That conclusion about the 1992 Master Agreement means that both it and the 2002 Master Agreement can then be considered side by side, in relation to the question for how long a suspended payment obligation remains in suspense. The only candidates raised in argument were:
- i) Until the expiry of the term of the Transaction;
 - ii) Indefinitely.
76. The proponents of the limited period in (i) point to the unlikelihood that commercial persons would contemplate, let alone specifically agree, to leave potentially large contingent obligations hanging over themselves indefinitely. They pointed to Section 9(c) as containing the necessary express provision, within the phrase "Without prejudice to Sections 2(a)(iii) and (6)(c)(ii)". The general effect of clause 9(c) is to provide for the obligations of the parties under the Master Agreement to survive "the termination of any Transaction". By making that general provision subject to Section 2(a)(iii) it is suggested that contingent obligations suspended by Section 2(a)(iii) will not therefore survive the termination of the Agreement by effluxion of time.
77. Mr Zacaroli for ISDA was the only proponent of the indefinite survival of contingent obligations suspended by Section 2(a)(iii). He sought to meet the objection that not even a limitation period would bring them to an end by suggesting that the Non-defaulting Party, if troubled by the contingent liability, could always elect for Early Termination, even after the termination of the Transaction by effluxion of time. He submitted that Section 9(c) was not concerned with termination by effluxion of time but rather merely with preserving the effect of the Master Agreement in relation to other Transactions from any unintended dissolution as the result of the termination of a particular Transaction.

78. Faced with those two alternatives, I consider that the first is clearly to be preferred. My main reason is that it seems to me to be wholly inconsistent with any reasonable understanding of the Master Agreement that payment obligations arising under a Transaction could give rise to indefinite contingent liabilities, because of the possibility that an Event of Default may be cured long after the expiry of a Transaction by effluxion of time. Secondly, although Section 9(c) is certainly a roundabout way of making express provision against payment obligations springing to life after the expiry of a Transaction by effluxion of time, it is the only relevant indication one way or another anywhere in the Master Agreement which bears on this issue. Finally, I am not at all persuaded by Mr Zacoroli's submission that the potentially indefinite risk of a contingent payment obligation beyond the natural expiry date of a Transaction could be avoided by a party electing, on or after that date, for Early Termination. It would not be early in any conceivable sense, and it would be difficult, to say the least, to apply the default method for calculating Early Termination payments where, *ex hypothesi*, there would be no continuing period in relation to which to obtain a Market Quotation for a replacement swap.
79. Nor am I persuaded that Section 9(c) has only the limited purpose identified by Mr Zacoroli. The deliberate use of "termination" with a small rather than capital "t" suggests that Section 9(c) is all about termination by effluxion of time (i.e. on the last payment date referred to under Section 2(a)(i)). The exclusion of Section 6(c)(ii) follows naturally from the comprehensive provisions about payment obligations triggered by Early Termination. The exclusion of Section 2(a)(iii) must therefore be a reference primarily to condition precedent (1) (i.e. the default condition). Although some provisions in the Master Agreement operate across rather than within transactions, (usually where an election is made that they should), generally the Master Agreement exists to provide the detailed terms of each of the Transactions to which it is applied. While by no means ideally phrased, I consider that Section 9(c) does mean that, where any obligation is suspended by Section 2(a)(iii) because of the non-fulfilment of a condition precedent, then that obligation does not survive the termination of a Transaction at the end of its natural term, if by then the condition precedent is still unsatisfied.

The Constructions Alternatively Advanced by the Administrators

80. The Administrators advanced three alternative submissions, the common objective of which was to prevent the respondents steering between the Scylla of an Early Termination and the Charybdis of committing to a full performance of all payment obligations under the Swaps. With the benefit of hindsight they suggest that either of those courses would have led to very substantial sums being payable by the respondents to LBIE.
81. All three alternative constructions are predicated upon an assertion that Section 2(a)(iii) of the Master Agreement serves a specific limited purpose, namely to protect the Non-defaulting Party from making payments to the Defaulting Party while exposed to that party's credit risk in the future. The Administrators submit that a construction of Section 2(a)(iii) which is properly responsive to that purpose will produce one of the alternative outcomes for which they contend.

The alternative outcomes are as follows:

A. That Section 2(a)(iii) suspends the Non-defaulting Party's payment obligations under condition precedent (1) only for a reasonable time: that is, a time sufficient to enable that party to decide whether to elect for Early Termination, or to continue to perform its payment obligations in full.

B. That Section 2(a)(iii) suspends the Non-defaulting Party's obligations under Section 2(a)(i) until such time as the Transaction, or alternatively all of the Transactions between the parties governed by the Master Agreement, have run their course (assuming no Early Termination) such that, at the expiry of the natural term of the last Transaction the Non-defaulting Party must either submit to a netting process which calls for payment of all suspended payment obligations or submit to the consequences of an Early Termination as at that date.

C. That the Non-defaulting Party is, under Section 6(a) under a constant obligation to exercise its discretion whether or not to designate an Early Termination Date in a manner which is not arbitrary, capricious or unreasonable so that, once it is clear that the other party's default is permanent, or where the Non-defaulting Party decides to re-hedge, it must exercise its discretion in favour of Early Termination.

82. Finally, the Administrators submit that the construction advanced by the respondents produces a result so divorced from any reasonable understanding of the purpose of Section 2(a)(iii) that it must give way to a construction more in accordance with commercial common sense. The Administrators' real complaint is that, in the events which have happened, the construction proposed by the respondents gives them a windfall rather than protection from, or compensation for, the consequences of LBIE's default.
83. I have not been persuaded by any of the Administrators' submissions on construction. In summary:
- (i) I am not persuaded that the purpose behind Section 2(a)(iii) is as narrow as the Administrators suggest.
 - (ii) Both of their alternatives A and B require substantial implication of terms in circumstances where the well-settled requirements for doing so are not met.
 - (iii) Alternative C is based on a misreading of Section 6(a) of the Master Agreement, which confers a right on the Non-defaulting Party to elect or to decline to elect for Early Termination as it thinks best suits its own interests.
 - (iv) By contrast the respondents' construction reflects the clear meaning of the express terms of the Master Agreement. It is neither un-commercial in its outcome, nor does it necessarily confer an unjustified windfall benefit on the Non-defaulting Party.

I will expand on each of those conclusions in turn.

Alternative A

84. While I accept that an important purpose of Section 2(a)(iii) is to protect the Non-defaulting Party against having to make payments to a Defaulting Party where there is a risk that the latter may in due course default on its own payment obligations, I am by no means persuaded that this is the Section's only purpose. In the context at least of interest rate hedges (which is the only type of agreement with which the court is at present concerned) the *quid pro quo* for the fixed rate payer's obligations is not merely the receipt of an income stream when the floating rate exceeds the fixed rate, but the conferral of protection, throughout the life of the swap, against exposure to the financial consequences of variable interest rates which it may not be able to afford. Similarly, for the floating rate payer, the *quid pro quo* for its promise to make payments to its counterparty is the assurance that, come what may, the fixed rate will be payable or will be taken into account. An assurance that it will receive or be credited with the fixed rate will be likely to form an essential constituent part of the balanced derivatives book of an institution which offers interest rate hedging in the market place.
85. The rationale for the listed Events of Default is "to identify the circumstances in which the risk of non-performance is so great that the basis on which the parties entered into the Agreement has broken down": see Firth (*op. cit.*) at paragraph 11-045. It is in those circumstances understandable that the Non-defaulting Party should be given a choice as to how to manage the risks with which it is threatened once its counterparty is in default.
86. The Administrators' case appears to assume that electing for Early Termination will always be a satisfactory risk management strategy because, it is said, the amount which the Non-defaulting Party may need to spend (or may receive) upon a replacement hedge will be, as far as valuers can make it, equivalent to the amount payable by (or to) the Defaulting Party as the Settlement Amount under the Section 6 Early Termination payment formula. Thus, (as a written submission from ISDA demonstrated to my satisfaction), where the market perception is that floating rates will fall, the market will offer the Non-defaulting fixed rate Party a replacement swap with a reverse premium, which will be broadly equivalent to the amount payable to the Defaulting Party by way of Settlement Amount. Conversely, if interest rates are thought likely to rise, the Non-defaulting Party will have to pay a premium for a replacement swap in the market, but will receive a similar Settlement Amount from the Defaulting Party. In short, it is suggested, the main purpose of the default formula for Termination Payments is to enable the Non-defaulting Party to re-hedge at the expense of the Defaulting Party.
87. That apparently happy equivalence assumes, contrary to the present facts, that the Defaulting Party will be good for the money, where the Non-defaulting Party has to pay to re-hedge. In the event of a Bankruptcy Event of Default, the reality will be that the Non-defaulting Party will have to buy its replacement hedge in the market, and prove for the Settlement Amount against the Defaulting Party in its liquidation or administration, from which it may receive a modest dividend, or, in many cases, no dividend at all. It follows that to treat the Early Termination election as always being a sufficient remedy to the Non-defaulting Party in connection with any Bankruptcy Event of Default is merely to provide the form, rather than the substance, of a remedy. It is in those circumstances no surprise to find in the Master Agreement an alternative

option to the Non-defaulting Party namely, for as long as the default lasts, to avoid making any further payment to the Defaulting Party, but taking the risk, if the Defaulting Party cures its default before the termination of the swap Transaction by effluxion of time, that the payments thus far avoided will then become due. Put another way, it is not surprising to find that the Master Agreement contains provision whereby the Non-defaulting Party may say that, for as long as the continuing default means that the secure hedge for which it had contracted is absent, no further payment will be made under the swap agreement.

88. In my judgment the attempt by implication to provide that the condition precedent in Section 2(a)(iii)(1) should fall away after a reasonable time, leaving the Section 2(a)(i) payment obligations fully enforceable is, quite simply, contrary to the express terms of the Master Agreement. Section 2(a)(iii) unambiguously provides that the condition precedent is to subsist for as long as no Event of Default or Potential Event of Default with respect to the other party “has occurred and is continuing”. By contrast, alternative A contemplates that the condition precedent will fall away, even if an Event of Default is continuing, once the Non-defaulting Party has had a reasonable opportunity to choose whether or not to elect for Early Termination. To use the modern language of Attorney General v. Belize, it is not what a reasonable addressee would think that the Master Agreement meant.

Alternative B

89. An implied term that the condition precedent in Section 2(a)(iii)(1) falls away at the end of the natural term of a Transaction, or of the term of the last open Transaction governed by the Master Agreement, leaving the parties with a mutual netting obligation in relation to all Unpaid Amounts, or with an obligation to make an Early Termination payment pursuant to Section 6, is even more obviously at variance with the plain language of the Master Agreement. It is, in the first place, flatly inconsistent with Section 9(c), which provides that the survival of any obligations under the Master Agreement after the termination of any Transaction is without prejudice to Section 2(a)(iii). While it is perhaps inelegant language for the purpose of encapsulating the concept that a payment obligation suspended by Section 2(a)(iii) does not survive termination, by no form of purposive reading can it be made to mean that the condition precedent in Section 2(a)(iii) itself falls away on termination of a Transaction (i.e. by effluxion of time).
90. Secondly, Section 2(c) makes no provision (unless the parties elect to the contrary, which none have done in the present Swaps) for anything other than netting within a Transaction, whereas one version of alternative B contemplates cross-transactional netting on the expiry by effluxion of time of the last Transaction of any series regulated by the same Master Agreement. To provide by implication for such netting would run directly counter to Section 2(c) in any case where no cross-transactional netting has been chosen.
91. Thirdly, the sub-alternative within alternative B (namely that there is an obligation on the Non-defaulting Party to designate Early Termination on the expiry of the last Transaction regulated by the Master Agreement, with a consequential payment under Section 6), would be tantamount to Automatic Early Termination, whereas, in all the present Swaps, no such election has been made. Furthermore it would (as already

explained) not be “Early”, nor would the Market Quotation part of the Early Termination payment formula be operable.

Unreasonable Exercise of Discretion

92. Mr Trower QC for the Administrators referred me to a number of authorities in support of the general proposition that, in certain circumstances, a contractual power or discretion must not be exercised capriciously or irrationally: see in particular Abu Dhabi National Tanker Co v. Product Star Shipping Co Ltd (No 2) [1993] 1 Lloyd’s Rep 397 at 404, Ludgate Insurance Co Ltd v. Citibank NA [1998] Lloyd’s Rep 221, at 239 - 240 and Socimer International Bank Ltd v. Standard Bank London Ltd [2008] 1 Lloyd’s Rep 558 at paragraph 60 to 66. I accept that the exercise of a contractual discretion in circumstances which affect both parties to the contract may call for honesty, good faith, and even an exercise for the purposes for which the discretion was conferred. It will nonetheless be a very rare case in which the apparently regular exercise of a purely contractual discretion can be successfully challenged, see per Brooke LJ in Ludgate Insurance at paragraph 35.
93. In the present case, the discretion in Section 6(a) of the Master Agreement was given by way of contractual right to the Non-defaulting Party, and was plainly to be exercised in such a way as the Non-defaulting Party considered best served its own interests, by way of a choice between alternative remedies arising out of its counterparty’s default. I do not begin to understand how the respondents’ choice not to elect for Early Termination in relation to the Swaps under review in the present case can possibly be categorised as dishonest, in bad faith or exercised otherwise than for the purpose for which it was conferred. In relation to the euro and sterling Swaps, since LBIE’s counterparties were in the money when LBIE’s default occurred, they may be expected to have had to make a payment in the market place for a replacement swap on precisely the same terms, against a speculative prospect of a refund by way of a Settlement Amount from LBIE if they elected for Early Termination. In the event, each of the respondents has been vindicated in its decision not to elect for Early Termination by the subsequent fall in interest rates. In the circumstances, the proposition that an election to do anything other than seek Early Termination amounted to a misuse of the Non-defaulting Party’s discretion strikes me as completely unarguable.

ANTI-DEPRIVATION

94. The anti-deprivation rule is the inelegant heading for a long established principle which:

“is essentially based on the proposition that one cannot contract out of the provisions of the insolvency legislation which govern the way in which assets are dealt with in a liquidation.”

(per Lord Neuberger MR in Perpetual Trustee Co Ltd v. BNY Corporate Trustee Services Ltd [2009] EWCA Civ 1160 [2010] 3 WLR 87, at paragraph 50). As the modern cases including Perpetual show, it is a principle which is easy to state, but difficult to apply, in particular in relation to sophisticated dealings between modern financial and commercial entities. This difficulty of application is best illustrated by the fact that, in British Eagle International Airlines Ltd v. Cie Nationale Air France

[1975] 1 WLR 758, all their Lordships were in substantial agreement about the nature of the principle, but split 3/2 over its application, the minority agreeing with all the judges in the courts below.

95. Although the rule serves a sound public policy objective, the jurisprudence about it has been disfigured by its tendency to throw up formalistic distinctions, such that its effect may easily be avoided (or, some would say, evaded) by clever draftsmanship without any underlying change in the economic reality between a structure which does, or does not, infringe the rule. This is, again, illustrated by the ease with which IATA managed to avoid the outcome of British Eagle for the future, by a modest amendment to its regulations, such that the High Court of Australia was able to find that the rule was no longer contravened, in International Air Transport Association v. Ansett Australia Holdings Ltd [2008] HCA 3, in circumstances where the underlying economic realities between the participating airlines remained exactly the same.
96. The modern trend has been to restrict rather than to broaden the ambit of application of the rule, for two reasons. The first is that, in a corporate context, the increasingly sophisticated anti-avoidance provisions now in the Insolvency Act 1986 (“the Act”) reduce the need for a general anti-avoidance principle originally developed to protect the much simpler bankruptcy legislation from evasion. The second is that the uncertainties of the rule’s boundaries risk coming into conflict with the countervailing public policy in favour of contractual certainty and party autonomy in bona fide commercial arrangements: see Perpetual (*supra*) at paragraphs 57 to 58.
97. The part of the insolvency legislation which the anti-deprivation rule exists mainly to protect is what is generally called the principle of *pari passu* distribution, namely that all the property owned by the company as at the commencement of its relevant insolvency process should, subject to the prior payment of preferential liabilities and expenses, be applied in satisfaction of its liabilities in proportion to the size of those liabilities: see Section 107 of the Act in relation to voluntary winding up and rule 4.181(1) of the Insolvency Rules 1986 (“the Rules”) in relation to compulsory winding up. A similar provision is now applicable in administration, where the administrators make a distribution to unsecured creditors pursuant to paragraph 65 of Schedule B1 to the Act: see Rule 2.69.
98. There was some debate between counsel as to whether the anti-deprivation rule applied, in the context of an administration, with effect from the making of the administration order or from the (necessarily later) date upon which the administrators gave notice under Rule 2.68 of their intention to declare and distribute a dividend. The Administrators of LBIE have given such a notice, but only after LBIE had been in administration for over a year. It is unnecessary for me to decide this question. For present purposes, I shall assume, but without deciding, that Mr Trower for the Administrators is correct in his submission that the rule is to be applied in relation to property owned by the company at the time of the making of the administration order, rather than to its property as at some later date.
99. Typically, an infringement of the rule in the context of the insolvency principle of *pari passu* distribution requires it to be shown that some part of the company’s property which it owned as at the date when its insolvency process commenced has by contract or other arrangement either (i) been taken away from the company or (ii) been subjected to a process of distribution to creditors other than as provided by the

Act and Rules. British Eagle may best be analysed as an example of the second of those alternatives. The IATA clearing house system to which the insolvent company was a party was described by Lord Cross as a form of “mini-liquidation” which could not prevail over the statutory *pari passu* scheme: see [1975] 1 WLR 758 at 780H.

100. The Administrators claim that Section 2(a)(iii) of the Master Agreement offends against the first limb of the rule, as I have described it. Mr Trower’s submission ran as follows:
- (i) At the moment when LBIE went into administration on 15th September 2008 it was the owner, under each of the Swaps, of an asset consisting of a contingent liability owed by each of its counterparties, the contingencies being:
 - (a) that floating interest rates should be such, on each of the outstanding payment dates in the relevant Confirmation, that a net sum was due from the counterparty to LBIE (i.e. that LBIE should be in the money); and
 - (b) that no Event of Default or Potential Event of Default had occurred and was continuing.
 - (ii) The operation of the condition precedent constituted by the requirement that there be no Bankruptcy Event of Default meant that, upon LBIE going into administration, it was (in all probability permanently) deprived of that asset, either for distribution to creditors *pari passu*, or for beneficial utilisation in the course of its administration.
 - (iii) It was no answer for the respondents to say that the condition precedent had existed from the moment when the asset (in the form of a contingent liability) was created. That was equally true of the royalties in ex parte Mackay (1873) 8 Ch App 643, approved in British Eagle and followed in Perpetual, in particular by Lord Neuberger MR at paragraph 67, with whom Longmore LJ agreed, at paragraph 99.
101. Mr Trower sought to bolster his case by a submission that the rule is infringed wherever a party in a contractual relationship with a company gains an advantage from that company’s going into an insolvency process which it would not otherwise have enjoyed. He described the freedom acquired by each of LBIE’s counterparties from having to pay very substantial sums to LBIE under the Swaps once floating rates fell below the agreed fixed rates as just such an advantage.
102. I do not consider that the anti deprivation rule includes any such broad element within it. It is commonplace for the insolvency of a contracting party to devalue its rights under the contract, and for the counterparty thereby to gain consequential benefits, under contractual provisions which do not infringe the rule. So broad a summary of the effect of the rule is entirely unsupported by any authority.
103. In my judgment Section 2(a)(iii) of the Master Agreement (in both its 1992 and 2002 forms) as incorporated into the five Swaps the subject matter of these proceedings does not contravene the anti-deprivation rule in relation to LBIE. My reasons follow.

104. Each of the Swaps conferred on LBIE contingent rights to receive payments from its counterparties on those payment dates specified in the various Confirmations as occurring after 15th September 2008. The contingencies were broadly as Mr Trower describes them, namely that LBIE should be in the money (i.e. entitled on that date to receive a net payment under Section 2(a)(i) and (c)), and that there should not on those subsequent dates be a continuing Event of Default under Section 2(a)(iii). Those rights had always been subject to both those contingencies from the outset, that is, from the day of the making of each Swap.
105. The nature of those rights did not change in any way on 15th September 2008. In relation to most of the Swaps, LBIE was out of the money on the immediately following payment date, but due to the subsequent fall in interest rates the “in the money” contingency was thereafter satisfied in relation to all of them.
106. LBIE remained contingently entitled to such net payments thereafter, for the duration of the agreed term of each Swap. Nonetheless the second contingency, that there should be no continuing Event of Default was, from 15th September 2008 extremely unlikely ever to be satisfied. There is, in reality, no significant prospect that LBIE will either itself survive its administration, or that the benefit of any of the Swaps can in practice be transferred by LBIE to a non-defaulting assignee under the limited scope for assignment contained in each Swap. That much is common ground.
107. The critical question is whether the inclusion of that second contingency from the moment of the creation of the rights to net payments offends the anti-deprivation rule. I agree with Mr Trower that it is not enough, as the authorities presently stand, for the respondents to say merely that the rights were subject to that contingency from the outset. That was the minority view of Patten LJ in Perpetual, at paragraph 135, but the majority did not feel able to accept it, because of its apparent inconsistency with the analysis in ex parte Mackay: see paragraph 67. It is therefore necessary to understand from the three decisions of ex parte Mackay, British Eagle and Perpetual (by all of which I am bound) why it is that in some cases the creation *ab initio* of a flaw in the relevant asset does, and in other cases does not, fall foul of the anti-deprivation rule. In all three cases the right in question was a form of chose in action, namely a royalty right in ex parte Mackay, a debt in British Eagle and a security right in Perpetual.
108. In my judgment the critical distinction which emerges from those and other cases may be expressed in the following way. Where the asset of the insolvent company is a chose in action representing the *quid pro quo* for something already done, sold or delivered before the onset of insolvency, then the court will be slow to permit the insertion, even *ab initio*, of a flaw in that asset triggered by the insolvency process. By contrast, where the right in question consists of the *quid pro quo* (in whole or in part) for services yet to be rendered or something still to be supplied by the insolvent company in an ongoing contract, then the court will readily permit the insertion, *ab initio*, of such a flaw, there being nothing contrary to insolvency law in permitting a party either to terminate or adjust what would otherwise be an ongoing relationship with the insolvent company, at the point when it goes into an insolvency process.
109. Examples of the former type are the royalty stream in ex parte Mackay, which was the *quid pro quo* for a patent sold outright by the person who later became bankrupt, and

the debt owed by Air France to British Eagle, which was for services already rendered by British Eagle to Air France prior to the commencement of its winding up.

110. Familiar examples of the latter category are leases and licences, where the right to enjoy the underlying asset accrues over time, in exchange, also over time, for payment of rent or fees, and which have always been terminable on bankruptcy without infringing the rule: see Perpetual at paragraph 64. A more telling example is the security right enjoyed by LBSF under its swap agreement in priority to the note-holders over collateral for which the note-holders had paid the price, and which was liable to be subordinated to the note-holders' security in the event of LBSF's insolvency. That right was conferred in connection with a swap contract also governed by an ISDA Master Agreement, pursuant to which LBSF had ongoing obligations at the time when it went into Chapter 11 bankruptcy.
111. As appears from Perpetual at paragraph 67, central to the decision of the majority was the fact that the provision for postponement of LBSF's security on its bankruptcy (the "flip") operated in relation to assets which had been acquired by money provided by the note-holders, and the flip was designed only to ensure that, on the failure of the transaction, the note-holders would be repaid out of those assets before LBSF. It was an *ab initio* adjustment to the ongoing relationship between LBSF and the note-holders triggered by LBSF's insolvency, but none the worse for that.
112. Returning to the present case, the contingent rights to future net payments, as at 15th September 2008 enjoyed by LBIE under each of the Swaps were the *quid pro quo* not merely for services previously rendered to the Swap counterparties, but for the ongoing provision of an interest rate hedge. LBIE's insolvency was one of those events which, as described by Mr Firth in his book *Derivatives: Law and Practice*, was sufficient to undermine the basis of that ongoing relationship with its counterparties. Reduced to its bare essentials, the condition precedent that there should be (*inter alia*) no Bankruptcy Event of Default was a provision designed to ensure that LBIE would only receive its *quid pro quo* for providing an interest rate hedge for as long as it was in a financial condition to be able to do so.
113. In my judgment that analysis places the contingent rights of which the Administrators complain that LBIE has been deprived clearly on that side of the difficult dividing line which permits the parties to include, *ab initio*, an insolvency based flaw, without infringing the anti-deprivation rule. For those reasons, the rule has not been infringed by Section 2(a)(iii) of the Master Agreement, as incorporated in the five Swaps in issue.
114. I must however add two warnings by way of postscript. The first is that this is a decision on these five interest rate Swaps, rather than one which may automatically be relied upon in relation to all possible circumstances in which an ISDA Master Agreement might be used. It is essentially based upon a perception that interest rate swaps constitute an ongoing relationship between the parties to them, in which their rights to receive contingent net payments accrue from time to time as the *quid pro quo* for the provision of a continuing service. It is perfectly possible that a different analysis might be appropriate where a Master Agreement was incorporated into some different kind of transaction.

115. The second warning is that, but for the concession that Section 2(a)(iii) operates, under these five Swaps, on a net rather than gross basis, analysed under the heading Gross/Net above, I might have concluded that if Section 2(a)(iii) operated so as to increase LBIE's obligation on any future payment date from a net amount (after giving credit for the fixed rate payment due from the counterparty) to a gross amount, namely the whole of the floating rate amount, that might well have offended the anti-deprivation principle, for the simple reason that it imposed a greater financial obligation on LBIE in favour of a particular creditor by reason of LBIE's insolvency, than would otherwise have been imposed. I have from start to finish suspected that the concession made by each of the respondents that these Swap agreements operate only on a net basis has been made for the specific purpose of avoiding that outcome. The concession that Section 2(a)(iii) operates in relation to these Swaps on a net basis means that LBIE will not on any payment date subsequent to 15th September 2008 be under any greater payment obligation to any of its counterparties than it would have been, had it not gone into administration.
116. I am invited, by reference to the Agreed List of Issues, to deal in addition with a particular timing point that arises as between LBIE and BEIG, from the fact that, on one view, LBHI suffered a Bankruptcy Event of Default shortly before LBIE did, LBHI being LBIE's Credit Support Provider under the BEIG Transaction. I am asked, on assumed facts, to address the issue on the alternative assumptions that LBHI's Bankruptcy Event of Default occurred either (i) before or (ii) at the same time as or (iii) after that incurred by LBIE.
117. On the view which I have taken of the anti-deprivation issue in relation to all five Swaps, it is unnecessary for me to decide this question. Nonetheless, and against the risk that this matter goes further, I shall briefly express my view upon it.
118. In the event that LBHI's Bankruptcy Event of Default preceded that of LBIE then, if I had otherwise been of the view that Section 2(a)(iii) deprived LBIE of anything, within the meaning of the rule, I would have concluded that the relevant deprivation had occurred before the commencement of LBIE's administration, with the consequence that it owned no asset at the moment of its administration to which the rule could apply: see Perpetual at paragraphs 69 to 72, and because the rule is not triggered by the insolvency of a third party: see paragraph 73.
119. If the Bankruptcy Event of Default of LBHI was coterminous with that of LBIE, then it seems to me that the same result would follow. LBIE would (on the present hypothesis) be deprived of property at what happened to be the moment of its insolvency, but not because of a provision which offended the anti-deprivation rule.
120. By contrast, if LBHI's Bankruptcy Event of Default followed that of LBIE, then the reasoning of Patten LJ in Perpetual in paragraph 163 might at first sight suggest that a further deprivatory event after the onset of LBIE's insolvency process would fall foul of the rule because, by then, the Insolvency Act regime had come into effect in relation to LBIE's property. Nonetheless, I consider that the result would still be the same as if LBHI's bankruptcy had been simultaneous with that of LBIE. The asset which LBIE owned as at the moment of its bankruptcy was a right to future payment which was always contingent upon there being no Event of Default in relation to LBHI on any subsequent payment date. That contingency might be unsatisfied, just like the contingency that LBIE should be in the money. In neither case could the anti

deprivation rule be offended merely because the contingent right to future payment continued to be subject to an unsatisfied condition precedent other than LBIE's own bankruptcy.

PENALTY

121. I can take this part of the Administrators' case very shortly indeed. The allegation is that Section 2(a)(iii) of the Master Agreement operates as a penalty when triggered by LBIE's Bankruptcy Event of Default. Before me, Mr Trower very sensibly conceded that I would be bound by the decision of the Court of Appeal in Associated Distributors Ltd v. Hall [1938] 2 KB 83, approved (*obiter*) in Campbell Discount Co Ltd v. Bridge [1962] AC 600, to conclude that the common law doctrine of penalty is inapplicable where the triggering event is not a breach of contract. Since Mr Trower accepted that LBIE's going into administration was, although a Bankruptcy Event of Default, not a breach of any of the Swap agreements, he readily accepted that the case as to penalty could not be pursued at first instance.

FORFEITURE

122. I can be almost as brief in relation to this final part of the Administrators' case. The allegation is that the loss of LBIE's right to contingent net payments occasioned by its Bankruptcy Event of Default was a forfeiture for which the court can grant relief. This case was not pursued at any length, and is in my judgment subject to two fatal objections. The first is that a contingent right to net payments of money under a contract is not, even if it constitutes property in other respects, a type of property in respect of which the jurisdiction to grant relief from forfeiture exists. The Swaps in issue in these proceedings are classic examples of the type of commercial transactions in relation to which the existence of a jurisdiction to relief from forfeiture would give rise to unacceptable uncertainties and fetters upon contractual rights: see Scandinavian Trading v. Flota Ecuatoriana [1983] 1 QB 529 per Robert Goff LJ at 541 C to E, approved in Sport International v. Inter-Footwear Ltd [1984] 1 WLR 776, by the House of Lords.
123. The second objection is that the condition precedent in Section 2(a)(iii) of the Master Agreement is not in any event a forfeiture, but a condition precedent: see by way of analogy Euro London Appointments v. Claessans International [2006] 2 Lloyd's Rep 436, per Lawrence Collins J at paragraph 44.

CONCLUSIONS

124. I can therefore address the Agreed List of Issues, part of which I have set out above, as follows.

Construction

- 1) No.
- 2) Not applicable.
- 3) No.
- 4) (1) No

(2) Yes, on a transaction by transaction basis.

(3) No.

Anti-Deprivation

5) No.

6) (1) Not necessary to decide.

(2) Yes, but regardless whether it provides a benefit to the Non-defaulting Party.

(3) No.

(4) Does not arise.

Penalty/relief from forfeiture

7) No.

8) Not applicable.

9) No.

10) (1) No.

(2) Not applicable.

(3) No.

11) No.

12) See the analysis in the judgment.

13) Not applicable.

Proving

14) The respondent Non-defaulting Parties in the present case all acknowledge that, as at present, the netting of the payment obligations which have arisen since 15th September 2008 mean that they have no present right of proof against LBIE in respect of the Swap agreements. LBIE is, on a net basis, heavily in the money under each of them. Further, in relation to such Swap agreements as have yet to reach their termination by effluxion of time, no rights of proof will arise unless changes in interest rates hereafter are so large that, even after giving LBIE credit for all the payments which would have been payable when LBIE was in the money, a net sum were still to be due to the respondent counterparty. Mr Fisher submitted that, even then, it would be necessary for the counterparty to waive the condition precedent constituted by LBIE's continuing default. I make no decision about that. For the avoidance of doubt, it has not been argued or decided whether that condition precedent is capable of unilateral waiver by the Non-defaulting Party.