No 7942 of 2008

IN THE HIGH COURT OF JUSTICE

CHANCERY DIVISION

COMPANIES COURT

9 October 2015

The Honourable Mr Justice David Richards

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

(1) ANTHONY VICTOR LOMAS

(2) STEVEN ANTHONY PEARSON

(3) PAUL DAVID COPLEY

(4) RUSSELL DOWNS

(5) GUY JULIAN PARR

(as the joint administrators of the above named company)

Applicants

- and -

(1) BURLINGTON LOAN MANAGEMENT LIMITED

(2) CVI GVF (LUX) MASTER S.A.R.L

(3) HUTCHINSON INVESTORS LLC

(4) WENTWORTH SONS SUB-DEBT S.A.R.L

(5) YORK GLOBAL FINANCE BDH, LLC

Respondents

SKELETON ARGUMENT ON BEHALF OF

THE FOURTH RESPONDENT

A INTRODUCTION

1. These submissions are filed on behalf of Wentworth Sons Sub-Debt S.a.r.l (**"Wentworth"**) in respect of consequential matters arising from the judgments in *Waterfall IIA* and *Waterfall IIB.*

2. The submissions address the following:

   (1) Points of dispute in relation to the terms of the declarations to be made in Part A and permission to appeal by Wentworth from certain of the declarations in Part A (Section B);

   (2) Points of dispute in relation to the terms of the declarations to be made in Part B and permission to appeal by Wentworth from certain of the declarations in Part B (Section C);

   (3) Costs of Parts A and B (Section D).

3. Except as defined herein capitalised terms have the meaning defined in the Application, which was issued by the Administrators' application notice dated 12 June 2014 as amended.

4. Draft orders for Part A and Part B have been provided to the Court. The aspects of each order which are not agreed are indicated in the drafts, and are considered in turn below by reference to the paragraph numbers in the drafts.

B PART A: DRAFT ORDER

Declaration (iii) (Issue 2)

5. This declaration gives effect to the Court's ruling that the rule in *Bower v Marris* does not apply in calculating interest payable under Rule 2.88.

6. It is agreed, apart from the fact that York wishes to include additional wording, so that it is clear that the declaration applies (in addition to proved debts) to preferential debts whether proved or not. Wentworth does not oppose this addition.

Declaration (vi) (Issue 2A)

7. This declaration is intended to reflect the Court's conclusion in [169] of the Part A Judgment that a claimant with a non-provable currency conversion claim, where the creditor had a contractual right (or other right existing apart from insolvency) to interest, carries interest.

8. There are two points of disagreement in respect of this declaration. First, the date from when interest on such a claim would run. Second, whether the declaration should extend to other non-provable debts.

9. So far as the first point is concerned, Wentworth contends that interest can only run, at the earliest, from the date of the payment of the final dividend in respect of the provable claim. The SCG and the Administrators contend that it runs from the Date of Administration (as defined in the Application Notice).

10. In considering the date from which interest on a non-provable currency conversion claim runs, it is important to keep in mind the Court's conclusion at [228] that interest under Rule 2.88 "*replaces all prior rights, including contractual rights*" to interest and that "*the only right of the creditor, whether its original debt was in sterling or in a foreign currency, is to receive interest in accordance with rule 2.88(7)-(9) on its admitted debt, which is necessarily expressed in sterling, from the date of administration.*"[1]

11. Until the date of payment of the final dividend in respect of the proved claim (i.e. the foreign currency debt converted into sterling for the purposes of proof), it cannot be known whether a currency conversion claim exists at all. That is because the currency

[1] Wentworth also relies on this conclusion in support of its application for permission to appeal the Judge's conclusion in [169]. Its submissions as to the date from which interest on a currency conversion claim runs are without prejudice to its application for permission to appeal the conclusion that interest runs on such a claim in the first place.

claim comprises the shortfall (if any) between the underlying foreign currency entitlement and the foreign currency equivalent of the sum of all sterling dividends paid, at the time of payment.

12. It may well be, for example, that although the exchange rate at the time of payment of an interim dividend of 50% of the proved debt in sterling amounted to 60% of the proved debt in its original foreign currency, and it was only later currency movements that resulted in an overall shortfall.

13. Conversely, it may be that the payment of an interim dividend of 50% of the proved debt in sterling resulted in a payment of only 30% of the proved debt in its original foreign currency, but that currency movements prior to the final dividend corrected the position.

14. In the second example, there can be no question of the creditor being entitled to interest on the shortfall between the foreign currency equivalent of the 50% dividend and 50% of its foreign currency debt (because there was in fact no currency conversion claim at all following payment of the final dividend).

15. In the first example, to allow a creditor interest on its currency conversion claim from the Date of Administration would result in that creditor being substantially over-compensated, because until the date of the final dividend it had received a sterling sum (and statutory interest on that sterling sum) which was greater, in its original currency, than the proportion of proved debts received by sterling creditors. Given, as the Court has found, there is no offset between currency conversion claims and statutory interest, there is a windfall benefit to the currency conversion creditor at the expense of others interested in the surplus.

16. In light of these considerations, if there is a right to interest at all on a currency conversion claim, it should run only from the date of the payment of the final dividend in respect of the proved debt.

17. So far as the second point is concerned, the SCG and the Administrators contend that the declaration should extend to all non-provable claims that carry a contractual or

other non-administration right to interest. Wentworth contends that it should be limited to currency conversion claims, which were the only species of non-provable claim under consideration at the hearing.

18. It is unnecessary for the declaration to be any wider, since there is no suggestion that any other non-provable claims are relevant to the LBIE estate. No argument was directed at this possibility. While it may be possible, as a matter of legal theory, to envisage non-provable claims which sit wholly outside the insolvency regime, where a contractual right to interest as part of that claim would be recognised, there may be other non-provable claims where there is good reason not to allow interest.

Declaration (x) (Issue 4)

19. This Declaration reflects the conclusion that the words "*the rate applicable apart from the administration"* in Rule 2.88(9) do not encompass a foreign rate of interest applicable to a judgment obtained after the Date of Administration.

20. Wentworth wishes to add words to clarify that a foreign statutory rate which was obtained after (or could have been obtained by taking steps after) the Date of Administration is also excluded. This reflects the issue as formulated in the Application and therefore the legal issue before the Court in the Part A trial. The logic of the Court's judgment, at [177], that the rate applicable apart from the administration does not include a rate which would only be applicable if the creditor took certain steps, extends to a statutory rate which would have become applicable to the debt if the creditor had taken certain steps (i.e. the wording proposed by Wentworth).

21. *Declaration (xvii) (Issue 10)*

22. This declaration reflects the Court's decision (at [231] of the Part A Judgment) that the calculation of a currency conversion claim should not take into account Statutory Interest paid to the relevant creditor.

23. The SCG and the Administrators wish to expand the declaration so that it refers also to any other non-provable claim.

24. Wentworth objects to this expansion. No consideration was given to any other potential non-provable debts, or their interplay with Statutory Interest. As noted above, there is no suggestion that there are any other non-provable debts in the LBIE estate, so the expansion would be unnecessary.

25. Moreover, it is possible to consider at least one other potential non-provable claim, namely a non-provable claim to some form of interest if and to the extent that an appeal court overturns the Court's decision on Issue 2A, in respect of which the expansion of the declaration on Issue 10 would be clearly wrong. If there were a non-provable claim to interest in respect of the period after administration, it is clearly one which would have to take account of Statutory Interest paid in respect of that same period.

Paragraphs 2&3 of the draft Order: Costs

26. The issue of costs of Part A and Part B is considered below at Section D.

Paragraphs 4-6 of the Draft Order: Permission to appeal

27. Wentworth does not object to permission to appeal being granted to the SCG in respect of the Declarations referred to in para 4 of the draft Order.

28. Wentworth in turn seeks permission to appeal in respect of Declarations (vi) (interest on non-provable currency conversion claim); (xiv) (statutory interest on contingent debts); and (xvii) (offset between currency conversion claims and interest).

29. Wentworth respectfully contends that, if permission is granted to the SCG in respect of the Declarations referred to in paragraph 4 of the draft Order, that alone is sufficient justification for permission to appeal being granted to Wentworth, given the inter-relation between all of the issues.

30. In addition:

    (1) In relation to the question of interest on currency conversion claims, Wentworth contends that it has a realistic prospect of persuading the Court of Appeal that this Court's conclusion is wrong, on the basis that it is inconsistent with the Court's

finding (at [228]) that Rule 2.88 is a complete code, which replaces all prior rights, including contractual rights, such that the only right of a creditor to interest after the Date of Administration, whether its original debt was in sterling or a foreign currency, is to receive interest under Rule 2.88;

(2) In relation to the question of interest on contingent claims, Wentworth contends that it has a realistic prospect of persuading the Court of Appeal that, in light of this Court's conclusion (at [218]) that a matured contingent debt is not discounted back to the Date of Administration, and the 'double-counting' to which this gives rise if interest is payable from the Date of Administration, this aspect of the Court's decision should be overturned; and

(3) In relation to the inter-relationship between a currency conversion claim and interest, there is a particularly close relationship with Declaration (v) (in respect of which the SCG seeks permission to appeal), and Wentworth in any event has a reasonable prospect of persuading the Court of Appeal to adopt a different, and broader, approach to the calculation of a currency conversion claim as the difference between (a) the original foreign currency entitlement outside of the statutory scheme for insolvency and (b) the foreign currency equivalent of the sum of all payments received from that statutory scheme.

Miscellaneous

31. Two additional matters arise in relation to Part A.

32. First, the Joint Administrators have prepared a draft note and draft order addressing Issue 37 which concerns the disaggregation of claims. Wentworth has some concerns in relation to the way in which the operation of set-off is addressed in the draft note and at para 5 of the draft order and, in particular, the inter-play between insolvency set-off and Currency Conversion Claims and Statutory Interest[2]. The mandatory and self-

[2] Wentworth has given two examples. First, a case where a creditor has two debts for which it proves - one denominated in £ and one in $. Second, a case where a creditor has two debts for which it proves - one with a contractual interest rate of LIBOR and one with a contractual interest rate of 10%.

executing nature of insolvency set-off means that it should apply pro rata to the proved debts of a creditor.

33. The Joint Administrators have now confirmed that, for the purposes of determining creditors' rights to Currency Conversion Claims and Statutory Interest, they will apply set-off in accordance with rule 2.85. Accordingly, it is anticipated that an agreed position can be reached in respect of this issue in advance of the hearing.

34. Second, in recent correspondence, York has suggested a Currency Conversion Claim may be created by the operation of insolvency set-off against a claim originally denominated in a foreign currency that has been converted into Sterling for the purpose of proof. York suggests that further written submissions may be required on this point with a view to the Court giving a supplemental judgment on the issue.

35. The Joint Administrators have previously explained, in June 2015, why no Currency Conversion Claim will arise in these circumstances. Moreover, the SCG and Wentworth have agreed that it is not an issue that needs to be considered by the Court.

36. In short, there is no basis for a Currency Conversion Claim arising as a result of the operation of insolvency set-off as rule 2.85 operates by reference to the exchange rate as at the Date of Administration.

37. Accordingly, Wentworth's position is that there is no need for further written submissions on this issue.

C PART B: DRAFT ORDER

Declaration (i)

38. This reflects the Court's conclusion that neither the CRA nor the CDDs had the effect of releasing any currency conversion claims.

39. The SCG wish to add that neither the CRA nor the CDDs had the effect of releasing any non-provable claim to interest arising in respect of a currency conversion claim during the period of administration.

40. Wentworth objects to this addition. Given the Court's conclusion that there was generally no non-provable claim to interest, it did not need to examine the issue of the release of such claims in detail. The Court did, however, conclude as follows in relation to non-provable claims for interest:

    (1) In relation to the CRA, "*I agree with the submission of Mr Zacaroli on behalf of Wentworth that the last sentence of clause 25.1 of the CRA precludes any such claim.*" [116]

    (2) In relation to the CDDs, "*In any event, it would be difficult to argue that such claims survived the express release in clause 2.1.1 of "all Claims for interest"*. [147] (Agreed Claims CDDs) and [162] (Admitted Claims CDDs).

41. Clause 25.1 of the CRA provides: "*For the avoidance of doubt, no interest shall accrue on any Net Financial Claim, save to the extent provided in Rule 2.88 of the Insolvency Rules"*.

42. A right to interest on a non-provable currency conversion claim is dependent on there being a contractual, or other non-administration, right to interest: see [169] of the Part A Judgment. Such a right to interest falls within the scope of interest accruing on a Net Financial Claim within clause 25.1 of the CRA, and within the scope of "all Claims for interest" within clause 2.1.1 of the Agreed Claims CDD. Wentworth accordingly invites the Court to make a declaration, consistent with its brief conclusions in [116], [147] and [162] of the Part A Judgment, that any such claim has been released by the terms of the CRA and CDDs.

Declaration (iv)

43. This declaration reflects the Court's conclusion that had the CRA or CDDs released currency conversion claims, the Administrators would have been directed not to enforce such releases, pursuant to the principle in *ex parte James* and paragraph 74 of Schedule B to the Insolvency Act 1986.

44. The SCG wish to expand the scope of this declaration to cover any non-provable claim to interest arising in respect of currency conversion claims during the period of administration.

45. Wentworth objects to this expansion. The Part B Judgment does not consider the enforcement of the release of claims to interest in the context of non-provable claims to interest. The Court's reasons (see [184] of the Part B Judgment) for concluding that the release of currency conversion claims offend the principle in *ex parte James* does not apply, or at least wholly apply, to the release of interest claims. In particular:

    (1) The fact that the release of currency conversion claims would be an "*unintended consequence*" of the CRA and CDDs does not apply, since the release of any and all interest claims other than claims to Statutory Interest is expressly provided for in the CRA and CDDs, and is thus clearly an intended consequence.

    (2) For similar reasons, the concern that the Administrators would have told creditors of the effect on currency conversion claims had they thought the CRA/CDDs had that consequence, is inapplicable to the release of claims to interest;

    (3) The concern that enforcing the releases of currency conversion claims would create "*unintended discrimination between different creditors for no reason in any way connected with the purposes of the administration or the best interests of creditors as a whole*" is inapplicable to the release of claims to interest. The only differential treatment, so far as interest is concerned, is between creditors who entered into the CRA or CDDs, and creditors who did not. The fact that creditors who wished to obtain the benefit of speedier resolution and distribution agreed, as one element of the price for doing so, to release all claims to interest, other than Statutory Interest, is neither discriminatory nor unfair.

46. If, as Wentworth contends, there is no reason based on *ex parte James* or paragraph 74 of Schedule B1 to preclude the Administrators from enforcing the release of non-provable claims to interest, generally, there is equally no reason for precluding enforcement of the release of that species of non-provable claims to interest that arises in respect of currency conversion claims.

47. Accordingly, Wentworth respectfully contend that the expansion of declaration (iv) sought by the SCG should be rejected.

Declaration (v)

48. This is a declaration that Wentworth seeks to have added to the draft Order to reflect the Judge's brief conclusion (referred to above) that, while the issue was academic, both the CRA and the CDDs had the effect of releasing non-provable claims to interest.

49. While the issue is, at present, academic (save in respect of interest on currency conversion claims, as discussed above), the SCG seek permission to appeal the relevant aspect of the Part A Order. In the event that the Court's decision on the existence of non-provable claims to interest, generally, is overturned, then Wentworth would wish the position so far as release of those claims to be made clear by the additional declaration it seeks in paragraph (v) of the draft Part B Order.

50. The SCG do not dispute that such a declaration would be correct, but dispute that it is necessary. If it is to be included, the SCG seek a carve-out for non-provable interest on currency conversion claims. Such a carve-out would be inappropriate for the reasons set out above in connection with Declaration (i).

Paragraph 2 of the Part B Order: Costs

51. The issue of costs of Part A and Part B is considered below at Section D.

Paragraphs 3 & 4 of the Part B Order: Permission to Appeal

52. Wentworth does not object to the SCG obtaining permission to appeal in respect of Declaration (v), if it is included.

53. Wentworth seeks permission to appeal against Declarations (i), (ii) and (iv) in the Part B Order. In particular, Wentworth makes the following points:

Declaration (i): construction

54. Wentworth seeks permission to appeal on the basis that it stands a real prospect of persuading the Court of Appeal to reach a different conclusion on the interpretation of the CDDs and CRA to that reached by this Court.

55. As with many questions of construction, reasonable judges may reasonably disagree on the outcome, and Wentworth contends that its chances of persuading the Court of Appeal are realistic, i.e. more than fanciful (CPR 52.3.7).

56. There are large sums at stake. As the Court noted at [8], currency conversion claims may amount to some £1.3 billion. While not all creditors with potential currency conversion claims entered into a CDD in the relevant form, it is likely that the question of release of such claims is worth many hundreds of millions of pounds.

57. In the following paragraphs, the principal points upon which Wentworth would seek to persuade the Court of Appeal to take a different view are identified. This is done mainly by reference to the Admitted Claims CDDs, on the basis that Wentworth's core argument is that a currency conversion claim no longer persists where the creditor has agreed to limit its entitlement to a sum payable in sterling, and that this is the case in relation to all of the Admitted Claims CDDs (but only in relation to a few of the Agreed Claims CDDs, and not at all in the case of the CRA).

58. Wentworth would seek to persuade the Court of Appeal:

    (1) First, that the Court took too restrictive a view of the purposes of the CDDs (at [69] and [165]) and of the proper functions of the Administrators (at [65]):

        (a) While it is true that a purpose of the CDDs was to accelerate the payment of dividends on proved debts, their purpose was also to achieve finality as between the creditor and the estate;

        (b) While the Administrators were required to perform their duties in the interests of LBIE's creditors as a whole, that is consistent with

adopting a commercial approach to negotiating, on a bilateral basis, with individual creditors to compromise disputes as to the quantum of their claims;

(c) In particular, Wentworth will contend that the entry into CDDs, with a bilateral release of all claims of whatever nature between the parties, save for an agreed claim amount, is wholly consistent with the Administrators duty to act in the interests of all creditors. The absence of a profit-motive on the part of an officeholder is irrelevant: an officeholder properly motivated to discharge his duties is entitled to bargain for finality;

(d) Moreover, a bargain with individual creditors which involves finality as regards all claims between the parties, whether those claims were provable or only claimable as part of a second-round proof process as against a surplus, is as much in the interests of the general body of creditors (including, for this purpose, subordinated creditors who rank only after payment of all proved debts and interest), as a bargain which seeks finality only in respect of provable claims;

(e) The attendant benefits of certainty flowing from a compromise in a definite amount and a full and final release of rights save for that definite amount is an outcome for which an administrator might properly bargain. If he has used language appropriate (indeed conventional) to achieve that result, his bargain should not be reduced in scope by a construction which, in essence, says he can bargain for no more than necessary to discharge his immediate statutory duty, namely the duty of admitting claims for proof and distribution. An administrator is entitled to bargain for certainty for all purposes, thereby providing certainty as regards second-round proofs and any other purpose to which the otherwise uncompromised rights would have been relevant;

(2) Second, that the Court's reliance (at [165]) on the fact that a release of currency conversion claims is irrelevant to the considerations that Admitted Claims should not be subject to subsequent challenge, or be augmented by additional claims, is undermined by:

(a) The acceptance that the CDDs had the effect of releasing *other* non-provable claims such as any additional right to interest (the release of non-provable claims to interest is equally irrelevant to the considerations relied on by the Court in [165]); and

(b) The fact that in any event the wording of the release clause in the CDDs clearly extends to the release of claims that are not provable;

(3) Third, that the Court erred in characterising a currency conversion claim as a free-standing claim, which could not have been released without the parties giving express consideration to it (see, e.g. [167] "*it was never contemplated or suggested that the effect of doing so would be to release the currency conversion claim which were, Wentworth agrees, preserved by the CRA"*). On the contrary:

(a) The foundation of a currency conversion claim is rooted in, and an inseparable part of, the underlying contractual claim – namely that part of the claim which requires payment to be made in a foreign currency;

(b) Where, as in the case of each of the Admitted Claims CDDs, all claims under the underlying contract are released, in exchange for an entitlement to be paid a specific sum, then there simply remains no basis for any other claim arising under the underlying contract, be it the right to be paid in foreign currency or any other claim;

(c) Where the specific sum, being the only sum payable following the execution of the CDD, is in sterling, it is by definition incapable of giving rise to a currency conversion claim, irrespective of the operation of any release, because payment of dividends in respect of

that sum will be in the same currency, thus eliminating any possibility of a shortfall;

(4) Fourth, that the observation in *BCCI v Ali*, that the court should be slow to extend the legal effect of the general language of compromise beyond its proper subject-matter, is irrelevant where, as in the case of the Admitted Claims CDD, the rights under the underlying contract are the main focus of the release clause, and no extension of the general language is required;

(5) Fifth, that the Court's conclusion fails to give adequate effect to the plain words of the CDDs, contrary to the Supreme Court's decision in *Arnold v Britton* [2015] UKSC 36;

(6) Sixth, that the Court, in construing the CDDs, erred in relying, at [153] and [166], on (a) what the administrators would have done had they intended to waive currency conversion claims or (b) the effect upon currency conversion claims was different (and wrongly discriminatory) as between creditors who entered into different forms of CDD:

(a) The Court erred in these respects because it had regard to circumstances (namely the existence of currency conversion claims) that were not in the contemplation of the parties at the time of the entry into the CDDs;

(b) For example, the fact that the administrators would have been required to make clear statements to creditors that the CDDs had the effect of releasing currency conversion claims, had that been their intention, is irrelevant in circumstances where such claims were in nobody's contemplation at the time;

(c) On the contrary, the fact that currency conversion claims were not in the parties' contemplation at the time, and thus are excluded from the relevant background material against which the documents must be construed, means that their existence provides no reason for departing

from the clear wording of the CDDs – i.e. that the sole surviving claim is a claim denominated in sterling, and that any other claim (including claims arising under the original contract) is released;

(d) This is particularly so, where the parties have expressed an intention to release claims unknown and not contemplated, save for a claim denominated in a fixed amount in sterling: the subsequent emergence of a currency conversion claim is equally irrelevant as the subsequent emergence of any other previously unknown claim;

(e) Additionally, based upon circumstances that were within the parties' contemplation at the time of entry into the CDDs, the only different treatment as between creditors entering into CDDs was whether they agreed to limit their sole entitlement, following entry into the agreement, to a payment denominated in sterling or in a foreign currency. That is something which required no explanation to creditors, since it was self-evident from the face of the CDD that this was the case;

(7) Seventh, that the Court erred to the extent that its decision was based on the "close connection" between a currency conversion claim and a claim to Statutory Interest, and the fact that Wentworth accepted that the latter was not released (see [70] and [164]). In particular, the essential feature of a currency conversion claim – that it is merely the unsatisfied portion of the underlying proved claim (prior to conversion), and thus is firmly within the class of claims expressly released (i.e. any rights under the underlying contract, save for the Agreed Claim Amount), is missing from a claim to Statutory Interest, which is a statutory right incident upon the right to prove.

Declaration (iv): Issue 35A

59. Wentworth seeks permission to appeal on the basis that it stands a real prospect of persuading the Court of Appeal that the Court erred in law in stating and applying the

principle in *Ex parte James* and the concept of unfairness in paragraph 74 of Schedule B1.

60. Wentworth would contend before the Court of Appeal, in particular, that the application of either *ex parte James* or paragraph 74 to the facts of this case would involve an unwarranted extension of the law, in particular because in none of the cases in which e*x parte James* has been applied, has it concerned unfairness said to arise from conduct to which the applicant has freely agreed.

61. The principal source of jurisprudence has been case of mistaken payments which necessarily involve a vitiating factor as to the applicant's consent to the transfer. That the principle in *ex parte James* necessarily operates on the basis of what is lawful, classically by defeating the bar against a mistake of law so as to allow a claim for mistaken payment to be sustained, does not therefore permit a court simply to ignore the fact of the parties' free agreement.

62. In other words the operation of the principle upon the premise of the parties' legal rights does not licence the court to reduce those rights to mere discretionary benefits to grant or withhold as it sees fair. A freely agreed contract should be enforced unless there is conduct by the officeholder as would warrant the intervention of the Court. This is because it is an agreement made without misrepresentation, undue influence or duress and in circumstances in which each party, as matter of law, is taken to have accepted the consequences of what was objectively agreed.

63. In particular, where parties have agreed a wide and mutual release of all claims, whether known or unknown and whether in existence now or only coming into the existence in the future, it is not so unfair as to engage either the rule in *ex parte James* or paragraph 74 that the bargain is enforced after one or more claims – within the broad terms of the release – later emerges.

64. On this basis, it ought to follow, from the fact that the Court appeared to accept, at [186], that the CRA and CDDs were not improperly entered into, that it did not become unfair to enforce those contracts at a later point, merely because of the later emergence of currency conversion claims.

65. Likewise it cannot have become unfair to enforce a release fairly entered into simply because another creditor entered into a different agreement the terms of which, although similar, were not effective to release the claim in question. Any creditor who enters into a bilateral agreement with an officeholder does so on the footing that a different agreement might be entered into with another creditor. A series of bilateral agreements is necessarily different from a class composition under a scheme of arrangement or a statutory contract under voluntary arrangement. If, for example, a later creditor should insist upon a carve-out from earlier wording, that fact is insufficient to allow other creditors to characterise their agreements, which must be assumed enforceable up until that point, as unfair.

D COSTS OF PARTS A AND B

Costs of the Administrators

66. Wentworth agrees that the Administrators' costs be paid from the administration estate on the usual (indemnity) basis.

Costs of the SCG, York and Wentworth

67. Wentworth objects to an order that the SCG's or York's costs in respect of Parts A or B be paid out of the administration estate. It submits that each party should pay its own costs. In summary:

    (1) Although this is in form an application for directions by the Administrators, it is in substance hostile litigation between (a) the SCG (and York), who hold (mostly through the acquisition of claims from other creditors) unsecured debt of LBIE and (b) Wentworth, as the holder of the Sub-Debt and equity[3] interests in LBIE. In relation to each of the questions raised, the SCG and York have sought, in their own commercial interests, to maximise their own recoveries from the estate, while Wentworth has, in its own commercial interests, taken the opposite view.

[3] Although it is only Wentworth Sons Sub-Debt S.a.r.l. that is a respondent to the application, its sister company, Wentworth Sons Equity Claims S.a.r.l. owns equity interests in LBIE indirectly.

(2) In such a case, in the absence of agreement between the parties (such as that each side bears their own costs), costs should normally follow the event.

(3) Although the SCG's and York's arguments may ultimately benefit other holders of unsecured debt in LBIE, that is not a reason for such to be paid out of the administration estate.

(4) The SCG and York are substantial, well-resourced and sophisticated parties with £billions at stake. The SCG is understood to hold claims of around £2.75 billion and York to hold claims of around US$700 million. This is not a case where a representative costs order would have been necessary in order to ensure that there was someone willing to take a particular position on each of the questions raised by an application for directions by the Administrators.

(5) It is likely, given the size of the surplus, that every £1 that is paid to unsecured creditors of LBIE is £1 less that is available for distribution to Wentworth or its associated entities, pursuant to their interest in the subordinated debt or equity, so that it is Wentworth alone that in practice will bear the burden of any costs that are reimbursed out of the estate.

(6) The outcome of the hostile litigation in respect of Parts A and B is that Wentworth substantially succeeded on Part A, defeating the SCG's and York's innovative arguments intended to maximise their recoveries in respect of interest claims, but was largely unsuccessful in its arguments as regards Currency Conversion Claims (but not non-provable interest claims) on Part B. Applying the usual approach to costs, therefore, Wentworth should be entitled to most of its costs of Part A from the SCG and York, and the SCG should be entitled to most of its costs of Part B from Wentworth. Wentworth contends, however, that a rough offset between the two parts is fair, such that that there should simply be no order as to costs. This outcome will save the cost of an extensive assessment, and a debate as to whether the SCG is entitled to recover more than one set of costs, it having engaged multiple firms to represent it. It will also save the cost of enquiring as to whether York in fact added to the debate in Part A.

68. The general rule as to costs is that the unsuccessful party pay the costs of the successful party (the "general rule"). The general rule is the starting point, and the court may make a different order, having regard to all the circumstances: see, for *Re Westdock Realisations Limited* [1988] BCLC 354, at 359-360 *per* Browne-Wilkinson J; and *Pearson & Ors v LBF SA & Ors (the RASCALS Application)* [2010] EWHC 3044 (Ch) at [7]-[13] *per* Briggs J.

69. The general rule plays an important role as it concentrates the litigants' minds upon the need constantly to address the strength or otherwise of the case, the risks and benefits of advancing particular arguments, and the wisdom of searching for alternative forms of resolution of their dispute, whether by compromise or even abandonment. As observed by Briggs J in the *RASCALS Application*, these objectives are as important in insolvency litigation as in other forms of adversarial litigation. He explained at [12]:

> "On the contrary, as is spelt out in Jackson LJ's recent Report on Costs in Civil Litigation, there is an ever present risk that the costs of insolvency litigation may easily get seriously out of hand. This must be *a fortiori* the case if litigants are encouraged to think that they could run weak arguments at great expense to their opponents, on the basis either that costs would come out of the insolvent estate, or that each party's costs risk would be limited to its own costs."

70. It is for litigants to justify any departure from the general rule "*by reference to the facts about their alleged predicament, rather than merely by recourse to some supposed general principle*". Moreover, the court should consider any case for a departure of the general rules with real caution. In relation to the costs of the RASCALS Application, Mr Justice Briggs declined to order any departure from the general rule and made a cost order in favour of LBIE. He explained at [13]:

> "It follows in my judgment that although there are features of insolvency litigation which, by analogy with litigation about deceased's estates, may justify a departure from the general rule, the court should nonetheless approach any particular case for a departure with real caution, and litigants ought to expect to have to justify such a departure by reference to the facts about their alleged predicament, rather than merely by recourse to some supposed general principle."

71. Briggs J held that LBIE's affiliate's characterisation of the issues in the RASCALS Application as aimed at the resolution of a common predicament affecting a number of

comingled insolvent estates within the same group, or as arising from the "fault" of LBIE, was insufficient to justify a departure from the general rule. To the contrary he was persuaded that the litigation was hostile litigation in which LBIE was ultimately vindicated in the stance it adopted: see [16]-[18]. Of the *RASCALS Application* he said, in summary, at [24]:

> "This was, in my judgment, litigation in which these respondents unsuccessfully advanced an adversarial case in the pursuit of a very large commercial objective, namely the obtaining of a proprietary interest in securities of enormous value. It was in truth litigation in which the expenditure in costs was by no means disproportionate to the value of the property in dispute, but that is not of itself any reason for displacing the general rule that costs should follow the event."

72. The most authoritative case on whether the resolution of an issue in relation to an estate or fund might justify a departure from the general rule is *McDonald v Horn* [1995] 1 All ER 961, a decision of the Court of Appeal. The appeal concerned a pre-emptive costs order made in relation issues in respect of a pension fund. In the lead judgment delivered by Hoffmann LJ, the court explained, at p.969, that is was "*a basic rule of English civil procedure* [that] *a successful litigant has a prima facie right to his costs*". He then went on to explain the exceptions concerned with the payment of costs from a fund.

73. The first exception is that in favour of the trustee. At p.970, Hoffmann LJ explained that "*the trustee is entitled to his costs out of the fund on an indemnity basis, provided only that he has not acted unreasonably or in substance for his own benefit rather than that of the fund.*"

74. The second exception is an extension of the first exception to beneficiaries. The classic statement is that of Kekewich J in *Re Buckton* [1907] 2 Ch 406. Hoffmann LJ explained the three-fold categorisation in that case as follows, at pp.970-71:

> "First, proceedings brought by trustees to have the guidance of the court as to the construction of the trust instrument or some question arising in the course of administration. In such cases, the costs of all parties are usually treated as necessarily incurred for the benefit of the estate and ordered to be paid out of the fund. Secondly, there are cases in which the application is made by someone other than the trustees, but raises the same kind of point as in the first class and would

have justified an application by the trustees. This second class is treated in the same way as the first. Thirdly, there are cases in which a beneficiary is making a hostile claim against the trustees or another beneficiary. This is treated in the same way as ordinary common law litigation and costs usually follow the event."

75. The above principles developed in the law of trusts and testamentary estates are applied to insolvent estates.

76. The essence of the SCG's and York's argument for a payment of their costs of Parts A and B from LBIE's estate is that the issues are of a "technical"[4] nature and that the determination of those issues is necessary for a correct distribution of LBIE's administration estate. The analogy is that a dispute as to the meaning of the Rules is a dispute as to the term of the statutory trust in administration and, therefore, logically equivalent to a construction summons as to the meaning of a trust deed. On that footing, it is said that Part A is within category 1 of the *Buckton* categorisation, and that Part B is within that same category by extension because the CRA and CDDs were promulgated by the Administrators in the discharge of their statutory duties and, by reason of their standard usage, affected creditors generally, even if each agreement or accession is a distinct contract.

77. The SCG additionally advance a general argument that the issues in Parts A and B have arisen because of the 'fault'[5] of LBIE by reason of its entry into administration (as opposed to any fault on the part of the Administrators). It is said that just as a testator whose affairs are disarray might be said to be at "fault" so as to justify a departure from the general rule a departure is similarly justified by reason of LBIE's administration giving rise to issues which would not otherwise have arisen.

78. Each of these arguments is wrong. As to the first, the correct characterisation of Parts A and B is hostile litigation as to the share of the anticipated surplus in LBIE's administration estate to be enjoyed by either the SCG and York, on the one hand, and

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4 See Freshfields' letters of 23 May 2014 and 17 February 2015.

5 See Freshfields' letter of 23 May 2014.

Wentworth, on the other hand. This characterisation necessarily follows from the origins of the application, the formulation of the issues and the conduct of the litigation.

79. The Administrators issued *Waterfall II* following the rejection by the SCG and Wentworth of the Administrators' Surplus Entitlement Proposal circulated to Wentworth and the SCG on a without prejudice basis on 10 March 2014 (the "Surplus Entitlement Proposal"). The Surplus Entitlement Proposal was to be implemented via a company voluntary arrangement. In simplified terms the proposal was to pay all creditors a share of the surplus based upon a compromise of a number of legal issues such as the survival or release of Currency Conversion Claims or the credit to be given for Statutory Interest in calculating such claims. If a sufficient majority by value agreed, the terms of that compromise were to be imposed upon all other creditors and members also. The SCG and Wentworth however rejected the Surplus Entitlement Proposal on about 14 March 2014. The rejected proposal was published by the Administrators on 28 March 2014.

80. The rejection of the Surplus Entitlement Proposal necessitated the issue by the Administrators of the Application. Had each creditor group not taken the view that they would overall do better by a litigation of the issues than by their compromise, the Surplus Entitlement Proposal would have remained a serious and viable proposal to put to creditors as the terms of a voluntary arrangement. The application therefore follows from a desire by each of the rival creditor groups to do better by litigation than by a compromise which would have provided a certain basis for distribution by the Administrators.

81. In this respect it is irrelevant that Wentworth – which is part of a complex joint venture whose affiliate entities hold various claims against LBIE – has interests in the ordinary unsecured debt of LBIE, the subordinated debt and the equity. Its decision to reject the Surplus Entitlement Proposal, like the decisions of the SCG or York, can only have been made by its assessment of its own commercial interest.

82. It is however relevant that the SCG did *not* leave to the Administrators the task of acting in the interests of ordinary unsecured creditors. The SCG chose not to do so and it instead decided to play a full part in the litigation because it considered that its

interest would be best served by doing so. Had it simply been necessary to have adversarial argument for a binding decision by the Court to enable a distribution by the Administrators, the Administrators could have acted to defend the interests of the ordinary unsecured creditors and could have appointed a representative respondent to act for the subordinated creditors and, if necessary, the holders of LBIE's equity. This would *never* have been acceptable to the SCG, York or Wentworth, who are entities controlled by investment managers who have made substantial investments in LBIE's debt and other rights against LBIE with a view to securing a profitable return for their own investors[6]. The protagonists behind this application are amongst the world's largest and most sophisticated hedge funds.

83. The adversarial nature of the issues in the application is apparent from the SCG's formulation of the issues and its argument to maximise its advantage. In this respect, there are a number of clear examples which negate the SCG's characterisation of the issues in Parts A and B as "technical" issues arising in the course of the administration and necessary to the distribution of the surplus.

84. Issue 1 was inserted at the insistence of the SCG who had hoped to identify a legal basis for applying the Judgment Act Rate on a compound basis, which would have increased the return for the SCG by hundreds of millions of pounds.

85. Issue 2 was also inserted at the insistence of the SCG. The SCG then developed a complex argument to support is position. The argument was not in its nature a "technical" argument about the Rules. It involved the assertion of a general principle of calculating interest common to testamentary and insolvent estates (and other contexts) – the principle in *Bower v Marris* – which, by a history of re-enactment of former Bankruptcy Act and Bankruptcy Rules from 1825 to 1883, it was said the Court was bound to impose on Rule 2.88, irrespective of the wording of that rule.

[6] The commercial motivation of the SCG and York is most transparent in relation to Part C, in which the SCG is to advance the argument that the relevant payee's cost of funding within the definition of Default Rate under the ISDA Master Agreement is to be assessed by treating the defaulted claim against LBIE *as if* an investment to be funded by the relevant payee and thereby assessed by reference to what its investors would expect of it in order for it to fund an asset of that nature. It is a way of taking from LBIE what the relevant payee's say its investors would expect of it in terms of a return for in investment.

86. This argument made up the majority of the written and oral submissions at the trial of Part A. It was not identified in any judgment or legal textbook as a live issue under the current statute but was a creation of the SCG's legal team intended to secure for the SCG a considerable financial return – the argument of the SCG, if correct, would have increased the return for the SCG by hundreds of millions of pounds. It provides a clear example of the hostile nature of the litigation between the SCG and York, on the one hand, and Wentworth on the other. The fact that the financial benefit had to flow through the waterfall of an insolvent estate is an irrelevant to the character of the dispute for the purpose of costs.

87. Issue 4 was also an argument developed by the SCG and York to maximise their share of the surplus. Its object was to enable a claim at the New York Judgment Act Rate on the basis of a hypothetical suit in New York on the basis of the debt proved, or some sort of contingent entitlement to have that rate applied to the debt proved. Issue 4 was one of a series of issues on which the SCG placed reliance upon a foreign statute to seek to increase its share of the surplus[7]. The SCG's approach to Issue 4 should, therefore, be seen as a further indication that the application is, in substance, hostile litigation.

88. Issue 39 (now Issue 2A) involved a series of alternative arguments by the SCG to maximise its entitlement to interest. The arguments ranged from a restitutionary claim for LBIE's enrichment by the time value of money to a *Sempra Metals* damages claim for failure to pay the surplus on time. The first of these arguments was not developed beyond position papers. The latter was pursued to trial without any successful explanation of the duty to pay the surplus at a particular time. If the SCG had been acting as a representative respondent in order to assist in the resolution of questions to which the Administrators required an answer, it would have been expected to resist the suggestion that Rule 2.88 was a complete statement of interest on proved debts. The SCG, however, no doubt because it took the view that its own commercial interests

[7] The German law issues remain to be tried in Part C notwithstanding the abandonment by the SCG of its original case on Issue 20 – on which it relied on clause 3(4) of the German Master Agreement – and its statement of a new case based upon clauses 7 to 9 of the German Master Agreement. Such conduct is indicative of a party *constructing* a case for its own advantage, not a party acting as a representative respondent to determine issues that *need* to be determined.

were best improved by success on Issues 2 (and 3), did not strongly resist a construction which treated Rule 2.88 as a code.

89. Likewise Part B was in the nature of hostile litigation. It involved rival constructions as to the meaning of the documents the effect of which was to either preserve or release entitlements to Statutory Interest or non-provable claims to interests and for currency conversion loss. A dispute as to whether a document released the rights of some but not other creditors is not a dispute arising in the course of administration equivalent to a constructions summons under a trust deed. It is a dispute about the existence of right which would benefit either the SCG or Wentworth depending upon how that dispute was resolved. The fact that the receipt of any benefit is mediated via the ranking of claims against an insolvent estate is, again, irrelevant.

90. The fact that neither the SCG nor Wentworth acted as representative respondents bound by duties to act for the interests of a defined class is highlighted by the Administrators' conduct of Parts A and B. First, the Administrators reserved the right to add to any arguments advanced or to develop different arguments to ensure issues were fully argued. Such actions would not have been necessary had defined classes been bound by orders argued for by representative respondents. The Administrators would only have had a limited amicus role in case no representative respondent could be appointed to argue from the perspective of a particular defined class, as has been the Administrators' role on other applications in this administration in which representative respondents were appointed (for example, the client money litigation).

91. Second, the Administrators have had to ensure continued publication of position papers and skeleton arguments because the orders on which they propose to act are not binding on any class by reason of having been made in relation to representative respondents. This underlines the fact that the Court did not apply its mind to the test to appoint representative respondents (because it was not asked to do so) and did not bind any of the respondents to the duties of representative respondents, which duties would have mandated each respondent to run arguments in respect of real issues affecting that class. The SCG, like Wentworth, has instead sought to advance its own commercial interests by creating and advancing legal arguments as it sees fit.

92. In light of the above the SCG places undue reliance on paragraphs 11 of the *Waterfall IIA* and *Waterfall IIB* judgments, which paragraphs only serve to acknowledge that the effect of the arguments of Wentworth, the SCG, York and the Administrators has been to provide answers on which the Administrators propose to rely in the conduct of the administration. That *practical* effect has been brought about by the careful management of this application by the Administrators in terms of the publicity given to the arguments and the Administrators' stance on particular issues. It would, indeed, now be very difficult for any creditor to re-litigate any of the issues in Part A or B on the basis that the orders are not formally binding upon it. That practical consequence does not however entail that any respondent has an entitlement to costs from the administration estate.

93. In this respect the further flaw in the SCG's first argument is to assume that a practical benefit to the estate entitles the respondents to costs from the estate. That is an incorrect application of *Buckton*. Categories 1 and 2 concern applications to determine "*some question arising in the course of administration*". As outlined above, it cannot be said that Issue 2 (for example) was properly "*some question arising in the course of administration*", as opposed to an issue created by the SCG to enhance its share of the surplus. In terms of its characterisation for the purpose of costs, it is on all fours with the arguments deployed by LBIE's affiliates in the RASCALS application. On that application, Briggs J rightly rejected the affiliates' abstract characterisation of the dispute as the resolution of "technical" issues necessary to unpick the commingled insolvent estates of the wider group. He held that it was a dispute in the nature of hostile litigation in which the protagonists each made a claim to assets, developing such arguments as they could. The contest as regards the division of the surplus is a dispute of the same nature.

94. Just as it was irrelevant to the costs of the RASCALS application that the resolution of the disputed asset claims would delineate the respective estates (and therefore benefit those estates), it is irrelevant to the costs of this application that the financial benefit to one or other respondent from the anticipated surplus has to flow through the insolvency waterfall. In other words, the fact that the Administrators will necessarily obtain answers that will help them workout how much has to be paid and to whom does not mean that the litigation is not, in substance, hostile litigation.

95. The above flaw is underlined by the fact that a benefit to other creditors does not imply an entitlement to costs from the estate. It implies a basis upon which the SCG might have asked for a cost contribution to its cost from other creditors. It is not known whether or not the SCG undertook any such steps. Its investment in claims against LBIE was such that it had motive and resources sufficient to litigate the issues important to it irrespective of any contribution from similarly interested creditors.

96. For these reason, the SCG's and York's first argument – that the issues in Parts A and B were of a "technical" nature arising in the course of the administration and therefore outside the general rule – should be rejected. The dispute was in the nature of hostile litigation to which the general rule should apply.

97. The SCG's second argument – that the issues in Parts A and B were the "fault" of LBIE by reason of having entered into administration and therefore justify a departure from the general rule by parity of reasoning which certain testamentary estate cases – is also misconceived.

98. First, as regards Part B, the issues arose out of post-administration conduct of the Administrators in promulgating the CRA and the CDDs. No criticism has been made of the Administrators in either respect and so there is no basis for alleging "fault" on their part or on the part of LBIE.

99. Secondly, as regards Parts A and B, the assertion that LBIE was at "fault" by reason of having entered into administration is the sort of abstract argument that Briggs J said in the RASCALS application was not to be accepted. The burden on a litigant was to justify a departure from the general rule by reference to the particular facts, not some abstract observation. The suggestion that an insolvent company is at "fault" by reason of having entered into administration would be true in all insolvent estate cases and cannot, therefore, be a basis for disapplication of the general rule. If true, it would always lead to a disapplication of the general rule and that is plainly not the law.

100. Thirdly, the SCG's reliance on the testamentary case in which "fault" is ascribed because a testator has left his affairs in disarray is inapt to Parts A and B. It was at least arguable in relation to the RASCALS Application because the dispute as to the

effective operation of the RASCALS system as to the holding of assets by the Lehman group prior to its collapse had at least some analogy with a testator's organisation of his affairs. None of the issues in Part A is capable of such characterisation, and no such characterisation is alleged in respect of Part B. The SCG simply relies on the asserted "fault" of LBIE having entered into administration.

101. Accordingly, the SCG's second argument must be rejected and the general rule applied.

102. In terms of the general rule, the appropriate costs order with respect to Parts A and B is that each party should pay its own cost. This outcome is justified because, looking at matters in broad terms, Wentworth can be said to have substantially succeeded to Part A. It was successful in respect of the issues which took up most time in written and oral submissions and which had the most substantial value.

103. By contrast, Wentworth was substantially unsuccessful on Part B (succeeding only in relation to the release of non-provable claims to interest and the (non) creation of Currency Conversion Claims by the CRA).

104. Part A was by far the more substantial hearing in terms of the length of written submissions and court time. Although there is therefore an argument that Wentworth should be entitled to a larger share of its overall costs from the SCG and York, than the SCG is entitled to recover from Wentworth in respect of Part B, Wentworth contends that a rough offset of each party's entitlement to costs from the other is appropriate, which is best achieved in this case by the court making no order as to costs between Wentworth, the SCG and York.

105. This approach is fair and has several advantages. First, it does not require resolution of the dispute as to whether the SCG is entitled to more than one set of costs, having engaged (at least) three law firms as compared to Wentworth's instruction of a single firm.

106. Secondly, it does not require resolution of the question of whether York is entitled to any costs, having appeared in its written and oral submissions largely to duplicate the submissions of the SCG.

107. Thirdly, it avoids the necessity of a time consuming and detailed assessment of costs. The fact that Part A was the larger part likely means that Wentworth is the party at risk of loss relative to an assessment of the costs to be paid to it under Part A and by it under Part B and an offset of the amounts so assessed.

108. For these reasons, Wentworth submits that it in all of the circumstances the order which best reflects the overall justice of the case is that each party should pay its own costs of Parts A and B.

109. Alternatively, if the Court considers that any part of the Respondents' costs should be paid from the administration estate then: (1) Wentworth objects to York receiving any part of its costs as it was unnecessary for them to be present when all points were already covered by the SCG; (2) the SCG (which is a collection of hedge funds each of which has separate solicitors) should not be permitted the costs of more than one firm of solicitors.

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