IN THE HIGH COURT OF JUSTICE **No. 7942 of 2008**
CHANCERY DIVISION
COMPANIES COURT

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION)
AND IN THE MATTER OF THE INSOLVENCY ACT 1986

B E T W E E N

(1) ANTONY VICTOR LOMAS
(2) STEVEN ANTHONY PEARSON
(3) PAUL DAVID COPLEY
(4) RUSSELL DOWNS
(5) JULIAN GUY PARR
(THE JOINT ADMINISTRATORS OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION))

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
(6) GOLDMAN SACHS INTERNATIONAL

Respondents

SENIOR CREDITOR GROUP'S SKELETON ARGUMENT CONSEQUENTIAL MATTERS (PART C TRIAL)

A. INTRODUCTION

1. This skeleton argument is filed on behalf of Burlington Loan Management Limited ("**Burlington**"), CVI GVF (Lux) Master S.a.r.l ("**CVI**"), and Hutchinson Investors LLC ("**Hutchinson**")(collectively, the "**Senior Creditor Group**") for the purpose of the hearing to deal with consequential issues arising from the Part C Judgment.

2. There are two groups of issues to be dealt with at the hearing: costs and permission to appeal.

B. COSTS

Introduction

3. The Senior Creditor Group submits that the appropriate order for costs is that the costs of the Administrators and of all of the Respondents be paid as an expense of the estate.

4. Following the judgments in Waterfall II Parts A and Part B, the Court heard extensive argument as to the appropriate order for costs:

   (1) Wentworth contended that, although the Application is in form an application for directions by the Administrators, "*it is in substance hostile litigation*" (Wentworth's Part A and B Consequential Issues Skeleton [67]) and that each Respondent should therefore meet its own costs of and occasioned by the hearings.

   (2) The Senior Creditor Group and York contended that the appropriate order for costs was for the costs of the Administrators and of all of the Respondents to be paid as an expense of the administration.

5. David Richards J rejected Wentworth's contention that the Application was, in substance, hostile litigation and was "*clearly and firmly of the view that the correct characterisation of this litigation so far brings this into the category of case where, as a general proposition, the costs of the respondents should be paid as expenses of the litigation*" (Part A

and B Consequential Issues Transcript p.96 lines 2 – 8). The Court made an order to that effect, albeit reducing the amount of York's costs to reflect the overlap between York's position and that of the Senior Creditor Group. David Richards J made the same order in connection with the Supplemental Issues. There is no reason to take a different approach in the context of the Part C decision.

6. Notwithstanding this, Wentworth contends that the Senior Creditor Group (and GSI) should be required to pay its costs of Part C of the Application on the supposed basis that Part C was "*in substance hostile litigation*" between Wentworth and the Senior Creditor Group (and GSI) (see Wentworth's letter dated 21 October 2016). Wentworth's position is wrong for the reasons set out below.

The principles

7. Although the general rule is that costs follow the event, the Court may, in any case, make a different order having regard to all of the circumstances; see CPR 44.2. Whilst there is no hard and fast rule in insolvency cases, an analogy is commonly drawn with trust cases:

   (1) If proceedings are brought to obtain the guidance of the court as to the construction of a trust instrument or some other question arises in relation to the trusts on which the property is held, the costs of all parties are, whatever the outcome, usually treated as necessarily incurred for the benefit of the trust fund and ordered to be paid out of it.

   (2) The position is different if, in substance, such proceedings have the character of a hostile claim, such that the claim is brought not in substance for the benefit of the trust fund, but for the benefit of the claimant, and is resisted for a similar reason.

   See, for example, *Re Buckton* [1907] 2 Ch 406 at 414; *Re Westdock Realisations Ltd* [1988] BCLC 354 at 359e-360h; *McDonald v. Horn* [1995] 1 All ER 961 at 968g-972d; *Pearson v. Lehman Brothers Finance SA* [2010] EWHC 3044 at [2]-[13]; and *Singapore Airlines Ltd v. Buck Consultants* [2011] EWCA Civ 1542 at [67]-[77].

The nature of the Application

8. The Application was issued by the Administrators to obtain the guidance of the court in respect of questions arising in the course of the administration so as to enable them to carry out their statutory duties.

9. The fact that the Application was issued to enable the Administrators to obtain guidance as to how to carry out their statutory functions and duties was emphasised by the Administrators on a number of occasions. For example:

   (1) "*In the course of planning for the distribution of a potential Surplus, when developing the LBIE Proposal, and in the course of discussions with the Senior Creditor Group and the Wentworth Group, the Joint Administrators have identified a number of issues on which they consider it appropriate to seek the Court's directions. This is either because the Joint Administrators consider there is some uncertainty as to the correct answer or because – even though the Joint Administrators may not consider there to be material uncertainty – alternative positions have been put forward by the Senior Creditor Group and the Wentworth Group such that (particularly in light of the sums at stake) the Joint Administrators have concluded that the questions require determination.*

   The Joint Administrators have concluded that, whilst there are funds available to distribute, they will not be in a position to make a distribution in respect of the Surplus absent resolution of the issues in the Application. The Joint Administrators have publicised the need for the Application both in the LBIE Progress Report and in the live webcast held by the Joint Administrators for LBIE creditors on 6 May 2014": Lomas 9 [35] – [36].

   (2) " …*it is of significant practical importance for the efficient distribution of any surplus from the LBIE Administration that the Joint Administrators receive clear guidance on how they should evaluate the cost of funding self-certified by ISDA creditors for the purposes of calculating their respective Default Rates*": Lomas 11 at [79].

   (3) "*All of the issues outlined above in this Section H* [concerning the Part C issues] *are relevant for the purposes of calculating the amount of Statutory Interest that LBIE will be required to pay to unsecured creditors on proved debts and, by extension, the*

amount of the Surplus (if any) that will be remaining after the payment of Statutory Interest to pay Currency Conversion Claims and the Sub-Debt which, following the Waterfall Judgment (and subject to any appeal thereof), both rank below Statutory Interest": Lomas 9 at [50].

(4) *"Similar issues…arise in respect of…foreign law agreements, on which (for the same reasons, given the similar effects the determination may have on the distribution of the Surplus) the Joint Administrators seek the Court's guidance"*: Lomas 9 at [48].

(5) *"The Court's determination of the correct construction of the Default Rate will set the parameters in accordance with which the LBIE ISDA creditors may certify their cost of funding for the purposes of establishing a claim for Statutory Interest"*: Lomas 12 at [11].

(6) *"The determination of the Tranche C issues is essential to enable the Administrators to assess creditors' claims to interest out of the surplus…the Administrators seek practical guidance from the Court, in the form of clear principles and guidelines, to enable them to assess creditors' claims for interest at the Default Rate"*: Administrators' Part C Skeleton [20].

10. It is clear from the Administrators' evidence that, like Part A and B, the Part C issues were included as part of the Application for the benefit of obtaining general guidance of the parameters in accordance with which claims for interest under the ISDA and foreign master agreements fall to be assessed for the purposes of assessing creditors' claims for Statutory Interest.

11. This was not, in contrast, hostile litigation between a party which happened to be in administration and an "*outsider*" (see *Re Westdock Realisations Ltd* at 360g). Nor was it a case which involved a hostile and adverse claim to assets otherwise forming part of the estate; compare, for example, *Pearson v. Lehman Brothers Finance SA* [2010] EWHC 3044 (the "RASCALS" case), where LBIE and various affiliates each asserted competing claims as to the ownership of securities. On the contrary:

(1) The issues relevant to Part C were identified on a cooperative basis among the parties on the basis that they reflected a range of arguable positions advocated for (or identified as capable of being advocated for) by relevant creditors of LBIE, including but not limited to members of the Senior Creditor Group.

(2) Where possible, those issues were framed in general terms enabling the Administrators to derive general guidance from their resolution. Question 11, for example, asked whether something is "capable" of constituting a "cost of funding" for the purposes of the Default Rate. The Court was not asked to decide the Part C issues by reference to any particular set of facts, nor was it provided with a series of actual certifications and asked to rule on whether they were rational, good faith and binding certifications.

(3) As explained at [37] – [38] of their Part C trial skeleton, the Administrators filed and served two position papers identifying additional arguments that were not being pursued by any of the Respondents and making it clear that, if no Respondent advanced those arguments at trial, the Administrators themselves would do so. In the event, the Administrators were content that "*most of the arguments identified by the Administrators are being pursued by one or more of the Respondents and, in those circumstances, the Administrators are not currently intending to advance adversarial arguments from the stand point of any particular constituency*".

(4) The Administrators identified a further nine sub-questions shortly before the Part C hearing and invited the respondents to address such issues, which they did (see Judgment [148]*ff*).

(5) The Part C issues would have had to have been resolved, so as to ensure that the estate was distributed between creditors in accordance with the statutory scheme, whether or not the Senior Creditor Group or Wentworth had been involved and regardless of the interests of any subordinated creditors or shareholders.

(6) The Administrators, throughout the proceedings, also made available to all creditors the relevant court papers and submissions, and invited such creditors to consider whether there were any further arguments that they wished to see raised, so as to ensure that they obtained the guidance they considered that they needed.

The role of the Senior Creditor Group

12. The Administrators joined the members of the Senior Creditor Group as Respondents to the Application to assist with the formulation of the issues and to advance arguments so as to enable the Administrators to obtain the guidance they desired. Had the members of the Senior Creditor Group not agreed to be joined as respondents to the Application, the Administrators would have had to join other creditors to advance such arguments or have sought to advance such arguments themselves.

13. Although not formally appointed as such, the role of the members of the Senior Creditor Group on the Application was akin to that of representative respondents whose role was to assist the Administrators is obtaining the guidance they needed. The position was clearly explained in the Senior Creditor Group's skeleton argument for trial (at [2]) and in opening oral submissions [Day 1, p.62, lines 2 -12]:

> "*As your Lordship knows, the administrators have issued the application to obtain guidance from the court. Although the Senior Creditor Group has not been appointed a representative of different classes of creditors, it is advancing arguments, in effect, on behalf of unsecured creditors to assist the administrators to obtain such guidance. It is obviously keen to assist the administrators to obtain the guidance that they need, if only because, unless and until this process finishes, they won't receive any of the money to which they are entitled*"

14. At no point did Wentworth or any other party suggest that this description of the nature of the Application or the Senior Creditor Group's role in it was in anyway inaccurate or that it did not apply to Part C. In their skeleton argument for the Part C trial, the Administrators emphasised (at [29]) that although neither the Senior Creditor Group nor Wentworth had formally been appointed as representative parties "*they were joined to the Waterfall II Application in the expectation*

that they would advance submissions that would take account of the interests of most if not all types of creditor in the estate".

15. The same statements were made by the Senior Creditor Group in the context of Parts A and B of the Application, were referred to by David Richards J in the Parts A and B judgments (at [11]) and relied on by him in reaching his conclusion that the appropriate order was for the Respondents' costs to be paid as an expense of the administration (Part A and B Consequential Issues Transcript p.95 lines 17– 21).

16. The manner in which the members of the Senior Creditor Group have conducted these proceedings has, it is submitted, been of assistance to the Administrators and the court and entirely reasonable. In the course of the proceedings the members of the Senior Creditor Group:

    (1) worked to agree the answers to certain of the issues with the Administrators where it appeared that there was, ultimately, consensus as to the correct approach to be adopted (e.g. Issues 14, 15, 16, 18 and 22 to 26);

    (2) made submissions on the remaining issues which, in the light of their own broad position as creditors, were likely to benefit unsecured creditors as a whole;

    (3) sought to limit their submissions to points of law which were in the interests of unsecured creditors generally, rather than sought to rely on facts which were likely to be of relevance solely to one or more of them;

    (4) advanced submissions on particular issues whether or not one or more of them might have had a lesser interest in such issues (because, for example, it did not have any substantial claims under German Master Agreements);

    (5) limited their submissions to those that were likely to be of general application to creditors. For example, in the context of the German law

issues the Senior Creditor Group limited their submissions on the question of "default" to whether certain generally applicable circumstances (i.e. LBIE's application for an administration order and the submission of proofs of debts by creditors) were capable of giving rise generally to a "default" in respect of close-out amounts due under the GMA. This was notwithstanding the fact that, as was made clear in Senior Creditor Group's skeleton argument (at [9]), whether "default" for the purpose section 286 of the BGB has occurred in respect of any payment obligation of LBIE under the GMA before, as at, or after the commencement of the administration was a question of fact, which would need to be determined on the case by case basis; and

(6) responded to the further sub-issues identified by the Administrators and the various additional contentions made by them (see Judgment [148]*ff*).

17. The mere fact that the members of the Senior Creditor Group are creditors, and thus have an interest in the outcome of the proceedings, obviously does not mean that they are "outsiders" or prevent them from being entitled to payment of their costs; *Singapore Airlines Ltd v. Buck Consultants* [2011] EWCA Civ 1542 at [70].

18. If the members of the Senior Creditor Group were required to bear their own costs or pay Wentworth's costs of these proceedings, the estate (and all unsecured creditors whose interests have effectively been represented by the members of the Senior Creditor Group) will have received the benefit of proceedings, brought by the Administrators in the interests of the estate and all such creditors, at the expense of the Senior Creditor Group. Indeed, those creditors include Wentworth itself, which holds very significant unsecured claims against LBIE. Thus Lomas 12 states that Wentworth holds £1.6 billion worth of ISDA claims alone, which materially exceeds the entire unsecured claims held by the members of the Senior Creditor Group.

19. That outcome would plainly be unfair and unjust, particularly in circumstances where:

(1) The Administrators' Application was divided into three parts solely for convenience. As recognised at paragraph 4 of Wentworth's skeleton argument for the CMC on 21 November 2014 (when the Court ordered the application to be divided into three parts) "*the principal rationale for determining different groups of Issues at different hearings is so that the determination of those Issues which can be dealt with expeditiously is not held up because other issues require greater preparation and thus more time before they are ready for trial*". It has never been suggested by any of the parties that the decision on whether, or how, to divide the application reflected the fact that the different parts were of a different nature or deserved different treatment from the point of view of costs.

(2) The court has determined, in the context of the hearings of Parts A and B of the Administrators' Application and in the context of the Supplemental Issues that the appropriate order was for the Respondents' costs to be paid as an expense of the administration.

(3) The parties were embarking on essentially the same exercise in Part C . In this regard at the consequentials hearing for Parts A and B, Wentworth emphasised that Part C was part of "*this single application"* in order to support its failed application for costs (Part A and B Consequential Issues Transcript p.88 lines 9– 13).

Wentworth's Position

20. In its letter of 21 October 2016, Wentworth asserted that Part C of the Application was only "*in form*" an application for directions by the administrators, that "*in substance this was hostile litigation between the SCG (and GSI) on the one hand and Wentworth on the other*" and that "*Part C raised issues of a contractual nature, the determination of which had nothing to do with LBIE's insolvency"*. Those assertions are wrong for all the reasons given above.

21. Although not raised by Wentworth in its letter of 21 October, and for the avoidance of doubt, there is no ground for Wentworth to object to the costs order sought by the Senior Creditor Group on the basis that, if costs are paid from the estate, they would be borne by Wentworth as the holder of the subordinated debt:

(1) Wentworth, as the holder of the subordinated debt, has contractually *agreed* that its claims in that respect are subject to the prior claims of the general unsecured creditors and the costs and expenses of the administration. There is no basis on which Wentworth can sensibly complain about the costs of the present Application being paid in priority to any payments in respect of the subordinated debt. This case is, in this respect, different from a case where an issue arises between an administrator and an outsider, and where no such prior agreement exists. Wentworth is no more able to complain about having to bear the costs of the Application in this case, than can a shareholder complain about having to bear the costs of ascertaining the claims of creditors and distributing the assets.

(2) Furthermore, given that the net financial position of LBIE remains unclear, it also remains possible that the total value of the provable and non-provable claims of LBIE's general unsecured creditors may exceed LBIE's assets, in which cases the costs will inevitably be borne in part or in whole by the general body of unsecured creditors, including Wentworth in its capacity as such.

22. Accordingly, the appropriate order for costs is for the costs of the Administrators and of all of the Respondents to be paid as an expense of the administration

C. APPEAL

23. The Senior Creditor Group seeks permission to appeal:

(1) Declaration (i): (*Issue 10 - Meaning of "relevant payee"*);

(2) Declarations (ii), (iii), (iv), (vi), (viii), (ix), (x), (xi) and (xii): (*Issue 11 – Meaning of the expression "cost (without proof or evidence of any actual cost) to the relevant payee (as certified by it) if it were to fund or of funding the relevant amount"*);

(3) Declarations (xiii) and (xiv): (*Issue 12 – Further definition of borrowing costs*);

(4) Declaration (xxii): (*Issue 19 – New York Law)*;

(5) Declarations (xxiii), (xxiv) and (xxv): *(Issues 20-21 – German Master Agreements*)

The ISDA Appeals

24. The basis on which Senior Creditor Group contends that an appeal against the declarations relating to the ISDA Master Agreements has a real prospect of success are the same reasons as were advanced at the Part C trial in relation to the respective issues (CPR Part 52.3(6)(a); Comment at White Book 2015 para 52.3.7).

25. The Court will undoubtedly have a view in that regard, and the Senior Creditor Group does not consider that it is likely to be of assistance to re-iterate the arguments made at trial.

26. The Court is however also reminded that:

(1) The ISDA Master Agreement, in its various iterations, is the most commonly used master agreement for OTC derivative transactions internationally and probably the most important standard agreement used in the financial world. Decisions on how English law interprets the ISDA Master Agreement therefore have major implications: see *KBF v. UBS* [2014] EWHC 2450 at [120].

(2) The conclusion that the "cost of funding" language in the context of the definition of Default Rate in the ISDA Master Agreement does not extend to equity funding caused the Court to "*waver considerably*"

(Judgment [114]). In this regard, the Court recognised that, as a matter of ordinary language, "cost of funding" is capable of including the cost of equity funding and, further, did have that meaning elsewhere in the ISDA Master Agreement, in particular in the context of the definition of "Loss" in the 1992 form: Judgment [145] - [146].

(3) Potentially huge sums turn on certain of these issues (ISDA claims in the LBIE estate total £4.52 billion).

27. The Senior Creditor Group also contends that there is, in any event, some other compelling reason why the appeal should be heard (CPR Part 52.3(6)(b)) on the basis that:

(1) If permission is given in respect of any of the issues, the interrelated nature of many of them is likely to make it sensible that the Court of Appeal is seized of all of the relevant issues that were before the Court; and

(2) The nature of these proceedings (see above), their potential impact on creditors who were not represented and on users of the ISDA Master Agreements generally, are all matters which suggest that there is a compelling reason why the Senior Creditor Group ought in any event to be able to challenge the declarations determined against its interests.

The GMA Appeals

28. Burlington and Hutchinson (but not CVI) also seek permission to appeal declarations (xxxiii), (xxiv) and (xxv) concerning the German Master Agreements.

29. Burlington and Hutchinson contend that an appeal against these declarations has a real prospect of success. For example:

(1) As regards declaration (xxiii), the Judge was wrong to conclude that, as a matter of German law, a "default" within the meaning of section 288(4)

BGB was not capable of being triggered following the commencement of LBIE's administration (Judgment [358]).

(2) In reaching that conclusion, the Judge relied on the view expressed by Judge Fischer regarding the similarities between a German insolvency proceeding and an English administration. However, it is plain that the view expressed by Judge Fischer was based on comparing a German insolvency proceeding with a *distributing* administration (see Judgment [357]). LBIE's administration did not become a distributing administration until December 2009 when notice of intention to make a distribution was given and Chapter 10 of the Insolvency Rules became applicable (see Wentworth's submissions in relation to this at [387(3)] Judgment).

(3) As a consequence, the Court's conclusion that, as a matter of German law, a "default" could not be triggered at any time after the commencement of LBIE's administration drew upon features of an English administration regime that did not apply to LBIE's administration for over a year after its commencement.

(4) As was made clear in the Senior Creditor Group's skeleton argument (see [9] – [10]) and as recorded at [289] of the Judgment, whether or not the conditions for a "default" (i.e. the service of a "warning notice" or a "serious and definitive refusal" by LBIE to pay a GMA Close Out Amount) have been satisfied in relation to any particular creditor in the period after the commencement of LBIE's administration but before it became a distributing administration is necessarily a question of fact which will need to be determined on a case by case basis. At trial, the Senior Creditor Group limited its submissions to whether certain generally applicable circumstances (i.e. LBIE's application for an administration order and the submission of proofs of debts by creditors) were capable of giving rise generally to a "default". Even if (which is not accepted) the Judge was correct to conclude that the making of the application for an administration order did not amount to a serious and definitive refusal, it does not follow that, factually, no creditor sent any

warning notice to or received any serious and definitive refusal from LBIE with respect to its GMA claim before notice of intention to distribute was given in December 2009.

(5) As regards declarations (xxiv) and (xxv), these reflect the Court's conclusions over the scope and effect of Rule 2.88(9). The scope and effect of that rule is already before the Court of Appeal in the context of the Senior Creditor Group's appeal of Issue 4 in Waterfall IIA. From the point of view of consistency and fairness, it is appropriate for related issues that turn on the scope and effect of Rule 2.88(9) to be before the Court of Appeal.

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9 December 2016

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