No 7942 of 2008

IN THE HIGH COURT OF JUSTICE

CHANCERY DIVISION

COMPANIES COURT

12 December 2016

The Honourable Mr Justice Hildyard

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 COSTS OF THE ISSUES DETERMINED AT THE PART C HEARING

1. Wentworth understands that the draft order in relation to Part C is agreed save as to the issue of costs[1]. Wentworth opposes the SCG's and GSI's application for their costs to be paid out of the LBIE administration estate. Wentworth however makes no submissions on the costs of Issue 1(a).

2. Wentworth contends that its costs of the issues determined at the Part C Hearing should be paid by the SCG and (in relation to the issues with which it was concerned) GSI, on the basis that as to all but an immaterial part, Wentworth was successful in respect of those issues. The general rule that a successful party is entitled to its costs from the unsuccessful party is referred to below as the "usual costs rule".

3. In determining the proper order for costs, it is the substance, not the form, of the proceedings that matters.

4. Although these proceedings are, in form, an application for directions by the administrators of LBIE, in substance they are hostile commercial litigation in which the SCG/GSI sought to establish a right *against LBIE*, pursuant to pre-administration contracts with LBIE, to payment of interest at rates greater than 8% p.a.

5. In earlier litigation in the LBIE estate, *Pearson & Ors v LBF SA & ors* [2010] EWHC 3044 (Ch) (the "RASCALS case") Briggs J identified the principles to be applied when considering whether circumstances justified a departure from the usual costs rule as follows (at paragraphs [7] to [13]):

    (1) CPR Part 44.3(2) prescribes a general rule that the unsuccessful party will be ordered to pay the costs of the successful party, although this starting point may be departed from, having regard to all relevant circumstances.

    (2) That general rule is not in terms disapplied merely because the litigation concerns a deceased's or insolvent's estate.

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[1] Wentworth is unaware of whether the SCG and/or GSI intend to seek permission to appeal.

(3) Nonetheless, in a deceased's estate case, two features may (if present) justify a ready departure from the general rule. The first is where the issue for determination arises due to the fault of the deceased, for example where the testator leaves a confusing will which calls for construction by the court. The second is where because of issues about the validity of a will, the court's task in deciding whether or not to grant probate calls for the assistance of the parties to contentious proceedings, in effect as contributors to a necessary judicial inquiry.

(4) While these exceptions continue, in *Kostic v. Chaplin* & ors [2007] EWHC 2909 (Ch) Henderson J noted, at paragraph 21, that there has been a change of emphasis in recent years:

> "*First, less importance is attached today than it was in Victorian times to the independent duty of the court to investigate the circumstances in which a will was executed and to satisfy itself as to its validity. Secondly, the courts are increasingly alert to the dangers of encouraging litigation, and discouraging settlement of doubtful claims at an early stage, if costs are allowed out of the estate to the unsuccessful party*."

(5) This principle is applicable by analogy to litigation about insolvent estates for two reasons. First, responsibility for issues arising in the administration of an insolvent estate may sometimes be laid at the door of the insolvent entity (e.g. where the insolvent has kept inadequate records). Second, there is a public interest in the due administration of the assets of an insolvent's estate in accordance with the statutory insolvency code, and parties who are joined in proceedings made necessary for that purpose should not be unduly discouraged by an unthinking recourse to the general rule where, in the end, the issue is decided against them.

(6) The court should nonetheless approach any particular case for a departure from the general rule that costs follow the event 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.

6. On the facts of the RASCALS case, Briggs J held, at [24], that "*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.*"

7. Wentworth contends that a similar conclusion should be reached here.

8. While the principles developed by the courts in relation to costs incurred in relation to the administration of trusts are not directly applicable to the present case, they provide further support for Wentworth's position. The court will identify the substance of the dispute and the usual costs order will be appropriate in circumstances where the dispute is characterised as hostile litigation in relation to the claims of beneficial ownership advanced against the fund: see Lewin on Trusts (19th ed.) at 27-145. Such cases are materially different from cases which raise issues as to the construction of a trust instrument.

9. For the reasons set out below, it is submitted that Part C is correctly characterised as hostile litigation between the SCG and GSI, on the one hand, and Wentworth, on the other hand, to which the usual costs rule should apply.

B THE ISDA MASTER AGREEMENT ISSUES

10. **First**, the case concerns the construction of pre-administration contracts between SCG/GSI and LBIE. (It has nothing to do with the interpretation of the statutory scheme and, in this respect, it differs from Waterfall IIA, in which the questions primarily concerned the interpretation of the statutory scheme relating to interest and non-provable claims)[2].

11. **Second**, it is litigation in which the SCG/GSI assert claims that are hostile to the interests of the LBIE estate, and all those interested in it apart from creditors in the position of SCG/GSI. In short, SCG/GSI contend that their contracts entitle them to

[2] In his judgment on the costs of Parts A and B given on 9 October 2015, David Richards J made clear that his judgment had no bearing on Part C: Transcript 9 October 2015, Page 96, Lines 9-15 [8/3A]

interest at rates in excess of 8% per annum. If they succeed, then the administration estate will be diminished by the increased amount of their claims. As to this:

(1) Part C was mostly taken up with (i) Issue 10 (who is the relevant payee?), (ii) Issue 11 (the meaning of Default Rate and, in particular, whether it includes cost of equity); and (iii) the GMA issues.

(2) These were raised for determination by the SCG. In Lomas 9, at paragraphs 47 and 51, Mr Lomas referred to the fact that creditors of LBIE had sought to assert claims to interest at rates significantly in excess of the Judgments Act Rate, and that it was the SCG that was "*very focused on the construction issues relating to the calculation of Statutory Interest*" [2/1A].

(3) It was evident during the process of formulating the issues, that the SCG was pressing to include issues that would maximise their prospect of recovering interest: see, for example, the introduction of Mr McKee's witness evidence[3], which evidenced various corporate finance theories upon which the SCG wished to rely for the purpose of demonstrating an entitlement to calculate the Default Rate by reference to their cost of equity, and other matters.

(4) The claim that Default Rate is to be construed by reference to the relevant payee's cost of equity, for example, thus giving rise to excessive interest rate, and the claim that the relevant payee is the assignee of rights under the ISDA MA, are claims which could have been made as much before, as after, LBIE's administration. They have nothing to do with the proper administration of the insolvent estate.

(5) Although the issues arise between SCG/GSI and LBIE estate, the role of defending the estate has been assumed by Wentworth, because on the projected outcome numbers, it is likely that the surplus available after payment of Statutory Interest and such non-provable claims that survive, will be paid to

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3 [2/4].

Wentworth, such that that every £1 out of the estate by way of costs is a £1 out of its pocket. Wentworth's involvement simply reflects economic substance.

12. **Third** it is irrelevant both that the SCG hold claims in a substantial aggregate amount, and that others might have a similar claim under the ISDA MA, if the SCG were to succeed:

(1) Assume, first, that one creditor asserts a claim for interest at 15% based on its preferred construction of "Default Rate". If it fought the estate's rejection of its claim and lost, there could be no basis on which it could contend that it should have its costs paid by the estate.

(2) It makes no difference that the claim is large in comparison with the size of the estate.

(3) Nor can it make any difference that there are two, twenty, or two hundred creditors who may wish to advance similar claims. The existence of others in a similar position may have justified the SCG reaching an arrangement with others as to the sharing of the costs burden between them[4], but it does not provide any reason to depart from the basic principle that they advanced a case hostile to the interests of the estate and lost.

(4) Likewise, efficiency of representation does not carry an entitlement to costs. It merely raises the question of contribution as between the members of that class.

13. **Fourth**, it is irrelevant that the administrators could not distribute the surplus without the issues being resolved. That will always be the case where a creditor asserts a claim so large that it would make a fundamental difference to distributions to other creditors. If it was otherwise appropriate to apply the usual costs rule, the fact that the distribution of the surplus is held up until the issue is resolved provides no reason for departing from it.

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[4] It is not known whether the SCG has reached such an agreement or, if not, why it has not taken steps to do so.

14. **Fifth**, and similarly, it is irrelevant that – the hostile claim having been asserted – the administrators say that they need to have an answer to the point. This on analysis adds nothing to the contention that the surplus cannot be distributed without the question being answered. Accordingly, the SCG's characterisation of the proceedings as "*giving assistance to the administrators*" is a hollow assertion of form over substance. The questions resolved in Part C needed to be resolved only because the SCG, GSI and possibly other creditors chose to assert that on the true construction of the ISDA MA they could claim interest at rates in excess of 8%. It was not for the administrators to go to court to prove a negative – i.e. that creditors do not have such an entitlement.

15. **Sixth** – the novelty and complexity of the arguments is irrelevant. Otherwise, the more outlandish and correspondingly difficult the assertion, the greater the chance of having costs paid from the estate when the argument fails. The reverse should be true.

16. **Seventh**, both the SCG and GSI have throughout acted, quite properly, in pursuit of their own very substantial commercial objectives. The arguments advanced by the SCG and GSI were intended to produce double digit and in some cases over 20% rates of interest[5]. Further in the case of GSI this is not just its interest in maximising recovery from the LBIE estate, but also its interest in maximising its claim to interest in the many ISDA Master Agreements it has entered into with countless other counterparties in the market.[6] The suggestion that GSI could recover from the LBIE estate (to the detriment of those interested in it, including Wentworth) its costs of <u>failing</u> to establish the right to claim interest based on its cost of equity, under its countless agreements with other counterparties in the market, is self-evidently absurd.

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5 By contrast, the evidence, mostly based on submissions in other Lehman entities, which are guarantors of LBIE's debts, is that the rate of interest claimed is very low (well below 8% pa): see Lomas 11/paragraphs 80 to 92 [2/3] and Bingham 1/paragraphs 12 to 20 [2/2].

6 See Mr Kelly's 2nd witness statement, paragraph 7 [2/7, p.314]: "*...the court's decision on the cost of funding issues will impact countless other ISDA Master Agreements, of which financial institutions like Goldman Sachs are among the principal counterparties. Consequently, Goldman Sachs has a broader interest in these matters*." GSI sought to advance such argument notwithstanding that GSI was part of a group able to borrow many billions of dollars at rates of interest ranging from 0.01% to 1.10% pa.

17. In conclusion, Leading Counsel for GSI hit the nail on the head, when seeking joinder he said: "*although this is not normal adversarial litigation, the reality is – of course, the administrators are there to assist the court – but* ***the reality is that you've got, on the one side, Wentworth seeking to reduce the certified cost and, on the other hand, the SCG and Goldman Sachs looking at arguments to seek to increase the amounts***" (emphasis added).[7]

C THE GERMAN MASTER AGREEMENT ISSUES

18. The same analysis applies in relation to the German Master Agreements ("GMA"). These were included in Part C at the instigation of the SCG. There are only 15 claims against the LBIE estate based on the GMA, totalling £311m. Wentworth does not hold any of these claims and believes that they are mostly, if not wholly, held directly or indirectly the SCG which introduced the German law issues into Part C [5/5/3].

19. As with the ISDA MA issues, these concerned hostile claims by the SCG to establish, as against the LBIE estate, a right to interest under German law governed contracts at a rate significantly higher than 8%.

D CONCLUSION

20. For the above reasons, neither SCG nor GSI should be entitled to any costs out of the LBIE estate.

21. Instead, the usual costs rule should be applied. As to this, SCG should be ordered to pay Wentworth's costs in respect of Issues 10, 11, 12, 13, 19, 20.1, 20.2 and 21, and GSI should be ordered to pay Wentworth's costs in respect of Issues 11 and 12.

22. If and insofar as the Court should be against Wentworth on its submissions that its costs should be paid by the SCG/GSI, Wentworth contends that it should have its costs paid as an expense of the administration.

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[7] Transcript of hearing on 23/6/15 [8/2, at p.69, internal p.19, line 22 to p.20, line 3].

ANTONY ZACAROLI QC
DAVID ALLISON QC
ADAM AL-ATTAR