Neutral Citation Number: [2011] EWHC 1233 (Ch)

Case No: 7942 of 2008

IN THE HIGH COURT OF JUSTICE
CHANCERY DIVISION
COMPANIES COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 17/05/2011

IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (in administration)

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

Before :

MR JUSTICE BRIGGS

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Miss Rebecca Stubbs (instructed by **Linklaters LLP, One Silk Street, London EC2Y 8HQ**) for the Administrators
Mr Jonathan Crow QC and Mr Richard Brent (jointly instructed by **Norton Rose LLP, 3 More London Riverside, London SE1 2AQ and Field Fisher Waterhouse LLP, 35 Vine Street, London EC3N 2PX**) for Lehman Brothers Inc. & Lehman Brothers Finance AG

Hearing date: 11th May 2011

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Approved Judgment

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

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MR JUSTICE BRIGGS

Mr Justice Briggs:

1. This is the first hearing of an application by the Administrators of LBIE for directions pursuant to paragraph 63 of Schedule B1 to the Insolvency Act 1986 designed to enable them to identify client money and its traceable proceeds received or held by Lehman Brothers International Europe ("LBIE"). It follows from the application pursuant to which I gave directions on 15th December 2009 and 20th January 2010, which were varied by the Court of Appeal on 2nd August 2010, from which there is a pending appeal to the Supreme Court due to be heard in October this year. I shall refer to that application as "Client money 1" and to the present application as "Client money 2".

2. Miss Rebecca Stubbs for the Administrators submits that I should give the following case-management directions with a view to progressing Client money 2:

   i) that the Administrators conduct further research and file evidence about four specific aspects of the underlying factual background;

   ii) that the application be adjourned for further hearing on the first available date in the Michaelmas term for the purpose of identifying appropriate respondents, and for the giving of all further directions necessary to enable the application to be heard, including identification of the questions to be answered, and provision for the filing of evidence by all parties;

   iii) the making of a protective costs order in favour of the Administrators, in relation to their further research and the preparation of the evidence referred to above.

3. The Administrators have prior to this hearing notified potential respondents of their case-management proposals. Most of those notified have, in correspondence, adopted a broadly neutral attitude. By contrast, Lehman Brothers Inc. ("LBI") and Lehman Brothers Finance AG ("LBF") have appeared by counsel to oppose the making of those directions. Put shortly, their stance is that:

   i) The application is premature, in advance of the Supreme Court's determination of the appeal in Client money 1 and, in any event, misconceived in its formulation.

   ii) To authorise the carrying out of any further work by the Administrators on Client money 2 would in the circumstances create an unacceptable risk of wasted costs.

   iii) A protective costs order in favour of the Administrators is therefore unnecessary and, in any event, inappropriate.

4. A sub-issue, which I have not been asked formally to determine, but upon which, on reflection, the Administrators have through Miss Stubbs invited me to express at least a provisional view, is whether, as they presently propose, the Administrators should advance the interests of the general estate, as against those with client money claims, or rather adopt a neutral position, leaving the interests of the general estate to be advanced by a nominated representative respondent.

Prematurity

5. The pending appeal to the Supreme Court in Client money 1 leaves still to be finally determined three major issues of fundamental importance to the application of the CASS 7 regime in LBIE's insolvency. Those issues are:

   (1) whether the statutory trust of client money arises upon receipt or only upon segregation;

   (2) whether the client money pool ("CMP") is constituted by all identifiable client money (including client money in house accounts) or only segregated client money; and

   (3) whether distribution of the CMP is to be made upon the basis of clients' contractual entitlements or by reference to the amount of their money contributed to the pool (the 'claims' or 'contributions' basis of distribution).

6. The necessity for the further research and preparation of evidence which the Administrators invite the court to authorise them to continue is all predicated upon an assumption that the Supreme Court will not disturb the conclusion thus far that the statutory trust arises upon receipt rather than segregation of client money. It is only if the trust arises upon receipt that there is a necessity to identify non-segregated client money, and Miss Stubbs for the Administrators acknowledges that, if the Supreme Court were to conclude that the statutory trust arises only upon segregation, then the work which the Administrators invite the court to authorise them to do would be wasted.

7. Nonetheless the Administrators are, entirely understandably, mindful of the delay in the progress of the administration of LBIE's insolvent estate generally, and the determination of all client money questions specifically, which would be engendered if nothing by way of further preparation is done in advance of the Supreme Court's judgment, which cannot with confidence be assumed to be available before the end of 2011. The Administrators' view is that, weighing the desirability of avoiding unnecessary delay against the risk that the cost of the proposed research and evidence will be wasted, the balance comes down in favour of authorising the further work in advance of the Supreme Court's decision.

8. The Administrators' evidence in support of the application provided no estimate of the likely cost of the further work, nor the amount of time which might be saved if it were carried out now rather than after the Supreme Court's decision. Upon inquiry, I was told that the cost would be between £5 and £10 million and that the work would be likely to take about three months.

9. Mr Crow QC for LBI and LBF submitted in addition that, even if it were to be assumed (or the Supreme Court had decided) that the statutory trust arose on receipt of client money, the work which the Administrators proposed to do was based upon a misconception as to the nature of the forensic inquiry which would be required for the purpose of identifying client money outside segregated accounts. In summary, the work proposed consists of the forensic examination of four aspects of LBIE's dealings designed to identify specific client money (whether upon initial payment by the client or upon tracing or following through successive accounts) within a larger pool of

LBIE's own money. Mr Crow submitted that the correct approach in relation to any accounts in which house and client money had been mixed was to treat the entirety of the money in that account as client money, save for that which LBIE could prove was its own. If that were the correct approach, he submitted that it would necessarily follow that the Administrators' work would have been largely, if not entirely, wasted.

10. The question how client money should be identified outside segregated accounts, and the incidence of any burden of proof in that respect, was specifically left by the Court of Appeal to be decided at first instance on further application. Miss Stubbs acknowledged that Mr Crow's assertion as to the correct method was an issue which would have to be decided as part of Client money 2. Neither side suggested that I should resolve it now. Mr Crow submitted that it would best be decided as a preliminary issue, to avoid expensive and lengthy forensic work on a potentially misconceived basis, and he submitted that two further preliminary issues could usefully be decided before addressing the questions raised by the Administrators in the Application Notice in its present form.

11. While I have considerable sympathy with the Administrators' desire to do everything reasonably possible to progress this enormously complex and long drawn-out administration, rather than to allow legal uncertainties to cause further delay, and while in accordance with the court's ordinary practice, real respect is to be accorded to the Administrators' own view as to the outcome of the necessary balancing of wasted costs against delay, I have come to the conclusion that the balance does not come down in favour of authorising the further work, or the preparation of evidence based upon it. My reasons follow.

12. The Administrators' proposal is that, in advance of the Supreme Court's decision, the further work and evidence should be carried out and prepared, and a further hearing of Client money 2 arranged for the purpose of identifying appropriate respondents and giving all necessary case management directions. I accept that if both these steps could sensibly be taken in advance of the Supreme Court's decision, then something like six months' delay might be avoided. Nonetheless I have no confidence that the court could properly identify suitable respondents, still less give all necessary case management directions for the hearing of Client money 2 in advance of the Supreme Court's decision in Client money 1, even if the further work were done and the evidence prepared and filed. It is in my view essential that the outstanding issues raised in Client money 1 be finally determined before the court commits both the Administrators and necessary respondents to the substantial further work and expense necessary for the preparation of Client money 2 for an effective hearing.

13. It follows in my judgment that, even if the further work was done and the evidence filed, it would save only about three months' rather than six months' potential delay. Bearing in mind the large uncertainty as to the risk that the work and evidence will be entirely wasted, I am not persuaded that it would be appropriate to authorise the incurring of up to £10 million further expenditure for the achievement of that uncertain objective.

14. I leave for a further occasion the question whether any issues (including those proposed by Mr Crow) arising in the context of Client money 2 should be directed to be determined as preliminary issues. Once the Supreme Court's decision is available, and the entirety of the issues arising under Client money 2 can then be identified with

greater certainty, it will then be necessary to balance, on the one hand, the risk of anything of up to two years' delay in the determination of preliminary issues at all potential levels of appeal against, on the other hand, the carrying out of forensic work upon alternative methods of identifying client money, one or other type of which might well prove ultimately to be wasted. That will, I expect, be a difficult balancing exercise at any time, but one which cannot sensibly be addressed in advance of the Supreme Court's decision.

15. It follows that, in my view, any further hearing of Client money 2 in advance of the Supreme Court's decision would be premature, and that, specifically, the work actually proposed to be done by the Administrators in the meantime should not be authorised. I do not in that context rule out the possibility that there may be further avenues of work worth carrying out before the Supreme Court's decision, upon which the Administrators may usefully embark. All I can say at present is that the work specifically proposed does not appear to me to come within that category.

Protective Costs

16. It follows from my conclusion that it would not be appropriate to authorise the carrying out of the proposed further work that the question whether a protective costs order in relation to it should be made does not arise. It is therefore unnecessary for me to address Mr Crow's submission that no such order should in any event be made in circumstances where the Administrators propose to adopt an adversarial rather than neutral stance at the hearing of Client money 2.

17. My provisional view (since the Administrators have invited me to express one) is that they would be well advised to re-consider whether the adoption of an adversarial position in favour of the general creditors will be best calculated to bring about a just and convenient determination of Client money 2. My reasons follow.

18. The Administrators find themselves in possession of a very large and complex fund which is likely to prove to be held by them for the benefit both of proprietary claimants and general creditors. In Client money 1 the Administrators acknowledged this fact, sought and obtained the appointment of a representative of the general estate, and contributed very effectively to the determination of the issues raised by that application by providing the benefit of their research, and tentative views about the issues, in a manner unconstrained by the dictates of seeking to advance the claims of any particular group of stakeholders.

19. I acknowledge that, in the Rascals litigation [2010] EWHC 2914 (Ch), the Administrators did adopt an adversarial stance in a dispute which was, essentially, between the general estate and proprietary claimants, and did so effectively, without undermining their role as the persons best placed to provide information about the underlying facts, both to the court and to the other parties. I also acknowledge that it is not uncommon for trustees to represent a particular class of interested parties (such as minors and unborns) in litigation where the other parties are suitably represented.

20. Nonetheless, having observed the effectiveness of the Administrators' independent role throughout the first instance stage of Client money 1, I am doubtful that an adversarial role in Client money 2 would be as effective a mode of participation. I recognise in that context that the Court of Appeal expressed reservations as to the

efficiency and economy of representation and submissions in Client money 1, at the Court of Appeal stage of the proceedings. But that stage did not involve the research into and identification of the relevant (and very complex) matrix of assumed facts, a process which, at least in relation to the identification of client money, the Court of Appeal has concluded would be more easily carried out by the Administrators by way of assistance, than by the persons claiming to have a client money entitlement. I find it difficult to envisage how the Administrators would easily and effectively be able to perform that task, while at the same time vigorously advancing the interests of those opposed to the identification of client money within LBIE's unsegregated accounts.

21. The correspondence which preceded this hearing demonstrates that it will not be difficult to identify a suitable representative of the general body of LBIE's creditors to advance their interests, as indeed occurred in relation to Client money 1.

Conclusion

22. I propose therefore to adjourn this application to a date not earlier than the handing down by the Supreme Court of its judgment in Client money 1, and to make no protective costs order in the meantime. It is unnecessary for me to make any order in relation to the costs already incurred by the Administrators in research and preparation for Client money 2. To the extent that the Administrators need an order for costs, this can be sought, in the usual way, at the conclusion of the application.

23. Nothing in those directions is intended to discourage the Administrators from giving further consideration to the identification of appropriate respondents to Client money 2, or to the ventilation in correspondence or otherwise of questions as to the issues which may need to be determined (depending upon the outcome of the issues before the Supreme Court) so that further consideration to the case management of Client money 2 can be given by the court reasonably soon after the Supreme Court's judgment is handed down.