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) ANTHONY 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 SÀRL
(3) HUTCHINSON INVESTORS LLC
(4) WENTWORTH SONS SUB-DEBT SÀRL
(5) YORK GLOBAL FINANCE BDH LLC

Respondents

SKELETON ARGUMENT OF YORK GLOBAL FINANCE BDH LLC

for the consequentials hearing on 9 October 2015

INTRODUCTION

1. This skeleton argument is on behalf of the Fifth Respondent, York Global Finance BDH, LLC ("**York**") for the hearing taking place on 9 October 2015 to deal with consequential issues arising from the Part A Judgment and the Part B Judgment.

(1) THE PART A DRAFT ORDER

2. York proposes one amendment to the Part A Draft Order,[1] namely, the insertion into declaration (x) of a subparagraph (c) excluding "*any other rate that would only accrue on a debt that was contingent or future at the Date of Administration if some action was taken by the creditor after the Date of Administration*" from definition of "*the rate applicable to the debt apart from the administration*".

3. Declaration (x) as presently drafted provides that "*the rate applicable to the debt apart from the administration*" in Rule 2.88(9) includes a foreign judgment rate of interest applicable to a foreign judgment obtained prior to the Date of Administration, but does not include a foreign judgment rate of interest where a foreign judgment had not actually been obtained by the Date of Administration.

4. The present draft order does not expressly deal with the situation where a creditor had at the Date of Administration only contingent rights (for example open swap positions under a master agreement) that, until closed out and any other required process is completed to determine a net settlement amount, cannot become debts that are due and payable, and so interest bearing, such that prior to the Date of Administration there was in fact no interest accruing on any debts relating to those contingent rights.

5. The logic of the judgment is that, just as a creditor cannot rely on the foreign judgment rate of interest unless he has actually obtained a foreign judgment before

[1] York had previously proposed amendments to declarations (iii) and (vi). The proposed amendment to declaration (iii) is no longer necessary, the Administrators having confirmed that there are no preferential debts in the LBIE administration that were not also proved. York is also content to leave the question raised by its comments on declaration (vi) to be dealt with at a later date, assuming that the same approach is taken in relation to the comments of the other respondents on declaration (vi).

the Date of Administration, a creditor cannot rely on the post-close-out rate of interest unless that rate of interest was in fact applicable to debt for which he is proving before the Date of Administration. The fact that the creditor may, at the Date of Administration, have a contractual right to take some action (such as obtaining a foreign judgment, or closing out a swap) which would result in his becoming entitled to a particular rate of interest, does not make that rate of interest a "*rate applicable to the debt apart from the administration*".

6. This much follows from these passages of the Part A Judgment **[1/2]**:

> [177] … The words "the rate applicable to the debt apart from the administration" cannot be read as including a hypothetical rate which would be applicable to a debt if the creditor took certain steps …
>
> …
>
> [180] … The White Paper preceding the new insolvency legislation, *A Revised Framework for Insolvency Law* (Cmnd. 9175) published in February 1984, stated that if "a higher contractual rate applies to the debt, post-insolvency interest will be chargeable at that rate". While the wording in the relevant provisions of the Insolvency Act 1986 is wider than that … it suggests that it was not intended to include rates of interest for which no right existed at the commencement of the relevant insolvency proceeding.
>
> [181] In my judgment, these grounds make a compelling case for the proposition that the rate applicable to the debt apart from the administration is to be determined by reference to the rights of the creditor as at the commencement of the administration. Mr Dicker submitted that the words "the rate applicable to the debt apart from the administration" were capable of including a rate applicable at or at any time after the commencement of the administration. I agree that as a matter of language this is correct but, having regard to the factors on which Mr Zacaroli relies, I consider that his suggested construction is to be preferred.
>
> [182] Mr Dicker also submitted that the creditor with a right to bring proceedings in a particular court, for example under a jurisdiction clause in a contract, has at the date of the administration a contingent right to obtain a judgment in that court and accordingly a contingent right to interest on that judgment at the relevant judgment rate … I do not accept this argument … the rather ethereal contingent right to which he refers cannot on any basis, in my view, be described as the rate of interest applicable to the debt apart from the administration.

7. This clarification may be particularly valuable in advance of the hearing of Part C of the Waterfall II Application (which is due to commence shortly). Whilst Issue 22 **[1/1/8]** which concerns interest under FBF Master Agreement has now become an agreed issue, that issue only ever addressed the question as to whether a contractual interest rate under an FBF Master Agreement that applies to amounts that are due and payable and overdue is *capable of* being a rate applicable to the debt apart from administration. It does not address whether such a rate *is in fact* a rate applicable to a debt arising under the FBF Master Agreement or similar master agreements in relation to claims arising under such master agreements that were, as at the Date of Administration, merely contingent claims.

8. By way of example of the point, under the FBF Master Agreement, the non-defaulting party may terminate the outstanding transactions following the Date of Administration. The non-defaulting party then has to determine the settlement amount for each transaction, to convert those amounts into the termination currency, to net out positive and negative values and thereafter to notify the defaulting party of the settlement amount. The defaulting party is obliged to pay the settlement amount within three business days of receiving notice of the settlement amount. Interest is only payable under clause 9.1 of the FBF Master Agreement if there is a delay in such payment with the interest rate being that applicable to the termination currency.

9. This interest rate does not apply unless certain steps are actively taken by the creditor. The process may take some considerable time. Moreover, the interest arises on a different debt (i.e. a single net debt in a single termination currency) from those which existed at the Date of Administration (gross contingent debts that could be in several different currencies, none of which need be the termination currency).

10. York suggests that additional language is included in the draft order to clarify the position in relation to this issue. Alternatively, if the Court considers that this matter does not arise sufficiently from the matters which were argued at the Part A hearing, York suggests that the Court direct the filing of written submissions on the issue (a course with which it is understood that the Administrators agree).

(2) THE PART B DRAFT ORDER

11. York has no comments on the Part B Draft Order.

(3) ISSUE 37

12. York agrees with the Administrators' draft order in respect of Issue 37 **[1/7]** and has no comments.

(4) PERMISSION TO APPEAL

13. York applies for permission to appeal declarations (iii), (iv), (v), (viii), (x), (xviii) and (xix) in the Part A Draft Order. The issues are plainly matters of some legal complexity and any appeal would have a real prospect of success.

(5) COSTS

14. In common with the SCG, York seeks an order that its costs be paid from the estate as an expense of the administration.

15. By way of background:

    (1) York's claims against LBIE arise out of New York law Prime Brokerage agreements. In contrast, the Senior Creditor Group and Wentworth both hold a large volume of ISDA Claims (a term used by the Joint Administrators to refer to claims arising under various forms of derivatives master agreements).[2] ISDA Claims in many cases arise under agreements that contain contractual rights to interest on amounts that have become due and payable under such agreements but are unpaid. In contrast, the NY law Prime Brokerage claims

[2] Although it is understood that both Wentworth and the SCG also hold some Prime Brokerage claims, without knowing the amount of those claims it is impossible to assess whether the other Respondents' economic interests in respect of their ISDA claims outweigh their economic interests in respect of Prime Brokerage claims, such that they might be motivated to take a position which maximises recovery under the ISDA claims at the expense of a reduced recovery under the Prime Brokerage claims.

held by York and other similar creditors of LBIE, arise under contracts that do not contain any contractual rights to interest when LBIE fails to pay the creditor any amount that has become due and payable by LBIE.

(2) As the holder of substantial NY law Prime Brokerage claims which crystallised after the commencement of the administration, York has been particularly concerned with the question when statutory interest started to run on future and contingent debts.

(3) The Administrators initially appeared to accept York's view that such interest should accrue from the Date of Administration, and made public pronouncements to that effect. The Administrators later announced their intention to issue the Waterfall II Application.

(4) York therefore asked the Administrators if it could be joined, pointing out that it held claims that would be particularly affected by that point and it was not clear that any other respondent with a material interest in the same point would argue the point taking account of the non standard facts applicable to York's claims. The Administrators agreed.

(5) Only after position papers were exchanged did it became apparent that the Administrators and Wentworth were opposing York on Issues 7-8, and that the SCG were supporting York.

(6) York has participated in the Waterfall II Application in a limited and proportionate manner. It is correct that York's written submissions have argued for a similar outcome to those of the SCG. However, the detail of the argument was not identical. It was also not possible to know exactly what points the other parties would be taking until exchange took place. York has sought to minimise time spent on oral submissions, and has sought to limit in participation in the Part B and Part C hearings to those matters necessary to understand the complex inter-relationship between all the issues raised in the Application that need to resolved so as to enable the Administrators to distribute the surplus at the earliest possible date.

The Law

16. Ordinarily, when a trustee applies to the Court for directions concerning the administration of a trust, the trustee and those beneficiaries joined as defendants are paid on an indemnity basis out of the trust fund: *Chancery Guide* para.25.8.

17. In some circumstances, the Court will direct in advance of any proceedings that the beneficiaries will be indemnified out of the trust fund in any event for any costs incurred by them and any costs which they may be ordered to pay to any other party (a prospective costs order): *Chancery Guide* para.25.9.

18. The reason for the costs of all parties being paid out of the trust fund is that where the trustee seeks "*the guidance of the court as to the construction of the trust instrument or some other question of law arising in the administration of the trust … the costs of all parties are, whatever the outcome, usually treated as necessarily incurred for the benefit of the trust fund*": *Lewin on Trusts* para.27.139(1).

19. The similarity between a trustee's application for directions and an administrator's application for directions is acknowledged in the authorities:

    (1) In *Re Westdock Realisations Ltd* (1988) 4 BCC 192 Sir Nicolas Browne-Wilkinson VC noted that if "*a trustee, liquidator or receiver, or any other person in a neutral capacity is holding moneys which belong to others but it is not known who is beneficially entitled, the court frequently makes orders that the costs of determining who is beneficially entitled to those moneys are to be paid out of the moneys held*" and went on to award the respondents their costs out of the surplus on the basis that the point being litigated arose in a number of other cases and affected a large number of other persons, and it was therefore necessary to have a "*test case*".

    (2) Pumfrey J in *Re Ciro Citterio Plc* [2002] EWHC 897 (Ch) described the administrator's application as "*similar to a Beddoe application*" ([3]), and held that the rules in *Re Buckton* [1970] Ch 406 (which form the basis of the extract from Lewin quoted above) applied to an application by administrators,

conferring on the court the jurisdiction to make a prospective costs order ([25]-[26]).

(3) Briggs J in the *RASCALS* judgment [2010] EWHC 3044 (Ch) held that the rules applicable to costs in trusts litigation are applicable "*by analogy to litigation about insolvent estates … there is an undoubted 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 [that costs follow the event] where, in the end, the issue is decided against them*" ([11]).

20. In the context of an officeholder's application for directions, rather than seeking a prospective costs order, the modern practice is for the officeholder to agree in advance with creditors that creditors' costs will be paid out of the estate in any event. It is understood that this practice was adopted in *Brazzill* v *Willoughby* [2009] EWHC 1633 (Ch) and *Re MF Global* [2013] EWHC 2556 (Ch).

The Present Case

21. In the present case, the costs of all parties have been necessarily incurred for the benefit of the estate, and the default position should be that all parties are entitled to have their costs out of the estate on an indemnity basis.

22. The Part A Judgment in particular can properly be described as a "*test case*". The Administrators sought the court's directions on a number of novel and important points of law, considering that they were unable to distribute the surplus without doing so. The Respondents participated in the application not just for their own benefit but also for the benefit of their respective types of creditor claims that they held, being in a sense different classes of creditors since the exact payments to each such class depends on the specific characteristics of the claims of that class. As the Part A Judgment **[1/2]** notes at para.11, the Respondents were not "*appointed as representatives of different classes of creditors but they have advanced submissions in effect on behalf of those classes*". Those submissions

were publicised on the administration website so that other creditors could see what positions were being argued and whether any further argument was required.

23. It is wrong to suggest, as Wentworth have in correspondence, that the present litigation was more akin to adversarial litigation, where costs follow the event. This would be true only if the Respondents to the Waterfall II Application were the only parties interested in the outcome. This is not the case, and it would be wrong in principle to allow creditors who are not respondents to the application to take the benefit of litigation conducted effectively on their behalf, while depriving the Respondents of their right to be paid out of the common fund.

24. The Administrators have indicated that they are neutral on the question of the costs of the SCG and Wentworth. However, they intend to oppose the payment of York's costs out of the estate. The reasons given by the Administrators are essentially twofold:

(1) York's position was almost identical to that of the SCG, so there was no need for York to participate; and

(2) The Administrators had previously written to York explaining that York would be responsible for its own costs.

25. As to the first point:

(i) As Maunder 1 explains, York did not know exactly what the SCG's position (or anybody else's position, including that of the Administrators) would be until the exchange of position papers and skeleton arguments. Even after exchange, there was no guarantee that the SCG would not change its position,[3] or argue the relevant issues in some way which was helpful to the SCG but unhelpful to York and the class of creditors York represents (i.e. creditors holding NY law Prime Brokerage claims). It was therefore necessary for York, whose claim profile is not the same as that of the SCG, to be independently represented.

[3] Wentworth, for example, reversed its position on Issue 3 of the Waterfall II Application on 30 January 2015 shortly before skeleton arguments were due to be exchanged.

(ii) Following exchange of skeleton arguments, York sought to avoid duplication of oral submissions, focussing on Issues 7-8, and kept its costs to a minimum. The result has been a helpful clarification of a novel point of law which will benefit not only York but all other creditors whose claims were contingent at the Date of Administration.

(iii) It was appropriate for York to seek to be joined in order to represent creditors with NY law Prime Brokerage claims who (unlike creditors with mainly ISDA claims such as the SCG) would be particularly affected by the Court's decision on Issues 7-8 since those creditors all had claims that were contingent at the Date of Administration and, unlike ISDA Claims, did not have rights simply to convert those claims into presently due and payable claims as a result of LBIE going into administration.

(iv) Moreover, there is no principled basis for saying that, where the SCG and York have argued for the same result, the SCG should have its costs but York should not. If two respondents happen to take the same position, there is no obvious reason why one should be more entitled to its costs than the other.

26. As to the second point, the Administrators' email said that "*at this juncture*" York would be responsible for its own costs. As Maunder 1 explains, this was understood to mean that York would have to fund its own litigation unless and until the Court made some other order, and would not have the benefit of a prospective costs order or an undertaking from the Administrators that they would fund York's costs in any event (as is increasingly common in modern insolvency litigation). It was not thought that the Administrators were attempting to alter or affect the Court's discretion to award York its costs if the Court ultimately considered it appropriate to do so.

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8 October 2015