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Re Lehman Brothers International (Europe) (In Administration) [2018] EWHC 924 (Ch) (24 April 2018)

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Summary

Costs associated with the Waterfall IIC proceedings, and specifically the costs arising from the proper interpretation and effect of standardised ISDA master agreements were determined to be payable out of the estate given that proceedings had been initiated by the administrators so that they could proceed with the distribution of a surplus to creditors. Accordingly, as the application had been made in the interests of the general body of creditors, the usual principle that costs follow the event was not appropriate. However, in relation to issues arising out of a German master agreement, it was determined that as this had been instigated by the senior creditor group for its own benefit, this rightly entailed a costs liability for that group.

Introduction

On 25 April 2018, Mr Justice Hildyard handed down judgment *in Lehman Brothers International (Europe) (In Administration), Re* [2018] EWHC 924 (Ch). The case concerned the question of costs in relation to the Waterfall IIC tranche of the Lehman Waterfall proceedings.

Factual background

Waterfall IIC concerned the construction and effect of various standardised pre-administration agreements on creditors' entitlement to statutory interest.

In particular, the Lehman group had entered into various derivative transactions under International Swaps and Derivatives Association ('ISDA') master agreements and a German master agreement ('GMA'). Early termination amounts were payable to creditors following the close-out of the ISDA agreements. The administrators of Lehman Brothers International (Europe) ('LBIE') brought the proceedings to seek directions from the court, in particular with regards to the statutory interest accruing on the amounts payable to creditors, asserting this was necessary before they could proceed with distribution.

In judgement on Waterfall IIC, the fourth respondent prevailed on many of the issues decided. The fourth respondent therefore claimed its costs on the basis of the general rule that costs follow the event, and a successful party is entitled to its costs from the unsuccessful party. The fourth respondent also opposed applications by the senior creditor group ('SCG') and the sixth respondent for their costs to be paid out of the estate, contending that the proceedings were no different in substance from ordinary adversarial litigation.

Issues

The primary issues to decide were therefore (i) whether the usual principle of costs follow the event should be applied, or whether it should be departed from, and (ii) whether the claims brought by the SCG and sixth respondent should be properly characterised as adversarial litigation, or as necessary for the proper administration of the LBIE estate.

Decision

Taken as a starting point, reference was made to Briggs J's judgment in *Pearson & Ors v Lehman Brothers Finance SA & Ors* [2010] EWHC 3044 (Ch) at [7], where it was held that the general rule that costs follow the event was a position from which the court may depart having regard to all the relevant circumstances of the case.

It was also acknowledged that in the context of an insolvent estate, the court has been disposed to depart from the general costs follow the event principle and to allow costs as an expense in the relevant process of administration. In giving judgment, Hildyard J noted that this disposition was evident from the earlier Waterfall proceedings where in every instance the court had directed for the payment of all parties' costs out of the administration estate.

It was accepted that the question was ultimately one of discretion. However, Hildyard J was guided by authority pointing to discretion being deployed cautiously according to the characterisation of the substance of

the proceedings. See for example Henderson J's decision in *Kositc v Chaplin & Ors* [2007] EWHC 2909 (Ch).

Accordingly, in reaching judgment, it was necessary to determine the proper characterisation of the Waterfall IIC proceedings. On this, it was evident that on the form of proceedings, Waterfall IIC was brought by the Joint Administrators of the LBIE estate to seek directions from the court on issues they considered had to be judicially determined in order to proceed with the administration of the estate. Further, although not formally appointed as representative respondents, it was noted that each of the Respondents was intended and called upon to advance arguments from the point of view not just of itself, but of all creditors having a like interest. The overall objective was clearly therefore for the resolution of issues in the interests of all creditors and the administration as a whole.

In making submissions, it was pointed out by the SCG that the fourth respondent (Wentworth) held £1.6 billion worth of ISDA claims alone, which materially exceeded the entire unsecured claims held by the members of the SCG. It was said that this illustrated the essentially sponsored and representative nature of the proceedings with participants playing roles which did not necessary reflect their actual overall interests, serving to emphasise that the usual costs follow the event order would not in truth reflect the economic realities, and would therefore be unjust and unfair. In supporting this contention, the SCG pointed to the circumstances of Waterfall II more generally, highlighting that the proceedings were divided into parts solely for the convenience and efficiency of determination. It had not been suggested that the decision on how to divide the application reflected that the different parts were of a different nature, or that they deserved different treatments on costs. In Waterfall II A and B, costs were ordered to be paid as an expense of the administration, and so it followed that the same treatment should be afforded in Waterfall IIC.

However, to the contrary of the SCG's (and sixth respondent's) position, the fourth respondent submitted that the court should look beyond the form to the substance of the proceedings. On this, they pointed the court to the fact that the proper characterisation of the proceedings was that of hostile commercial litigation in which the SCG and sixth respondent sought to establish a right against LBIE pursuant to pre-administration contracts with them, which provided for the payment of interest at rates greater than 8% p.a. Given Waterfall IIC concerned the construction of pre-administration contracts between those parties, this had nothing to do with the interpretation of the statutory scheme, such that costs should not be paid out of the administration estate in respect of those claims.

In balancing these competing claims, Hildyard J held that in respect of the adjudication of the ISDA agreement issues, this should be characterised and treated for the purposes of costs as a necessary application for direction to be given in the interest of the general body of creditors, despite the process being necessarily adversarial. Overall, the application was required to clarify the interest and was conducted to the overall benefit of the administration estate, therefore meaning that the costs should come out of the LBIE estate.

However, on the adjudication of the GMA issues, Hildyard J considered that they should be characterised as a commercial claim against the interests of the LBIE estate, which were raised for no identified benefit beyond that of the SCG. There were no sufficient factors to displace the ordinary rule that costs follow the event, and so costs were ordered to be paid accordingly.

Comment

This case highlights yet again the complexities that can arise in costs proceedings. It also provides further commentary on the circumstances when it is appropriate to divert from the usual cost follow the event principle in the context of applications brought by the administrators of an insolvent estate. Parties involved in such litigation should consider the true purpose behind their position, and whether that stance will benefit the wider estate, or whether the stance is being taken solely for their own benefit. Whatever the answer will ultimately have costs consequences.

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