International Corporate Rescue

ChaseCambria

3-4 SOUTH SQUARE
BARRISTERS

UCL
UCL LAW FACULTY
CENTRE FOR COMMERCIAL LAW

Published by:
Chase Cambria Company (Publishing) Ltd
4 Winifred Close
Barnet, Arkley
Hertfordshire EN5 3LR
United Kingdom

Annual Subscriptions:
Subscription prices 2009 (6 issues)
Print or electronic access:
EUR 695.00 / USD 845.00 / GBP 495.00
VAT will be charged on online subscriptions.
For 'electronic and print' prices or prices for single issues, please contact our sales department at:
+ 44 (0) 207 014 3061 / +44 (0) 7977 003627 or sales@chasecambria.com

International Corporate Rescue is published bimonthly.

ISSN: 1572-4638

Lehman Administrators not at 'Beck and Call' of Creditors: *Four Private Investment Funds v the Joint Administrators of LBIE (in administration)* [2008] EWHC 2869 (Ch)

John O'Driscoll, Associate, Orrick, Herrington & Sutcliffe, London, UK

Introduction

This case arises out of the recent collapse of the Lehman Brothers banking group (the 'Lehman Group'). The applicants, four private investment funds managed in the USA, sought an order requiring the administrators of Lehman Brothers International (Europe) ('LBIE') to provide additional information regarding certain securities held by LBIE on behalf of the applicants.

Mr Justice Blackburne refused the application and held that the court would not be justified in intervening in the day-to-day management of the administration by ordering the administrators to provide additional information to the applicants. Whilst the court was sympathetic to the position of the applicants, the court was firm in its view that the administrators must be accorded a wide measure of latitude to achieve their statutory purpose, particularly where there was no suggestion of improper conduct by the administrators.

This decision follows on from the recent case of RAB Capital plc[1] where the applicants sought the return of securities held on their behalf by LBIE. Both of these decisions are illustrative of the court's non-interventionist approach to applications brought by parties adversely affected by the collapse of the Lehman Group.

Facts

Each of the applicants was party to both a prime brokerage agreement with Lehman Brothers Inc ('LBI') (a US company) and LBIE (a UK company) and a margin lending agreement with LBIE which was arranged by LBI as agent. The prime brokerage account under the prime brokerage agreement was maintained by LBI while the lender's account under the margin lending agreement was maintained by LBIE.

The funds lodged securities with LBI, which acted as their prime broker, as security for payment and performance of their obligations and liabilities to LBIE. These securities were then transferred to LBIE which was authorised to make loans to the applicants and provide other services. Under clause 5 of the margin lending agreement, LBIE was authorised to lend the securities to itself or others, and to pledge, re-pledge, hypothecate and re-hypothecate them on the terms that (unless otherwise agreed) the funds would be entitled to any distributions made in respect of those securities.

The applicants' case

The applicants claimed that by Friday 12 September 2008 that they had agreed with LBI that most of their securities would be transferred to a third party bank on 16 September 2008. Due to the collapse of LBI and LBIE on 15 September 2008 the transaction was never completed.

The applicants criticised the administrators for having 'a marked reluctance' to providing them with further and better information about the state of their securities and for providing unsatisfactory reasons for their failure to do so. Counsel for the applicants submitted that the applicants were not seeking to involve the administrators in a 'burdensome fact-finding investigation' nor were they seeking to put themselves in a more favourable position compared to other former LBIE clients. They stated that their objective was merely a 'reporting to investors' exercise.

The funds specialise in investing in companies, restructuring them and creating value in them. The applicants argued that the administrators' failure to provide information would adversely affect the confidence of their investors. This in turn, they contended, could lead to revenue impairment and economic loss

Notes

1 *RAB Capital plc and RAB Capital Market (Master) Fund v Lehman Brothers International (Europe)*, [2008] EWHC 2335 (CH.), dated 22 September 2008.

not just for the funds themselves but also for their investors. With reference to two of the funds the applicants stated that if by mid-December 2008 their managers were unable to provide assurances as to the likelihood of recovery, the funds would have to be wound down immediately. This, it was claimed, could lead to the loss of jobs and the collapse of companies in which securities were held.

The administrators' case

The respondents argued that before securities and monies provided by way of collateral could be returned to former clients of LBIE a detailed and time-consuming reconciliation would firstly have to be undertaken. Such a reconciliation would necessitate the completion of a series of complex steps including:

(i) investigating and obtaining definitive information on closing, reversing, unwinding or otherwise dealing with any unsettled trades which could have affected the client's account;

(ii) conducting a reconciliation of LBIE data and records held by LBIE's custodians and resolving any differences or disparities; and

(iii) determining the extent of any indebtedness of the client to LBIE and any other Lehman Group entity.

The respondents further argued that they would not be able to discharge their statutory functions properly if they were to divert resources to carry out investigations for the benefit of the applicants and other parties in a similar position. They pointed out that LBIE had more than a thousand prime brokerage clients and that there were approximately 140,000 failed or pending trades which would have to be investigated.

The respondents explained to the court that LBIE had extensively exercised its right to re-use securities that the applicants had provided as collateral. It is likely that some of those securities would have been transferred to LBI and other securities would have been provided to other third parties as collateral for other transactions. Further detail was given by the respondents that LBIE held securities provided to it by way of collateral in segregated client accounts with sub-custodians. Due to the fact that such securities were held in pooled client custody accounts other clients could also have a claim on the pool. As such, the respondents claimed that until such time as all claims have been received and a reconciliation carried out, it would not be possible to determine whether assets could be returned in full or whether there would be a shortfall which would have to be shared *pro rata* amongst all client holdings.

The administrators pointed out that they had already provided what readily available information they could to the applicants. They argued that to devote a disproportionate amount of time to one particular counterparty or small group of associated counterparties would delay the task of returning client assets.

Judgment

The applicants submitted that the court had jurisdiction to make an order under paragraph 68(2) or 74(1)(b) of Schedule B1 to the Insolvency Act 1986 or under the court's equitable jurisdiction in relation to trusts.

Paragraph 74(1)(b) provides that an application can be made to court if an administrator 'proposes to act in a way which would unfairly harm the interests of the applicant.' The applicants sought to invoke paragraph 74(1)(b) on the basis that the administrators' refusal to provide the information requested would unfairly prejudice their interests.

Mr Justice Blackburne acknowledged that there was 'no suggestion that the administrators [were] acting other than in accordance with their obligations under Schedule B1.' With this in mind, he felt unable to conclude that there would be any case of 'unfair harm' within the meaning of paragraph 74(1) where the administrators 'are endeavouring to avoid being deflected from this course by devoting what they fairly regard as a disproportionate amount of time and resources to dealing with requests for information from a particular group of former clients, such as the applicants.'

Paragraph 68(2) of Schedule B1 of the Insolvency Act 1986 enables a court to 'give directions to the administrators of a company in connection with any aspect of his management of the company's affairs, business or property.' This power however is subject to the proviso at paragraph 68(3)(b) that the directions are consistent with any proposals or revisions approved by the creditors.[2] On 7 October 2008, Mr Justice Blackburne approved the administrators' processes for the identification of property held on trust and the management of claim by creditors. On 14 November 2008, the creditors of LBIE approved the administrators' proposals in accordance with the court order dated 7 October. Taking this into account the judge stated that any direction given must be consistent with these proposals. The judge concluded that it would be 'quite wrong to accede to this application' whether under paragraph 68(2) or by recourse to the court's equitable jurisdiction in relation to trusts and trustees.

Due to the fact that the court declined to exercise its powers under paragraph 68(2) the applicants could not

Notes

2 In accordance with paragraphs 53 or 54 of the Insolvency Act 1986.

have recourse to the court's wider equitable jurisdiction in relation to trusts to secure the same objective.

The judge was of the opinion that 'the administrator must be accorded a wide measure of latitude in the way he goes about the exercise of his powers so as to achieve the statutory purpose.' The judge went on to say that an administrator's task would be rendered unmanageable if he were to be at the 'beck and call of each and every creditor.'

The judge felt that 'it would run flat contrary to the nature and purpose of an administration if the court were to interfere in the detailed day to day management of the administration in the way that this application suggests.' In the absence of some wrongful conduct on the administrator's part, it is for the administrator to decide where the balance lies between the need 'to proceed with the administration in the interests of creditors as a whole against the desirability of responding to legitimate enquiries from individual creditors and others.'

Conclusion

This case showed the English High Court to be unwilling to meddle with or overrule the commercial decision-making of the administrators despite the likely hardship being faced by the applicants. Generally it would seem that having commercial decisions of administrators set aside in the absence of improper or wrongful conduct on their part is becoming increasingly difficult to achieve. The court in this case recognised that an administrator is afforded a wide discretion to decide where the balance lies between the need to proceed with an administration in the interests of creditors as a whole against the desirability of responding to their legitimate enquiries. As a consequence it is likely that potential applicants, particularly in relation to the Lehman collapse, will think twice before making such applications in the future. Due to the scale and complexity of the Lehman collapse and the possible repercussions of a successful application by the funds any other result would almost certainly have rendered the task before the administrators even more unwieldy.

International Corporate Rescue

International Corporate Rescue addresses the most relevant issues in the topical area of insolvency and corporate rescue law and practice. The journal encompasses within its scope banking and financial services, company and insolvency law from an international perspective. It is broad enough to cover industry perspectives, yet specialized enough to provide in-depth analysis to practitioners facing these issues on a day-to-day basis. The coverage and analysis published in the journal is truly international and reaches the key jurisdictions where there is corporate rescue activity within core regions of North and South America, UK, Europe Austral Asia and Asia.

Alongside its regular features – Editorial, The US Corner, Economists' Outlook and Case Review section – each issue of *International Corporate Rescue* brings superbly authoritative articles on the most pertinent international business issues written by the leading experts in the field.

International Corporate Rescue has been relied on by practitioners and lawyers throughout the world and is designed to help:

- Better understanding of the practical implications of insolvency and business failure – and the risk of operating in certain markets.
- Keeping the reader up to date with relevant developments in international business and trade, legislation, regulation and litigation.
- Identify and assess potential problems and avoid costly mistakes.

For more information about *International Corporate Rescue*, please visit www.chasecambria.com