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Case No: **CL-2008-000012**

IN THE HIGH COURT OF JUSTICE
BUSINESS AND PROPERTY COURTS OF ENGLAND AND WALES
INSOLVENCY AND COMPANY LIST

Royal Courts of Justice, Rolls Building
Fetter Lane, London, EC4A 1NL

Date: **15 July 2020**

Before:

Sir Geoffrey Vos, Chancellor of the High Court

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In the matter of Lehman Brothers International (Europe) (in administration)

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Mr Daniel Bayfield QC and Mr Ryan Perkins (instructed by **Linklaters LLP**) for the **Applicants**
Ms Louise Hutton (instructed by **Dentons LLP**) for the **LB Holdings Intermediate 2 Ltd**

Hearing date: **15th July 2020**

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JUDGMENT

Sir Geoffrey Vos, Chancellor of the High Court

Introduction

1. The Joint Administrators (the "Administrators") of Lehman Brothers International (Europe) (in administration) ("LBIE") apply to the court for a direction pursuant to paragraph 63 of Schedule B1 ("Schedule B1") to the Insolvency Act 1986 (the "1986 Act") that they be at liberty to consent to a request from the directors of LBIE (the "directors"), pursuant to paragraph 64 of Schedule B1, to distribute surplus funds to LBIE's sole shareholder, LB Holdings Intermediate 2 Limited (in administration) ("LBHI2"). LBHI2 is an indirect subsidiary of Lehman Brothers Holdings Inc ("LBHI") a company which is the subject of Chapter 11 bankruptcy proceedings in New York.
2. The directors have requested the Administrators to consent to their proposal that they (the directors) cause LBIE to make one or more distributions to LBHI2 (the "request").
3. The Administrators' position, in summary, is that:

> "Given that it is clear that the LBIE estate is solvent (with all admitted creditor claims having been paid in full and a sufficient reserve being maintained for the small number of unresolved claims) and given that the Administrators are holding a substantial sum of money to which [LBHI2] is entitled, the Administrators consider it appropriate to consent to the request".

4. It is unnecessary to recite the history of LBIE's administration or of the administration of other Lehman companies, which have come before this court on numerous occasions since September 2008. Suffice it to say that the original purpose of the administration of LBIE was

to achieve a better result for LBIE's creditors as a whole than would be likely if the company were wound up (without first being in administration) under paragraph 3(1)(b) of Schedule B1.

5. The administration has been successful. There is a cash surplus in the hands of the Administrators which is said to be likely to grow. In summary, (i) some £23 billion of custodied securities, investments and associated cash has been returned during the course of the administration, (ii) £12.6 billion has been paid in distributions to unsecured creditors, (iii) £5.1 billion has been paid in statutory interest on those unsecured distributions and (iv) £2.2 billion has been paid to the holder of subordinated debt. As to the latter, it may be noted that the subordinated creditor supports the application, as does LBHI2.

6. The request explains what the directors wish to do as follows:

> "The directors propose to make an initial distribution in the amount of £29 million out of the surplus presently available. The directors may also wish to make further distributions of any additional surplus funds which the Administrators confirm are available for distribution to LBHI2 by reducing LBIE's share capital in the manner set out [in the request] (or by creating distributable reserves in any other lawful manner), and/or by making further interim dividend payments on or partial redemptions of the 5% redeemable preference shares and/or the class B redeemable preference shares ("Further Distributions"). The directors will seek the consent of the Administrators before taking any steps to make Further Distributions".

7. Moreover, one of the Administrators, Mr Russell Downs, explains to the court that: "[t]he Administrators have taken legal advice and reviewed the accounting analysis performed by colleagues at [PricewaterhouseCoopers] to determine whether the [directors' request] is lawful and available to LBIE, and have satisfied themselves that it is both".

8. Mr Downs explains in his evidence that as at 10 June 2020 there was approximately £493 million in the LBIE estate, the majority of which is held as a conservative reserve against its potential liabilities and against the future estimated costs and contingent expense claims of the administration. That figure does not include anticipated future realisations and Mr Downs says that: "[i]n some instances, if these matters are resolved in favour of LBIE, there will be a double benefit to the estate: not only will there be a recovery of further debts but also a release of the reserves currently held against the claims submitted by putative creditors". Of the £493 million held, £29 million is said to be a "true surplus" available for distribution now, and £145 million is expected to be available for distribution by the end of 2020.
9. Mr Downs has given the court a full account of the nature of the unresolved claims by and against LBIE's estate. It is not necessary for me to recite that account in this judgment. Suffice it to say that I accept on the evidence that the £29 million is indeed a true surplus, and that there is no reasonable likelihood of those monies being needed to satisfy liabilities of LBIE at any stage.
10. Mr Downs has also explained in some detail why it is not now possible for the administration of LBIE to be terminated. There are some outstanding creditor claims that need to be resolved before that can happen. The timescale is unclear, although I was told in oral argument that the Administrators' term will expire in 2022, so the administration will need to terminate then unless their term is further extended.
11. The Administrators have notified all creditors (by their website), the Commissioners for HM Revenue and Customs ("HMRC") and the Financial Conduct Authority (the "FCA") of this application, and none has sought to attend the hearing. I was told that HMRC and the FCA

have each indicated in the last day or so that they do not oppose the Administrators' application.

12. On 1 July 2020, however, a Mr Rex Wu emailed indicating an objection. He subsequently repeated that objection in letters to Mr Justice Hildyard and later to me. The substance of his objection was that LBIE and/or LBHI2's capital stock are not entitled to receive a distribution as a result of a covenant given by LBHI as part of a guarantee of certain preferred securities. He contends that the distribution would violate the terms of LBHI's Chapter 11 recovery plan confirmed by the US Bankruptcy Court for the Southern District of New York on 6 December 2011.

13. The essential legal question before the court is whether in consenting to the request the Administrators would be performing their functions with the objective stated in paragraph 3 of Schedule B1 ("paragraph 3"). That said, of course, the court has nonetheless to decide, in all the circumstances, whether it is appropriate as a matter of its discretion to accede to the distributions sought under paragraph 63 of Schedule B1 ("paragraph 63").

The relevant statutory provisions

14. Paragraph 1(1) of Schedule B1 provides that: "[f]or the purposes of this Act "administrator" of a company means a person appointed under this schedule to manage the company's affairs, business and property".

15. Paragraph 3 provides as follows:

> "(1) The administrator of a company must perform his functions with the objective of -
> (a) rescuing the company as a going concern, or (b) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up

(without first being in administration), or (c) realising property in order to make a distribution to one or more secured or preferential creditors.

(2) Subject to sub-paragraph (4), the administrator of a company must perform his functions in the interests of the company's creditors as a whole.

(3) The administrator must perform his functions with the objective specified in sub-paragraph (1)(a) unless he thinks either - (a) that it is not reasonably practicable to achieve that objective, or (b) that the objective specified in sub-paragraph (1)(b) would achieve a better result for the company's creditors as a whole.

(4) The administrator may perform his functions with the objective specified in sub-paragraph (1)(c) only if - (a) he thinks that it is not reasonably practicable to achieve either of the objectives specified in the sub-paragraph (1)(a) and (b), and (b) he does not unnecessarily harm the interests of the creditors of the company as a whole".

16. Paragraphs 59, 63 and 64 of Schedule B1 provide as follows:

"59 (1) The Administrator of a company may do anything necessary or expedient for the management of the affairs, business and property of the company. (2) A provision of this schedule which expressly permits the administrator to do a specified thing is without prejudice to the generality of sub-paragraph (1)" ("paragraph 59").

"63 The administrator of a company may apply to the court for directions in connection with his functions".

"64 (1) A company in administration or an officer of a company in administration may not exercise a management power without the consent of the administrator. (2) For the purposes of sub-paragraph (1) - (a) "management power" means a power which could be exercised so as to interfere with the exercise of the administrator's powers;

(b) it is immaterial whether the power is conferred by an enactment or an instrument; and (c) consent may be general or specific" ("paragraph 64").

17. Paragraph 68 of Schedule B1 ("paragraph 68") provides as follows:

"(1) Subject to sub-paragraph (2) the administrator of a company shall manage its affairs, business and property in accordance with - (a) any proposals approved under paragraph 53; (b) any revision of those proposals which is made by him, and which he does not consider substantial; and (c) any revision of those proposals approved under paragraph 54.

(2) If the court gives directions to the administrator of a company in connection with any aspect of his management of the company's affairs, business or property, the administrator shall comply with the directions.

(3) The court may give directions under sub-paragraph (2) only if - ... (b) the directions are consistent with any proposals or revision approved under paragraph 53 or 54; (c) the court thinks the directions are required in order to reflect a change in circumstances since the approval of proposals or a revision under paragraph 53 or 54 ...".

18. Paragraph 74 of Schedule B1 ("paragraph 74") allows a creditor or a member of a company in administration to apply to the court claiming that the administrator is acting or has acted "so as unfairly to harm" their interests.

19. Paragraph 111(1) of Schedule B1 provides that "the purpose of administration" means an objective specified in paragraph 3.

20. Finally in this connection, an administrator also has a "power to carry on the business of the company" under paragraph 14 of Schedule 1 to the 1986 Act ("paragraph 14").

<u>The Administrators' submissions</u>

21. The Administrators made four main submissions in support of their proposition that they can and should consent to the directors' request:

(1) The request does not interfere with the exercise of the Administrators' powers, because the Administrators do not have the power to distribute assets to shareholders: see Briggs J in *Re LBEL*, unreported, 25 June 2012, and Hildyard J's judgment in *Re LBEL No. (9)* [2017] EWHC 2031 (Ch), [2018] Bus LR 439 ("*Re LBEL*"). In addition, the directors do not propose to distribute any funds required to fulfil creditors' claims.

(2) The request complies with the Companies Act 2006 and LBIE's Articles of Association as explained in the evidence.

(3) The directors are not prevented by Schedule B1 from reducing capital or making a distribution to members in accordance with the Companies Act 2006 and LBIE's Articles of Association (so long as they first obtain the consent of the Administrators); see Hildyard J in *Re LBEL* at [56] where he said: "The 1986 Act and the 2016 rules do not prevent recourse to the provisions of the 2006 Act in relation to distributions of the surplus further to a reduction of capital, nor do they curtail the residual powers of the directors and members of the company in that regard. On the premise that the Administrators hold a surplus in which only the members are interested, but which the Administrators cannot themselves distribute to them, it would seem to me unlikely that it was intended to exclude the powers of the directors and members under the 2006 Act to release and distribute such surplus, leaving liquidation as the only route, unless the purposes of the administration can be said thereby to be impeded or frustrated".

(4) The request is consistent with, and assists in, the discharge of the directors' duties to act in this case (where LBIE is in administration) under section 172 of the Companies

Act 2006 “in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole”.

22. I do not need to go into further detail in relation to these four submissions, which I accept.

23. What, however, is slightly more complex is the question of whether the Administrators can consent to the request on the basis that they will thereby be complying with their own statutory duties. It is submitted that the functions of an administrator are very broad, in that an administrator can consent to the exercise of a management power by a director under paragraph 64, carry on the business of the company under paragraph 14, and “do anything necessary or expedient for the management of the affairs, business and property of the company” under paragraph 59.

24. It is said that consenting to the request falls within these provisions, and I agree. That, however, simply brings me to the final submissions and the final question, namely whether the course of action proposed by the Administrators complies with paragraph 3 of Schedule B1.

25. The question before the court today, therefore, is whether in consenting to the request the Administrators would be performing their functions with one of the three statutory objectives in paragraph 3. Paragraph 3 imposes a mandatory requirement (“must perform his functions”) so that if the answer to that question were in the negative the court could not, as it seems to me, sanction the Administrators’ proposed course of action.

26. The first question then is towards which statutory objective are the Administrators now obliged to perform their functions. I do not think that that question need detain me long in the unusual circumstances of this case. Whilst the administration of LBIE began with the second objective in paragraph 3, namely “achieving a better result for the company’s creditors as a whole”, that objective has clearly now been achieved. Paragraph 3(3) requires the administrator to perform

his functions with the "rescuing the company as a going concern" objective in paragraph 3(1)(a) unless he thinks that is not reasonably practicable to achieve, or the objective in paragraph 3(1)(b) would achieve a better result for the company's creditors as a whole. Quite plainly neither of those conditions is any longer satisfied, since the rescue objective is, on the evidence, reasonably practicable and the objective in paragraph 3(1)(b) would plainly not achieve a better result for the company's creditors as a whole, since they have all been or will be paid off in full with full interest.

27. In these circumstances, it is now clear that the only objective of LBIE's continuing administration is to rescue LBIE as a going concern. That much was effectively confirmed by the LBIE scheme of arrangement which was sanctioned by Hildyard J in July 2018 ([2019] Bus LR 1012). The LBIE scheme resolved any uncertainty as to the solvency of LBIE and itself envisaged, at clause 33, the possibility of a surplus being available for LBHI2 (see also [23] of Hildyard J's judgment).

28. I shall therefore view the Administrators' submissions on the basis that the relevant statutory objective is that in paragraph 3(1)(a), namely rescuing LBIE as a going concern.

29. The Administrators submit, first, that paragraph 3 identifies the general overall objective to which an administrator's activities must be directed, and that this duty should be given a broad interpretation so as to avoid placing an unnecessary fetter on the powers of an administrator.

30. Secondly, by consenting to the request the Administrators would, they submit, act in a way that is directed towards the overall objective of rescuing LBIE as a going concern. The making of equity distribution is an important aspect of carrying on a company's business as a going concern.

31. Thirdly, the Administrators submit that even if the course of action proposed is not directed towards the purpose of administration they can nevertheless consent to the request. Where they face a binary choice between two alternative courses of action and neither course of action is directed towards the purpose of administration, then they can, and should, act in whatever manner is most consistent with their other duties under Schedule B1.

The authorities

32. In *Denny v. Yeldon* [1995] Pens LR 37 (a pre-Enterprise Act case), Jacob J said this at [17] about the then statutory purposes of administration, in the context of whether the Administrators had power to amend the pension trust deed and otherwise administer the company's pension scheme: "It will be noted that my view deliberately ignores which of the statutory grounds were the basis for the administration order. Those grounds go only to what the Administrators, as officers of the court, should be trying to achieve. They do not limit the powers of the Administrators once they are appointed". There was reasoning to a similar effect in both *Re Polly Peck International plc* [1999] Pens LR 37 per Buckley J at [19]-[24], and in *Re Allanfield Property*, [2015] EWHC 3721 (Ch) per HHJ Keyser QC at [49]-[50]. The latter case was decided under the current legislation but, correctly in my view, the judge did not think that that made any difference to the applicability of the principle emanating from *Denny v. Yeldon* and *Re Polly Peck International plc*.

33. Hildyard J considered this question in *Re LBEL*, where a similar issue presented itself to the one that the court faces here. He said this at [59] to [67]:

> "59. [The administrators'] position was modified ... when Ms Toube ... submitted that while she was not convinced that the Proposal needed to comply with the statutory purpose, that purpose was in fact furthered in this case ...

61. The term “functions” is not defined in the 1986 Act. However, paragraph 1(1) of Schedule B1 defines an “administrator” by reference to what may be considered his role or functions, as follows: “For the purposes of this Act, ‘administrator’ of a company means a person appointed under this schedule to manage the company’s affairs, business and property”. In like terms, paragraph 59(1) empowers an administrator to “do anything necessary or expedient for the management of the affairs, business and property of the company”.

62. The performance of such broad functions, however, is of course subject to certain statutory constraints, which include the requirement for an administrator to perform his functions with the objective of fulfilling the purposes of the administration.

63. In my judgment, there is little doubt that any action taken by the administrators to give effect to the proposal, including the appointment of a director and consenting to the exercise of management powers by the director and members, would be a performance of their functions as administrators of the company.

64. Accordingly, it seems to me that on a plain reading of paragraph 3(1) of Schedule B1, any such function must be performed with the objective of the administration’s statutory purpose. That provision does not, as the administrators at one point seemed to contend, permit an administrator to perform any of his functions so long as doing so does not conflict with the statutory purpose of the administration. If it had been Parliament’s intention to so provide, it could easily have done so. Rather, the statute is clear that any

performance of an administrator's function must be performed for, and only for, the administration's purpose.

65. As to whether the prospective director (and the company's members) would need to act in accordance with the purpose of the administration, the position is less clear. Directors and administrators owe different duties. But it must be a very rare case in which a director is asked (as here) to take steps typically suited to the purposes of a trading company, but in fact for the purposes of bringing the administration to an end ...

66. Since "management powers" can only be exercised with the administrator's consent (see paragraphs 64(1) and 64(2) of Schedule B1), and the administrator can only perform his functions for the statutory objectives (see paragraph 3(1) of Schedule B1), I tend to the view that whilst a company is in administration any exercise by the company or its directors of "management powers" would have to be consistent with the purpose of the administration: that seems to me to be the intent or corollary of paragraph 64 of Schedule B1.

67. However, in this case I do not think I need to decide whether the powers to be exercised by the director and the general meeting respectively are "management powers" as defined for the purpose of paragraph 64 or other powers of the company, nor whether the exercise of such powers by the director and/or the general meeting must be consistent with the purposes of the administration: for I am satisfied that, in the particular circumstances of the case, the contemplated exercise of their powers by the member and proposed director, even assuming them to be "management powers", and [thus] subject to the

> constraints of paragraph 64(2) of Schedule B1, is calculated to achieve the purposes of the administration ...".

34. The sentence in paragraph 64 that has been the subject of the Administrators' submissions was where Hildyard J said that: "The statute [paragraph 3(1)] is clear that any performance of an administrator's function must be performed for, and only for, the administration's purpose". It is submitted first that, in this case, that stricture is satisfied (see what I have described as the first and second submissions above), but that if the Administrators are wrong about that, either (a) Hildyard J was wrong in what he said in this sentence, or (b) his decision was *per incuriam* the trilogy of cases I have described.

35. In *Davey v. Money* [2018] Bus LR 1903 at paragraph 283, Snowden J said this about rescuing a one property company as a going concern: "The concept of rescuing a company as a going concern is not achieved by successfully realising all of its assets so that distributions of surplus moneys can be made to shareholders after paying creditors in full. It connotes the retention of all or a material part of the business of the company, together with the restoration of the solvency of the company, so that the company can properly continue to trade as a going concern". This does not, as it seems to me, much inform the concept of rescue for a multi-faceted financial services company like LBIE.

Discussion

36. I am conscious that I have not heard legal argument opposing the Administrators' standpoint, but I have nonetheless reached a clear view. It seems to me that I need first to consider the proper construction of the words in paragraph 3(1) that provide that the administrator must perform his functions with the objective of rescuing the company as a going concern. It is not possible properly to consider the Administrators' second submission that they would, by

acceding to the request, be acting in a way that is directed towards the overall objective of rescuing LBIE as a going concern, without understanding what the words in paragraph 3(1) should properly be understood to mean.

37. Plainly, the Administrators have the express powers to "carry on the business of the company" (under paragraph 14) and to "do anything necessary or expedient for the management of the affairs, business and property of the company" (under paragraph 59). In addition, paragraph 64 expressly allows the administrator to consent to the directors of a company in administration exercising a management power (that term being defined negatively, but still sufficiently broadly to encompass what is proposed here. It is defined as a power which "could be exercised so as to interfere with the exercise of the Administrators' powers"). Thus, the power that the Administrators are seeking to exercise is clearly sanctioned by the legislation.

38. The perceived problem is that paragraph 3 enjoins an administrator to perform his functions with the objective of rescuing the company as a going concern, and it may be said that there has to be some causal relationship between the exercise of the functions (in the shape of the powers in this case that I have mentioned) on the one hand, and the achievement of the rescue objective on the other hand. The words of paragraph 3 are that the administrator "must perform his functions" with that objective.

39. Paragraph 3 must, as I see it, be construed in the context of the legislation as a whole. The administration regime places multifarious demands upon an administrator. As the trilogy of cases starting with *Denny v. Yeldon* shows, there must be an element of pragmatism. It may be impossible, or at least a stretch, to tie every step that administrators need to take by the lawful exercise of their powers in an administration directly and causatively to the relevant objective in paragraph 3. But paragraph 3 does not say that every exercise of every function

must be with that objective. The administrators' functions are more general than that and are, in fact, not defined in the legislation at all.

40. As it seems to me, Hildyard J in *Re LBEL* was considering the question without the benefit of the reasoning contained in the trilogy of cases I have mentioned. He seems to have focused upon whether paragraph 3 required every function to be exercised with the objective of achieving the statutory purpose, or whether its exercise must merely not conflict with that purpose. Plainly, as he said, it is the former. But he did not go on to consider in more detail what it meant to say that every function must be exercised with the objective of achieving the statutory purpose. I have had the benefit of more detailed submissions and have been referred to the trilogy of cases already mentioned.

41. In my judgment, the question is whether paragraph 3 requires a causative analysis at all. I think that it does not. Paragraph 3 is, in my view, simply directed at the administrators' overall objective or, to use a close synonym, goal. The administrator should obviously not do anything that is directed at achieving an objective that is inconsistent with the relevant statutory purpose. That does not, however, mean that every exercise of every power must be capable of being shown specifically to advance the statutory objective in a definable way. Such a requirement would be unworkable.

42. In my judgment, it should not be necessary for administrators to argue, in cases of this kind, by some tortuous path, that the powers they are exercising will, if not exercised, possibly have a negative effect that might damage the achievement of the statutory objective. As I say, no specific causation needs to be demonstrated. All that is required is that the statute authorises the administrators to perform the function in question, and that they are faithfully pursuing the statutory objective. Jacob J put the point well when he said in *Denny v. Yeldon* that the grounds

(now the objectives) "go only to what the administrators, as officers of the court, should be trying to achieve. They do not limit the powers of the administrators once they are appointed".

43. This case provides a good example. As Mr Daniel Bayfield QC, leading counsel for the Administrators, submitted, it would have been impossible, in this administration, for every exercise undertaken by the Administrators to have been tied causatively to the furtherance of the statutory purpose. LBIE was an investment bank whose business involved holding client money. At the start of the administration, the greatest number of demands came from clients who wanted the return of their assets that were held in custody by LBIE. Those assets were held in trust and fell outside the company's estate. It was not suggested by either Blackburne J or the Court of Appeal, in determining the way in which those assets were to be dealt with in a scheme of arrangement, that the Administrators could not undertake that process because none of the statutory objectives was being furthered by so doing: see *Re LBIE (No. 2)* [2009] EWCA Civ 1161.

44. Examples can be multiplied, as the trilogy of cases show. Administrators need every day to exercise powers (that are properly described as functions) that are absolutely necessary but are not specifically directed at any of the statutory purposes because they are ancillary. As Mr Bayfield submitted, this approach would not open any Pandora's box. The Administrators' conduct is closely controlled by paragraphs 68 and 64 amongst other provisions. Moreover, in the present context the distribution of the surplus to LBHI2 makes obvious commercial sense for all the reasons Mr Downs has adumbrated. The administration will have to continue for some time; the money will not be required to pay creditors, interest or expenses, and will otherwise be sterilised, possibly for a considerable time. LBHI2 will be deprived of the time value of the money for no possible good reason. This is an exceptional case, but it would

nonetheless reduce the flexibility and utility of the legislation if it were to be interpreted as preventing the Administrators from giving the consent that is so obviously required.

45. Against that background, I need to consider the Administrators' second submission that they would, by acceding to the request, be acting in a way that is directed towards the overall objective of rescuing LBIE as a going concern. As paragraph 3 is properly to be understood, I accept that consenting to the directors' request would be performing a function with the objective of rescuing LBIE. That is not, however, because I accept that making equity distributions are causatively related to achieving the rescue of LBIE as a going concern. Shareholders certainly acquire shares with the objective of receiving distributions when the company does well, as Mr Bayfield submitted. But, acceding to the directors' request to make a distribution now will not itself cause, or specifically promote, LBIE's rescue. It may assist LBHI2's rescue, but that is a different point.

46. None of that, however, detracts from the fact that the Administrators are performing all their functions with the overall objective of rescuing LBIE as a going concern. Acceding to the request is a proper exercise of the Administrators' powers, and appropriate commercially in all the circumstances Mr Downs has described to the court. I shall direct that they be at liberty to give the consent requested under paragraph 64.

47. I should say also that I am entirely satisfied that the objection raised by Mr Rex Wu is not a valid impediment to the Administrators consenting to the directors' request. The distributions being made are not distributions of LBHI or LBHI2's capital stock, they are distributions from LBIE to LBHI2. Mr Wu is not a creditor of LBIE.

Conclusion

48. For the reasons I have given, I will make a direction under paragraph 63 that the Administrators be at liberty to consent to a request from the directors of LBIE under paragraph 64 to distribute surplus funds to LBHI2.