BACFI

THE DENNING LECTURE 2012

"HAS ENGLISH LAW COPED WITH THE LEHMAN COLLAPSE"

MR JUSTICE BRIGGS

1. The insolvent collapse of the Lehman Brothers group in September 2008 was a cataclysm not merely for the international banking industry. It imposed unprecedented strains on the legal and regulatory systems of all the countries where its main business was based. Never before had there been an international insolvency on anything approaching such a scale. Never before had the insolvency provisions of international standard form derivative and other agreements been tested against the wholly unexpected insolvency of the banking counterparty, as opposed to that of the customer on the street, for which they were no doubt primarily designed. Never before have the numerous internal agreements put in place without any arm's length bargaining, between companies in the same group, and designed mainly to satisfy regulators, become the arbiters of the innumerable and hugely complex disputes as to who owned the remaining assets when the music stopped, between group companies now at loggerheads under the management of separate office holders, in the interests of different classes of creditors.
2. I may fairly be described as having lived for the last three years in the eye of this particular storm (at least insofar as it has affected England). This is because I have, since early on in the litigation following the collapse, been the judge in charge at least of the case management of the numerous applications for directions made by the administrators of Lehman Brothers International Europe ("LBIE"), the main hub company for Lehman group business in Europe, and one of the group's three main trading companies worldwide. In the event I have been the first instance trial judge for all those applications except (I think)

the first, which was dealt with by my predecessor Mr Justice Blackburne, before his retirement, to the complete satisfaction of the Court of Appeal. As will appear, I cannot quite say the same. I have had to deal with what I would classify as four very large cases, five large to medium sized cases and numerous smaller cases, and the administrators have asked me to resolve about 200 mainly legal questions on the way. The amounts at stake have been, by comparison with anything in which I had been involved before, on the bench or at the bar, truly astonishing.

3. The recent announcement of a provisional settlement between LBIE and the main American hub company Lehman Brothers International Inc ("LBI") probably means that the tide of English litigation which has flowed from the collapse is now very much on the ebb, at least at first instance, although there remain some big cases still pending at the appellate level. As a mere puisne judge I am therefore freer than I have been for some time to stand back, think and speak about what the whole affair has meant for English law and practice, and (without prejudice to what may still emerge from pending appeals) to begin tentatively to answer the question: has English law coped with the challenge?

4. It is a feature of modern international financial transactions that English law is chosen to a much greater extent than might ordinarily flow from England's (or in reality the City of London's) substantial share in the financial markets. By 'English" I of course include Welsh, but I hope I may be excused for using the phrase English law as shorthand. For example English law is one of only two main systems chosen to govern the overwhelming bulk of derivative transactions under the international standard forms of ISDA contract, which lie at the heart of most derivatives in the same way as a Pentium microchip lies at the heart of most personal computers. The result of the widespread choice of English law (and often English jurisdiction) is of course jobs for English lawyers (and accountants), invisible exports and added GDP for the UK. So it is a Good Thing if English law copes,

and a Bad Thing if it does not. The same goes for litigation in England. Have our courts and lawyers had the capacity to cope with the incoming tide? Are the results sufficiently impartial, fair, cost effective, timely and predictable to serve the reasonable needs of the international business community?

5. The time allotted for this address permits only a brief overview of these questions, at a relatively high level of generality. I will not be able to begin to unravel the enormous complexity of some of the underlying transactions and business structures. They often take days for a court to grasp, before even addressing the legal issues raised for decision. The need for brevity will ensure that such explanations as I do give will be oversimplified and for that reason distorted. But for diligent students there are some very long and tedious judgments of mine on the internet (Bailii.org) and some shorter, much more illuminating versions from the appellate courts.

6. I propose to concentrate on six main topics: (1) the challenges posed to the common law (i.e. non statutory rather than non-equity) by the uses to which it has been put by the transaction designers; (2) the stresses to which statutory and regulatory schemes have been subjected by the happening of an event for which they were designed, (i.e. insolvency), but on an unimaginably larger scale; (3) the litigation about the uncertainties as to the meaning of the standard forms of ISDA contract; (4) the alleged infringement of the English insolvency code posed by the operation of insolvency default clauses in complex derivative structures, usually ISDA based, triggered by the Lehman group's insolvency; (5) the challenges posed to the management and adjudication of the many cross-border issues by this huge international insolvency, and; (6) the way in which our litigation procedures have responded to the need to deal quickly and efficiently with the mass of factual and legal issues thrown up by the collapse.

(1) The Common Law (i.e. law and equity).

7. Apart from money (i.e. in accounts not hard cash), the main stock in trade of the Lehman group was dematerialized securities. They are a form of intangible asset represented by an entry in the account of the legal owner of the security, recognizing the beneficial owner (or some intermediary between the legal and ultimate beneficial owner) as entitled to a stated number or fraction of an otherwise undifferentiated block of those securities held by the legal owner. There may commonly be a long chain of intermediaries between the legal and ultimate beneficial owner of a particular number of (say) ordinary shares in BP. In English law this tiered structure works, and only works for the purpose of creating proprietary interests at all levels, by the recognition of a trustee / beneficiary relationship between each member of the structure. Otherwise the separation of legal and beneficial ownership, and the creation of intermediate layers of proprietary holders, just does not work conceptually.

8. Lehman group companies featured in these chains, often being the first level beneficiary (or account holder) beneath the depositary holding legal title to the securities, often holding its interest as custodian for its customers on the street ("clients"), and often for one of its affiliates within the group, either for the affiliate's house account as ultimate beneficial owner, or for the affiliate as custodian (i.e. trustee) for one or more of its own clients.

9. But the group was not content just to hold property of this kind in safekeeping, either for street clients or affiliates, in some virtual electronic version of a vault at Gringotts, in the way that a traditional trustee might be expected to do under English law (leaving on one side duties to invest and to transpose investments). There is no reason to suppose that the Lehman group was unique, or even unusual, in having this - let's call it restless - attitude to its clients'

property. It wanted to put it to work in the meantime, for itself rather than for its clients, for example by what is known as 'lending it to the street'. So it bargained with its street clients, and arranged with its affiliates, for what are called rights of use and rights of substitution, in relation to property thus held. So far did these rights or (between affiliates) practices go that in one case they came near to destroying, and in another case actually did destroy, the very substratum or essential features of a trustee beneficiary relationship, so that the client (or affiliate) risked losing (or actually did lose) any proprietary interest in the security, in exchange for purely personal contractual rights as against the Lehman entity holding the security.

10. For as long as the Lehman group remained a going concern, good for its personal undertakings, this mattered little. The substitution of personal for proprietary rights as against the mighty Lehman entities secured for clients and affiliates the enjoyment of the economic fruits of beneficial ownership just as well. The exercise by the group of rights of use and of substitution no doubt usually swelled its profits in good times, and may even have led to a reduction in fees charged to clients(well, maybe…). But of course the onset of insolvency within the group made the difference between a personal and proprietary right of the utmost importance, not only to street customers, but also as between Lehman companies in a quasi trustee / beneficiary relationship with each other. As a result the potentially fine line in English law between derogations from the 'normal' duties of a trustee which do or do not prevent the recognition of a trust relationship altogether (or prevent it from arising in the first place) became of crucial importance. That distinction is part of the common law of trusts which originated in the context of family estates and succession, as far removed from the modern world (or jungle) of investment banking as it is possible to get.

11. Did that common law prove fit for the unplanned purpose? I think it did. Whether a relationship between two persons in connection with particular property is that of trustee and beneficiary is ultimately a

question of intention. This is as true of the relationship between bankers and their customers in connection with securities as it is between cohabitees in connection with a shared home. I want to illustrate the point by reference to three cases. In the first case *Lomas v RAB Market Cycles (Master Fund) Limited* [2009] EWHC 2545 (Ch) the standard form of Lehman International Prime Broker Agreement (Charge version) gave LBIE rights of substitution and use in relation to client property which the agreement otherwise described as being beneficially owned by the client, while held by LBIE. A representative of LBIE's unsecured creditors argued with force that these rights were irreconcilable with LBIE being the client's trustee in relation to the property, so that it all fell into LBIE's insolvent estate, leaving the clients only with claims for its value as unsecured creditors. I concluded that, taken as a whole, the agreement did disclose a sufficient intention to make LBIE the client's trustee of the property or its substitute, notwithstanding the conferral of rights on LBIE in relation to it which would have made a 19th century trust lawyer turn in his grave. There was no appeal.

12. In the second case, *Pearson v Lehman brothers Finance SA* [2010] EWHC 2914 (Ch),generally known as RASCALS (an acronym for Regulation and Administration of Safe Custody and Global Settlement), the Lehman group set up a system for the acquisition and holding by hub companies (i.e. LBIE in Europe) of all securities which any Lehman company wished to acquire in the relevant territory, so that the hub company held all the securities, between acquisition and sale, for the account of its Lehman affiliates. But the practice within the group was for the hub company to use the securities for its own purposes, including lending to the street for liquidity management, selling to meet short positions of its own or of other affiliates, and generally acting in a comprehensively un-trusteelike manner in relation to the holding, while crediting the relevant affiliate (for whom the security was held) with both its value and with any intermediate income, such as dividends on shares.

13. Regulatory and capital adequacy concerns in the mid 1990s led to the erection of a remarkable and complex computer automated structure whereby the relevant securities were made the subject of daily repos or open ended stock loans between the hub company and the relevant affiliate (for the account of which they had been purchased) for the whole of the period between acquisition from and disposal to the street. It operated on a daily basis without any human intervention at all. This structure only made sense on the assumption that the parties intended the beneficial interest to start with the affiliate, i.e. that they were acquired by LBIE for the affiliate as its trustee. The purpose of the repos and stock loans was then to transfer beneficial ownership of the security in question back to the hub company for the whole period of its holding within the group.

14. When the music stopped in September 2008, the computer automated process bizarrely continued on its sweet way, doing thousands more repos every day for a further ten days until someone from the administrators asked what the flashing light on the relevant computer was about, found out, and then ordered it to be switched off. The question then arose: who then beneficially owned the underlying securities, LBIE or its relevant affiliates? In the end the answer turned on the intricate mechanics of the automated scheme, coupled with the group's centralized book entries, spiced with a crucial bit of estoppel. But LBIE's administrators alleged that there had could never have been a trust between LBIE and the affiliates in the first place, so that the automated structure was both misconceived and completely unnecessary.

15. I concluded that, prior to the erection of the automated structure, that submission would have succeeded. The use which the affiliates allowed LBIE to make of the securities was inconsistent with LBIE being intendd to be a trustee. All the affiliate got was a personal right against the hub company to the economic fruits of the underlying securities, which belonged from purchase until re-sale to the hub company, legally and beneficially. But since the automated structure

only made sense on the assumption that the parties assumed they had transferred the beneficial interest to the affiliate, this disclosed, for the first time, a sufficient intention to create a trust so as actually to achieve that result. The Court of Appeal agreed.

16. More recently, in *Re Lehman Brothers International Europe* [2012] EWHC 2997 (Ch), known as the Extended Liens case, an unsuccessful attempt was made to imply a trust between LBIE and relevant affiliates as the result of the creation of a charge (misdescribed as a lien) by clients (including affiliates)over property deposited with LBIE as custodian under a standard form Master Custody Agreement, as security for debts owed by the clients not only to LBIE but also to other affiliates. I concluded that the requisite necessity for the recognition of a trust by way of an implied term was lacking, and that the whole benefit of the charge was an asset in LBIE's insolvent estate. It remains to be seen whether this will be appealed.

17. To my mind these cases demonstrate the continuing vigour and above all flexibility of the common law of trusts in the face of unprecedented challenges, in a very unfamiliar international business environment. The outcome produced both justice and the practical vindication of the parties' apparent intentions, as discernable from the relevant documents and their habitual behaviour towards each other. By contrast in the USA there has been devised a new artificial legal structure as the conceptual basis for the holding of dematerialized securities which does not depend upon traditional concepts of the separation of legal and beneficial interests by a trust, as part of the Uniform Commercial Code ("UCC"). It remains to be seen which will work best for all concerned. For the moment I would rate this part of our common law as having passed a difficult test with distinction.

(2) STATUTE AND REGULATION

18. The same cannot however be said of attempts at statutory intervention, either of a home grown or Euro directive inspired origin.

Two examples will suffice. The first is the Euro inspired set of client money rules known as CASS7, formulated to implement a directive usually called MIFID. The simple objective of these rules was to require financial intermediaries to segregate client money from their own house funds so that, if the intermediary went bust, the client money would be safely there, available for swift distribution to those entitled to it, ahead of and immune from the claims of unsecured creditors, and pooled for distribution *pro rata* in the unlikely event of a shortfall. The basis for the implementation of this laudable objective in the UK was the erection of a statutory trust, biting on all client money after receipt by the intermediary, with detailed provisions about how it should be segregated, accounted for, and distributed in the event of insolvency.

19. It took no time at all for the Lehman collapse to reveal the utter failure of this statutory scheme to achieve its stated objectives. First, LBIE had completely failed to treat as client money (and therefore to segregate) any money of by far the largest group of its clients, namely its own affiliates. Secondly, it had banked a large proportion of the client money which it did segregate with a particular affiliate, Bankhaus AG, which went as spectacularly bust as the rest of the group. Thus, regardless of the difficulties in understanding how the statutory trust was meant to work, there was always going to be a gaping hole in the trust fund from which the clients were meant to be repaid. This was due to a pair of basic shortcomings in LBIE's application of the client money rules which apparently wholly escaped the attention of its lawyers, accountants, auditors and regulators.

20. That might be regarded as bad enough, but at least the clients might nonetheless have received a *pro rata* share of the sadly reduced client money pool reasonably soon after the collapse, were it not for the crippling uncertainties in the meaning of the client money rules, which it took nearly three years for the courts to resolve, and then only by a 3-2 bare majority in the Supreme Court in which the minority were so baffled by the argument which ultimately prevailed that one of them

described it as incomprehensible, and calculated to make "investment banking more of a lottery than even its fiercest critics have supposed". You will probably either know, or will by now have guessed, that the minority agreed with my view at first instance, on the two issues on which I was reversed on appeal (out of nine main issues which I had to decide, coupled with a veritable exam paper of more than 70 questions on which, in that case alone, the bewildered administrators found it necessary to seek the court's directions).

21. The result of this unholy mess is that, believe it or not, it is likely that unsecured creditors will start receiving dividends in LBIE's administration before the beneficiaries in the client money pool receive a penny or a dime! I resolutely deny that this delay was my fault, by getting the answer on those two points wrong in the first place (although I admit that I did). Even if I had decided them the other way, the uncertainties on those and other issues would still have led to appeals all the way to the Supreme Court, with a *de facto* stay on any distribution until they had been finally resolved.

22. It might be suggested that the interested parties had only themselves to blame for failing to settle their differences. The insolvency and companies legislation provides valuable avenues for compromises and schemes of arrangement designed to achieve exactly that, among large classes of affected stakeholders, and the administrators did their best to travel down that route. Unfortunately, as was held by Blackburne J and the Court of Appeal, the legislation did not extend to such schemes as between proprietary rather than purely personal claimants: see *Re Lehman Brothers International (Europe)* [2009] EWHC 2141 (Ch) and [2009] EWCA Civ 1161. Some inroads into this lacuna have recently been made by the Investment Bank Special Administration Regulations 2011 (SI 2011/245) but, alas, too late for Lehman clients. Their scope is well beyond the confines of this address.

23. The second example of a spectacular statutory failure revealed by the Lehman collapse concerns the shiny new Financial Support Direction regime in the Pensions Act 2004. It is designed to top up the pension

funds available to the staff of the employment service companies in corporate groups which go bust with big pension scheme deficits. It was again inspired to some extent by a Euro directive. The regime enables the Pensions Regulator to impose, subject to the supervision of a specialist tribunal, a novel form of order called a Financial Support Direction ("FSD") requiring associated companies to make appropriate contributions to the deficient group staff pension fund. I will call the associated company in the Pensions Regulator's sights the "target company". It will usually have more assets (even if insolvent) than the employer service company.

24. The trouble with the new regime is that the drafter (and therefore Parliament) gave no conscious thought, and therefore made no bespoke provision, about the priority in the target company's own insolvency between the FSD (designed to benefit pensioners who would not otherwise be its creditors at all) and the claims of what might be thought to be its equally deserving but unsecured creditors, where the FSD is imposed after the onset of the target company's insolvency process (whether liquidation or administration). The alternative conclusions in the expensive and still unresolved litigation which ensued lie between a *pari passu* sharing, absolute priority on the basis that the cost of complying with the FSD is a liquidation or administration expense, or the outcome that the FSD is inadmissible to proof at all, thereby falling down a form of black hole, so as to be, in all reality, a mere *brutum fulmen*.

25. I decided in December 2010 in *Re Nortel GMBH and Lehman Brothers International (Europe)* [2010] EWHC 3010 (Ch) that the pensions legislator had naively left it to the existing insolvency legislation to resolve this ticklish priority conundrum without asking anyone versed in those matters what the outcome would be. It turned on the House of Lords' decision in re *Toshoku Finance plc (in liquidation)* [2002] 1WLR 671, together with a string of Court of Appeal decisions about the cut-off date for proof of debts in insolvency. However unfortunate and unfair to the creditors, the result was that the FSD liability had

complete priority over the creditors' claims as a liquidation or administration expense, being a payment imposed on the target company by Parliament, regardless whether the company was insolvent or not.

26. The Court of Appeal agreed, in October 2011 [2011] EWCA Civ 1124, perhaps with less obvious reluctance, but the final resolution of this impasse awaits the decision of the Supreme Court. Burdened as it is with issues of immigration and human rights, it will not even hear the case until next May. Meanwhile the already complex statutory procedure of imposing an FSD and defending it from the target companies' attack remains stayed. The pensioners and creditors are being forced to endure the resulting uncertainty, so much so that there has not yet (as far as I am aware) been a single example of the successful making and enforcement of an FSD since the Pensions Act was passed. The 2004 Act will probably be almost 10 years old before that crippling uncertainty is resolved, or corrected by amendment if, as I suspect, the priority outcome is not what Parliament would have wanted if it had thought about it at all in the first place.

27. The same case threw up some quite extraordinary and irrational consequences upon the effect and priority of an FSD where the target company passed from administration to liquidation. These could by now easily have been dealt with by amending legislation, but this opportunity (with no significant problems of retroactivity) was missed.

28. These two examples do not I am afraid reveal the modern process of statutory protection and regulation in anything like a good light. It should not be thought that I wish to heap the blame upon the benighted parliamentary drafters. They necessarily work in a kind of anticipatory vacuum, in which they can only guess at the events which, in the near or distant future, will put their complex but fragile structures under a form of destruction testing. As I said in the *Nortel / Lehman* case, if the pensions drafter had asked an insolvency specialist what priority the new FSD would be likely to have in a

liquidation or distributing administration of the target company, he might well have found it hard to suspend his disbelief at the answer. It may not appropriately be a question of blame at all, but just a wry comment on human frailty and the ever-increasing complexity of business life. But I do wonder whether in the light of these failures there should not be some fast track (or faster track) way of resolving uncertainties in the meaning, or even plain deficiencies in the working, of these elaborate structures, before the combination of both leads to the result that the attendant delay and expense proves worse than the illnesses they were meant to alleviate.

(3) THE ISDA CONTRACT

29. The ISDA form of contract is by far the most widely used contract in the derivatives market worldwide. It is probably the most widely used standard form contract in the world, and certainly in the financial markets. Although originally devised for interest rate swaps, it has become widely used for all kinds of derivatives, including contracts for differences, caps and floors. By 2008 it had also been embedded in a variety of highly complex structured transactions to which member companies in the Lehman Group were party.

30. Parties to an ISDA contract have a choice as to its governing law. The vast majority are governed either by English or New York law. Both in absolute terms and in order to compete with New York, it is central to the attractiveness of the ISDA contract for which English law is chosen that its meaning should be clear, commercially sensible and predictable, and that the English courts should be able to iron out any ambiguities both speedily and in a consistent way.

31. The Lehman collapse has thrown up or contributed to some fundamental uncertainties about the meaning and effect of the ISDA contract. The result is that there has been a flurry of hard fought litigation mainly but not exclusively involving one or more Lehman entities. I want to mention three of those uncertainties. They are (or

may be labelled) (1) section 2(a)(iii), (2) valuation on early termination and (3) anti deprivation. The last is a subject in its own right, not limited to its effect on the ISDA contract, so I will under this heading confine myself to the first two. By way of summary they illustrate a remarkable divergence in the English courts' speed and consistency in resolving relevant uncertainties in this vital form of contract.

32. The section 2(a)(iii) issue may be summarized thus. The central obligation in the ISDA contract is the mutual obligation of each side to make periodic payments or deliveries to the other, which may inelegantly be summarized as payments by the out of the money party to the in the money party. Thus in an interest rate swap the floating rate payer is in the money if the chosen interest rate falls below the fixed rate chosen by the parties as the measure of the fixed rate payer's liability. If the floating interest rate rises above the fixed rate, then the fixed rate payer is in the money. Generally speaking, interest rate swaps are sold by banks to business customers to enable the customer to hedge its exposure to interest rate volatility. The bank is therefore the floating rate payer, and in the money during periods when floating interest rates fall below the chosen fixed rate.

33. Section 2(a)(iii) of the ISDA contract provides that the out of the money party's payment obligation is subject to the condition precedent that the other party is not in default under the agreement, as defined. Default includes breach of the agreement and going into an insolvency process. The non defaulting party may choose to terminate the agreement (if it does not already provide for automatic early termination). If he does, then various forms of valuation are applied so as, in effect, to capitalize the value of the remaining payment obligations under the agreement and (depending on the close out method chosen) to require the out of the money to pay the other party that sum.

34. The Lehman crash actually caused (or at least it coincided with) a sustained and deep fall in interest rates which produced the result

that the Lehman parties to interest rate swaps (usually the floating rate payers) became heavily in the money. But a small number of clever counterparties saw that reliance on the non-fulfilment of the clause 2(a)(iii) condition precedent was a much mere rewarding response to the Lehman party's default than early termination. They simply said, to the consternation of the Lehman office holders, you may be in the money, but we just don't have to pay you a dime, and we never will.

35. This gave rise to the conundrum: did default on a particular payment date simply extinguish the non-defaulting party's payment obligation otherwise due on that day. Or did it just suspend it, and if so, permanently, or so that (if the default continued) it expired at the natural expiry of the agreement or, as the Lehman parties argued, did it suspend it only for a reasonable time sufficient to allow the non-defaulting but out of the money party to decide whether to pay up or go for early termination.

36. This conundrum produced three different answers, from three different first instance judges. In the *Marine Trade v Pioneer* case [2009] EWHC 2656 (Comm)Flaux J said that it extinguished it. In the *Lomas* v *Firth Rixson* case [2010] EWCC 3372 (Ch) I said that it suspended it, but that it became extinguished (if the default persisted) at the expiration of the agreement. In the *Pioneer Freight v TMT Asia* case [2011] EWHC 778 (Comm), Gloster J said that it suspended it, but that it remained a debt, payable in the indefinite future, if the default was ever remedied. None of us accepted the only alternative which would have done the Lehman parties any good, namely brief suspension pending a decision whether to go for early termination. In consolidated appeals in April 2012 [2012] EWCA Civ 419 the Court of Appeal agreed with Gloster J, but permission has now been granted for an appeal to the Supreme Court. So, at least at present on the section 2(a)(iii)issue, the English courts may be said to have scored nil for consistency, and precious little for speed.

37. In relation to the valuation issue, the contrast could not be more marked. The 1992 version of the ISDA contract gives the parties choices as to the early termination valuation method. The most widely chosen method (later adopted with some tweaking as the sole method under the 2002 version) requires an identification of the non-defaulting party's loss of bargain arising from the early termination of the agreement due to the other party's default. It can be a negative or a positive figure. That calls for a counter-factual analysis of the question what would have happened if the agreement had not been terminated early due to the default.

38. In a whole series of cases (including *Australia and New Zealand Banking Group Ltd v Soc Gen* [2000[CLC 833, *Peregrine Fixed Income Ltd v Robinson Department Store plc* [2000] CLC 1328, *Britannia Bulk plc v Pioneer Navigation Ltd* [2011] 2 Lloyd's Rep 84, the *Pioneer v TMT* case, *Anthracite Rated Investments (Jersey) Ltd v Lehman Brothers Finance SA* [2011] EWHC 1822 (Ch), the conjoined appeals in *Firth Rixson* and *LBIE v LBF* [2012] EWHC 1072 (Ch), a succession of judges at first instance and in the Court of Appeal have with complete harmony developed the principle that it must be assumed that, but for the default, the agreement would have run its course to maturity, however remotely improbable that might appear to be in the real world. It is usually called the value clean principle or the continuity assumption. It can, and often does, produce a result markedly different from the more flexible common law test for the quantification of damages in a comparable situation. So, on this issue, the English courts have scored 100% for consistency, and haven't done at all badly on speed.

39. Try as hard as I can, I cannot fathom the reason for this patchiness in performance. All I can say in mitigation is that the differences in our analysis of the section 2(a)(iii) issue, however fundamental conceptually, have made little practical difference to the small number of parties involved (despite the enormous sums at stake). This is because, regardless whether the payment obligation is extinguished,

suspended permanently or only until extinction at the end of the agreement, the inability of the Lehman (and other insolvent) parties ever to remedy their defaults means that they will never get their dollars or dimes. What never? No never. By contrast the valuation issue has I think been of real commercial importance. So, all in all English law has more or less done its stuff in relation to its stewardship of the ISDA agreement, for all those who have chosen it.

(4) ANTI DEPRIVATION

40. The Lehman collapse was a main catalyst (albeit not the only one) for an anxious re-consideration of a long established but difficult and in many ways unsatisfactory principle of English law now inelegantly labeled the anti deprivation principle. It is now recognized as a sub rule of a general principle that it is contrary to English public policy to seek to contract out of the English insolvency code, pursuant to which an insolvent's property is realized and distributed *pari passu* among its (or his or her) unsecured creditors, such that attempts to do so are legally invalid. The principle had become encumbered with all sorts of artificial and unsatisfactory distinctions, to the extent that its purpose had become almost totally obscured, and its operation prone to avoidance by drafting techniques that evaded the principle without altering the substance of the otherwise offending bargain.

41. Various companies (or their office holders) affected by the collapse within and without the Lehman group sought to pray in aid the ant deprivation principle as a means of escaping from, or mitigating the dire consequences of, a variety of contractual provisions which may very loosely be called insolvency default clauses. They include, but are by no means limited to, ISDA based structures. Usually they were originally inserted by the very banking entities now seeking to escape from their consequences, in the unforeseen event that the banking party rather than the street counterparty has gone bust. So far as I know those attempts have been uniformly unsuccessful, the

underlying contest between on the one hand certainty and party autonomy between businesses, and creditor protection on the other, being clearly won by the former.

42. The really interesting aspect of the contest, once the advocates and judges had cut their way through the horrendously complex transactional structures concerned, was to see by what rational or purposive principles the contest could or should be resolved. I had my own little stab at a solution to part of the problem, namely to understand which flawed asset structures did or did not offend the principle and why, in *the Firth Rixson* case [2010] EWHC 3372 (Ch), at paras 108 – 110. Lord Walker was kind enough to suggest it showed some promise and Lord Mance said (obiter) that it was correct, in the *Belmont* case that finally dealt comprehensively with anti deprivation. But the solution proposed by Lord Collins and adopted unanimously by the Supreme Court was <u>in my view</u> a wholly new and refreshingly simple piece of original creation, sweeping away all the old technicalities, and most if not all the earlier cases, in favour of the apparently simple question, at least in relation to complex commercial transactions: was it entered into in good faith? I describe it as new in my view because Lord Collins would say that he identified it as the unifying principle in the old authorities. If so, it takes someone of his stature to find what has eluded the rest of us for so long.

43. The decision is still too recent for it yet to be clear how easy this new test for the validity of an apparently deprivatory provision will be to apply in practice, and by what process of fact finding and interpretation. Nonetheless the anti deprivation litigation is a good example of the way in which high value litigation arising from a business crash can concentrate legal (and in particular judicial) minds upon a previously dormant but important defect in the common law, and give rise to a decisive result in a relatively short space of time.

(5) CROSS BORDER ISSUES

44. It might have been thought that a huge world-wide international multi company insolvency like that which destroyed the Lehman group would have been a perfect (destructive or otherwise) testing ground for the great strides which have been made in the last few years to bring order out of the potential chaos of cross border insolvency. Oddly enough, it is in the Lehman context a fertile battleground that has remained almost empty of armies. If battles there have been they have taken place mainly in tunnels dug beneath the trenches, away from the public gaze and even, largely, away from the active scrutiny of judges. By this I do not mean that there has been anything inappropriate or hugger mugger about it. On the contrary, the various office holders appear to have taken sensible and usually correct decisions about the appropriate forum in which to have particular disputes or issues resolved. There has, as far as I know, been no unedifying rush to attract the jurisdiction of a particular country's courts by suing, or getting to judgment, there first.

45. There was, in late 2009, a preliminary exchange of letters between the Chancellor here and Judge James Peck in New York. There followed a hearing before Henderson J here about whether a further letter should be sent and, if so, in what form. The outcome at that stage was that each court confined itself to declaring the effect of its law on common transactions in issue: see *Perpetual Trustee v BNY Corporate Trustee Services Limited* [2009] EWHC 2953 (Ch). Thereafter matters proceeded without further direct contact at judicial level.

46. That does not mean that there have not been real differences in meaning, effect and outcome when particular structures are tested against the insolvency laws of different countries. For example the general tendency for insolvency default clauses to survive challenge by recourse to the anti deprivation principle has not been matched, as I understand it, by similar success when faced with the safe harbour

principles designed to deal with creditor protection under New York insolvency law.

47. The practical reality has been (as far as I have been able to discern) that the courts applying the law chosen by the parties to govern the transactions in question have been the arbiters of issues as to the legal effect of those transactions. Where the distribution of assets is in question, then the courts of the country in which those assets are situated have in general been the arbiters of issues as to their distribution, in the absence of agreement by office holders and stakeholders to the contrary. That is as it should be. It is a relief that this general international peace between potentially rival insolvency jurisdictions had been achieved without blood letting.

(6) PRACTICE AND PROCEDURE

48. The Lehman related litigation in which I have been involved has been conducted on the grand scale, as perhaps befits the truly astonishing amounts of money, and the value of the property, at stake, and the complexity of the underlying transactional and business structures under review. Very large numbers of questions have been presented for decision in single applications. Almost all of them have been multi party, ranging in my cases from 4 to 10 parties, all turning up with large, sometimes very large, teams of lawyers and accountants. It has been unusual for a party to be represented by less than two counsel. The average is three and there have been instances of four or more, with proportionately large posses of solicitors and accountants in support. This has placed considerable burdens on the Court Service in terms of the timely provision of very large or 'super' courts, recently very much eased by the opening of the Rolls Building, where there are three.

49. But the trials and hearings have in general been (to my mind) surprisingly short, and the preparation and waiting times, at least at first instance, reasonably short. I think I can claim that the delivery of

judgments has also been prompt, I hope not at undue cost to their reliability. I have asked myself whether there have been lessons learned about practice and procedure, capable of being applied more widely in the future. I think there are.

50. I have already touched upon the need for some form of fast track (or, as the Americans would say, rocket docket) for the determination of legal issues affecting whole classes of on-going business in the financial markets. In theory there are processes for expediting matters at every level (first instance and appellate), and they can lead to amazingly fast determinations. I recall at the bar getting a case from issue to a court of appeal judgment on the merits in 12 weeks, about a one-off contract for a $billion or so of North Sea gas. But in practice this is very rarely achieved, not least because of the lawyers' desire to leave no stone unturned, the parties' desire to have counsel of their choice (despite their busy diaries) and parties' tactical reasons, from time to time, to go slow, e.g. if they have a first instance judgment in their favour which they don't want to be disturbed. Finally settlement negotiations can perfectly properly stop a case from progressing for significant periods. If settlement ensues, the point of general public importance may never be reviewed at the appellate level at all.

51. What may be lacking is any level of cradle to grave active judicial case management spanning both first instance and appellate levels, to drive the process on in the public interest, however occasionally reluctant the parties. The court's occasional readiness to expedite is essentially responsive to intermittent party pressure, rather than pro-active. Furthermore there is almost no case management communication between different levels of court. The initiative for expedition has to start all over again at each level, and has to be party led.

52. There is the leapfrog option (cutting out the Court of Appeal where a case is bound to end in the Supreme Court) but again it is very sparingly used. I almost did so in the *Nortel/Lehman* case, but there

was one big point that deserved Court of Appeal attention first. In the end, the Supreme Court did not expedite the final appeal, and it is still to be heard.

53. There is also the difficulty that business cases are in the final analysis about money and property, rather than liberty, life and death, the health and the security of children or of the state. This inevitably leads to other types of case being prioritized for the available attention of our very hard working appellate courts. But I do sometimes wonder whether the real effects of legal uncertainty on business activity, and the knock-on consequences in terms of economic prosperity and competitiveness are fully recognized in the competition for speedy hearings. UK plc does very well out of the high international reputation of English law and of those who administer it, both judges and lawyers. But there is no point in having the finest law in the world if its uncertainties take so long to sort out that the determination comes too late to cure the malaise caused by the uncertainty, in the minds of those whose on-going business transactions are thereby undermined. It is an aspect of our national and economic health, and deserves to be prioritized accordingly.

54. Turning to procedure, the starting point is the benefits available to sensible litigants from the almost complete procedural flexibility of the office holder's application for directions under the Insolvency Rules. Although their distant origin may lie in the family trustee's application for directions under procedures established in the 19th Century, there are, quite literally, no holds barred when it comes to wrestling with the case management of these large and potentially very cumbersome pieces of adversarial litigation. For example, the office holder may, but need not be, neutral as to the outcome. In some cases LBIE's administrators have asserted disinterested neutrality, joining a representative of the unsecured creditors to argue for the interests of LBIE's insolvent estate. More often the administrators have not hesitated to put forward firm and adversarial positions with a vigour which may fairly be described, however polite the advocacy,

as red both in tooth and claw. This has in appropriate cases enabled hearings of what are in form applications for directions to be conducted in substance just like adversarial trials, as if begun under Part 7 of the CPR, but without the need automatically to engage in the usual time consuming paraphernalia of statements of case, disclosure, etc. where other methods offer a quicker way of getting to grip with the real issues. Case management has been mainly judge led (rather than by the masters or registrars), and has commenced upon the first short hearing of each application, with regular review thereafter.

55. The exploitation of this procedural flexibility depends critically upon the good sense (and good faith) of the parties and their legal teams, which has, mercifully, been present in super-abundance throughout. Indeed it has been the parties and their legal teams who have been the inventors and developers of the bespoke procedures which have contributed so much to the efficiency and reasonable speed of the process.

56. Foremost among those procedures are the following: First, a collaborative approach to the identification, up front, of an agreed list of issues. In my cases this has (with my encouragement) been an organic document, capable of being amended from time to time, even during trial, as the answers to issues are agreed (so that the issue falls away) or as the development of thinking reveals new issues which need to be added and decided.

57. Secondly, sensible use has been made of position statements, usually sequential, whereby the parties summarise their cases on the agreed issues, in lieu of the much more formal statements of case. They entirely avoid the recitation of (usually uncontentious) fact, and their only role is to inform opponents of the case to be advanced, so as to focus the preparation of written submissions (still misleadingly called skeleton arguments). By the time of trial the position statements have done their task, and are hardly ever referred to.

58. Thirdly, huge amounts of time have been saved at trial by the preparation in advance of statements of agreed or assumed facts.

These are again organic documents, added to and altered as the parties' researches shed new light on the underlying business and transactional structures. There is an important distinction, at least at the conceptual level, between agreed and assumed facts, although in practice they perform the same role at trial. Statements of agreed facts are a familiar enough concept. They serve the vital purpose of concentrating the forensic part of the trial on the usually small residue of facts which cannot be agreed. In several of the Lehman cases, that residue has thereby been reduced to zero.

59. Statements of assumed facts are an unusual animal, and the special creature of this type of application. When office holders apply for directions, they frequently want help on questions of principle, or on matters of widespread application in relation to the forensic tasks which they have yet to perform. Frequently, at the level of finer detail, office holders have to be their own *prima facie* judges of fact (subject to court control), for example in the acceptance, rejection and valuation of proofs. Armed with directions on assumed facts, which they calculate to be sufficiently proximate, though not necessarily identical, to the true facts as they emerge, they can proceed, correctly armed as to the law to be applied, once the infinitely variable detail has been hammered out.

60. The advantage of agreed statements of assumed facts, as to the precise content of which the office holder's judgment usually has to prevail, is that the case avoids becoming bogged down in a minute investigation of detailed factual issues which may be disproportionate to their impact on the issues of principle to be decided. Bucket loads of time are saved, and swearing matches avoided. From the judge's perspective, he is saved the time consuming task of setting out the non-contentious but relevant facts, often the longest (and most tedious) part of the preparation of a judgment. The judge can just press a button on his computer and, hey presto, the agreed statement is incorporated, lock stock and barrel, into the judgment. The other advantage of assumed facts is that parties can agree them purely for

the purpose of the instant proceedings, while remaining free, should it matter on points of detail, to contest them in the future without being issue estopped. This greatly contributes to a collaborative and constructive hearing, where the presentation of helpful argument is not hindered by worries on the part of the legal teams that they have left some forensic stone unturned in their preparation, or unwittingly given hostages to fortune.

61. Last but by no means least, I want to say something about the vital, indeed preeminent, role of oral argument. It might be thought that, armed with agreed or assumed facts, full written submissions and copies of every authority under the sun, the prudent judge would be best advised to lock himself away, put a cold towel round his head (or a stiff gin on his desk) and work out the answer in the peace and quiet of his chambers, like the fictional judge in Lord Templeman's explanation of the best way to identify the *forum conveniens* in international jurisdiction disputes. That is indeed how most continental legal systems are run.

62. I want to say, with all the emphasis at my command, that this is not the best route to legal scholarship, to justice, or to wisdom of any kind. Nothing comes near, in the pursuit of the answer to legal problems, to the cut and thrust of oral legal argument. It is a process in which the judge can and should play a full part, in subjecting submissions to stress testing, in separating the wheat from the chaff and in exposing his half thought out, tentative and provisional views to the merciless public scrutiny of learned counsel.

63. Time and time again in the Lehman litigation I have found that the adversarial oral process has led to the development of legal understanding on an altogether higher plane than would have been achieved merely by the reading and comparison of dry written submissions. I acknowledge that this may have extended the duration, and therefore the cost, of the proceedings well beyond the court time and expense likely to have been incurred in dealing with the same case elsewhere in mainland Europe. But I fervently believe that the

time and expense of oral argument continues to pay rich dividends, quite apart from the forensic value of cross examination. The importance which English legal procedure continues to attribute to this oral process is a key feature in my conclusion that English law has indeed coped with the Lehman collapse. It is why my coat of arms in Lincoln's Inn hall bears the motto '*e colloquium sapientia"* (from discussion comes wisdom). Long may it continue.