

Applicants
S A Pearson
Fourth Statement
"SAP4"
8 May 2009

IN THE HIGH COURT OF JUSTICE

No. 7942 of 2008

CHANCERY DIVISION

COMPANIES COURT

**IN THE MATTER OF LEHMAN BROTHERS INTERNATIONAL
(EUROPE) (in administration)**

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

**FOURTH WITNESS STATEMENT
OF
STEVEN ANTHONY PEARSON**

I, STEVEN ANTHONY PEARSON, of PricewaterhouseCoopers LLP, Plumtree Court, London EC4A 4HT, state as follows.

A. INTRODUCTION

1 I am a licensed insolvency practitioner and a partner in PricewaterhouseCoopers LLP ("**PwC**"), a firm of accountants at the above address. My partners, Anthony Victor Lomas, Michael John Andrew Jarvis, Dan Yoram Schwarzmann and I are the joint administrators of Lehman Brothers International (Europe) ("**LBIE**") (in administration) (together the "**Administrators**" and each an "**Administrator**"). We were appointed as such by order of Mr Justice Henderson on 15 September 2008. I am duly authorised to make this witness statement on behalf of LBIE and the other Administrators.

- 2 One or more of the Administrators, together with other partners in PwC, are also the joint administrators appointed in respect of a further eighteen Lehman companies in the UK (together with LBIE, the "**Lehman Administration Companies**").
- 3 I make this witness statement in support of the Administrators' application under Rule 2.30 of the Insolvency Rules 1986 ("**Insolvency Rule 2.30**") for an order permitting limited disclosure of information in respect of the LBIE Statement of Affairs (the "**Statement**"), prepared by Dominic Gibb, a director of LBIE and former head of financial reporting within the Lehman Europe group, in accordance with paragraph 47 of Schedule B1 to the Insolvency Act 1986 (the "**Act**").
- 4 There is now shown to me a paginated bundle of copy documents, marked "**SAP4**", to which I refer in this witness statement. Where no cross reference to the paginated bundle is provided and where there is no other indication of the source of my information or belief, the contents of this witness statement are derived from facts and matters which are within my own knowledge and belief. These facts and matters have been learned either as a result of the work undertaken by me as one of the Administrators of the Lehman Administration Companies, or they have been provided to me either by my partners and colleagues at PwC involved with the administration of the Lehman Administration Companies, or by the employees of the Lehman Administration Companies who are still available to the Administrators, or by the Administrators' legal advisers, Linklaters LLP.
- 5 Nothing in this witness statement is intended to waive privilege in respect of any matter referred to and privilege is not being waived.

STATUTORY ACTIVITIES UNDERTAKEN TO DATE

- 6 Under paragraph 49 of Schedule B1 to the Act, an administrator of a company is required to make a statement setting out proposals for achieving the purpose of the administration and a copy of that statement must be sent to (among others) every creditor of the relevant company of whose claim and address the administrator is aware. Under paragraph 51

of Schedule B1 to the Act, the administrator must ensure that each copy of the proposals referred to above is accompanied by an invitation to an initial creditors' meeting at which the creditors are entitled to vote in respect of the proposals.

- 7 Accordingly, on 28 October 2008, in advance of the initial meeting of creditors held on 14 November 2008, the Administrators wrote to all of LBIE's creditors. A copy of the letter sent to creditors (including the proxy voting forms) is at **pages 1 to 8 of SAP4**. Enclosed with the notice of the meeting of creditors was a copy of the "Joint Administrators' Proposals for Achieving the Purpose of Administration" (the "**Proposals**") (a copy of which is at **pages 9 to 55 of SAP4**).
- 8 For the reasons explained in brief below, it was not (and is still not) possible to establish definitively which of LBIE's counterparties are debtors and which are creditors. Accordingly, it was decided that it would be prudent for the Administrators to write to all of LBIE's counterparties of which they were aware, notifying them of the initial creditors' meeting, thereby ensuring that the maximum number of parties who are (or may be) creditors were in receipt of the Proposals and had been provided with details of the meeting. A full list of LBIE's counterparties to whom we wrote on 28 October 2008 is reproduced on the PwC website as part of the "Creditors Update" section, together with a list of known trade creditors. These lists are accompanied with a note to potential creditors providing details of how they can contact the Administrators to lodge a claim in the event that they have been incorrectly omitted from the lists. The list of counterparties contains a note explaining that those named "*are not necessarily creditors of LBIE, some will be debtors*".
- 9 As indicated above, the initial meeting of creditors was held on 14 November 2008. The Proposals were approved at that meeting, with one modification which is not important for present purposes, in accordance with Paragraph 53 of Schedule B1 to the Act. It was also agreed at the meeting that a creditors' committee should be formed (the "**Creditors' Committee**") to assist the Administrators in discharging their functions. The Administrators are in regular contact with the Creditors' Committee.

- 10 Under paragraph 47(1) of Schedule B1 to the Act, as soon as is reasonably practicable after his appointment, an administrator shall, by written notice, require one or more relevant persons to provide the administrator with a statement of the affairs of the company.
- 11 Paragraph 47(3) of Schedule B1 to the Act provides further details of who constitutes a “relevant person” for these purposes although usually (as is the case with LBIE) the administrator will require someone who has been an officer of the company in question to prepare the statement of affairs.
- 12 A person required to prepare the statement of affairs should do so within 11 days following receipt of the notice referred to in paragraph 10 above. It is customary for a statement of affairs to be included in the administrators’ proposals which must be provided to creditors before the initial creditors’ meeting (i.e. within eight weeks from the date on which the company entered into administration). However, in some circumstances it will not be possible to prepare a statement of affairs within the usual timeframe. Consequently, under paragraph 48(2)(b) of Schedule B1 to the Act, an administrator is entitled to extend the period in which the statement of affairs can be produced if he thinks it would be appropriate to do so.
- 13 As reported in the Proposals, the Administrators elected to exercise this discretion and granted Mr Gibb an extension of time in which to prepare the Statement. We did so because the task of putting the Statement together is, in my experience, unprecedented in its complexity. The counterparties were also told in the Proposals that when the Statement was available, it would be placed on the PwC website as well as being lodged at Companies House (see page 42 of the Proposals at **page 50 of SAP4**).
- 14 On 14 April 2009, the Administrators wrote to LBIE’s counterparties and creditors, pursuant to Rule 2.47(3)(a) of the Insolvency Rules 1986, providing them with a report detailing (amongst other things) the work undertaken and progress of the administration over the first six months of the administration (the “**Progress Report**”). A copy of the letter is attached at pages **56 to 58 of SAP4** and a copy of the Progress Report is attached at **pages 59 to 151 of SAP4**.

- 15 Mr Gibb has been working on preparing the Statement over recent months and the document is currently in an advanced form. In the normal course, once finalised, it would, pursuant to Rule 2.29(7) of the Insolvency Rules 1986, be lodged with the registrar of companies at Companies House "as soon as reasonably practicable".

REASONS FOR SEEKING LIMITED DISCLOSURE IN RESPECT OF THE STATEMENT

- 16 Where an administrator thinks that it would prejudice the conduct of the administration for the whole or part of the statement of the company's affairs to be disclosed, he may apply to the Court for an order for limited disclosure in respect of the statement, or any specified part of it, under Insolvency Rule 2.30.
- 17 For the reasons set out below, the Administrators seek an order for limited disclosure, so as to permit the names of individual creditors and details of LBIE's estimated liabilities to individual creditors contained in the Statement to be redacted and the Statement then to be delivered to the registrar of companies in its redacted form.
- 18 The form of the Statement which the Administrators wish to be able to file with the registrar of companies and post on the PwC website is that exhibited at **pages 174 to 177 of SAP4**.
- 19 The Administrators believe that, as things currently stand, the conduct of the administration would be prejudiced if the Statement were to contain details of the identity of LBIE's creditors and the estimated values of creditors' claims for the following three principal reasons:
- 19.1 LBIE is subject to wide-ranging duties of confidence, particularly in relation to its regulated business, which could be breached if certain details of creditors and their claims were to be made public.
- 19.2 Valuing the claims as between LBIE and its counterparties with any degree of certainty is extremely problematical. Accordingly, there is a real risk that the estimated values of creditors' claims, as set out in the Statement, will be substantially different from (a) that which the creditors might expect to see, based on their own assessments of

their positions; and (b) the true values which will be established in due course. Indeed, it is possible that, as a result of the difficulties in valuation, some counterparties who have, at this stage, been listed as creditors could, in fact, turn out in due course to be debtors and vice versa. The Administrators therefore take the view that disclosing names of creditors and valuations of their claims could be materially misleading and could result in claims submitted against the estate increasing, referencing values in the Statement.

19.3 The Administrators are aware that there is concern in the financial markets that the fact that certain counterparties are creditors of LBIE could impact upon the businesses of those financial clients of LBIE in an adverse manner, particularly if the Statement discloses estimated values of their claims against LBIE. The Administrators are concerned that, such is the level of sensitivity around this information, its disclosure would have a detrimental impact on what is currently a cooperative and mutually beneficial relationship with LBIE's counterparties.

20 I deal with each of these points in further detail below.

CONFIDENTIALITY

21 LBIE entered into a large number of contracts as part of its regulated business. Although I have not, for present purposes, reviewed each of these, I am advised that these contracts do, in many cases, contain confidentiality obligations.

22 By way of specific example, LBIE used standard terms of business, which were sent to all of its financial business clients. A number of different forms of these standard terms of business have existed over the years. An example of a recent form is contained at **pages 152 to 173 of SAP4**.

23 Under Clause 13 of the standard terms of business referred to above (**see page 165 of SAP4**), LBIE agreed (amongst other things) that it would:

"...treat as confidential any information learned about you, your investment strategy or holdings in the course of our relationship with you under these Terms and will not disclose the same to anyone

(other than our associated companies) except where (a) such information is or becomes public knowledge other than by breach of this Clause; (b) such information is received from a third party who lawfully acquired it and who is under no obligation restricting its disclosure; (c) such information is in our possession without restriction in relation to disclosure before we receive it from you”.

- 24 I am advised that the wording of this Clause is broad and that it would, on its face, appear to prevent LBIE from disclosing information about clients' claims (since this would reflect their positions or holdings with LBIE). Although Clause 13 contains a number of limited exceptions, I am advised that it is unclear whether these would permit disclosure in the present circumstances.
- 25 As mentioned above, in the context of the preparations for the initial meeting of creditors, the Administrators published a list of LBIE's counterparties on the PwC website. The list was published subject to a clear warning that inclusion on the list did not mean that a certain counterparty was a creditor and it was possible that they were in fact a debtor. However, in light of the confidentiality obligations contained in LBIE's contractual documentation, the Administrators do have concerns about disclosing creditors' names and specific details, including quantum, of creditors' claims in the Statement.

ACCURACY OF INFORMATION

- 26 LBIE's debtors and creditors are mainly financial trading counterparties and the debts or liabilities in question often arise out of a number of complex inter-related arrangements. Assessing the value of a counterparty's claim will in many cases, therefore, involve performing a large number of different valuations and calculations in order to reach an overall figure. In respect of forward and derivatives contracts, the calculations to be performed can give rise to materially different valuations, depending upon, among other things, the valuation date and the valuation method adopted.
- 27 There is scope for significant variation in values depending on a series of factors which have to be considered in valuing positions. Indeed, the

valuation of a position could fluctuate to such an extent that it might be “in the money” to the counterparty (i.e. give rise to a sum due to a counterparty by LBIE upon the termination of a contract) on one day and “out of the money” (i.e. give rise to a termination sum owed by a counterparty to LBIE upon the termination of a contract) on a subsequent date.

- 28** By way of example, the valuation date used for the purpose of the Statement is Friday, 12 September 2008 (this being the latest date upon which complete information was available to LBIE). However, the earliest date upon which counterparties would or could have terminated their contracts with LBIE as a result of its administration was Monday, 15 September 2008 (being the date of LBIE’s administration). Not all of LBIE’s counterparties sought to terminate contracts immediately. Whilst many counterparties did terminate some or all of their contracts in the days and weeks following LBIE’s administration, a proportion have yet to exercise their rights to terminate. In both cases therefore (i.e. in respect of both terminated and open contracts), the finally determined valuation of termination amounts could be materially different from the valuation used by Mr Gibb for the purpose of the Statement.
- 29** In addition to using a different valuation date from that required under the applicable contract, Mr Gibb has reflected the carried book value using LBIE’s historical valuation methodology. He has not reflected the termination of trades. In the majority of cases, however, it is for the non-defaulting party (i.e. LBIE’s counterparty) to calculate the sums due, using the relevant method in the underlying contract. Accordingly, it is likely that this difference in approach and environment (i.e. the prevailing market conditions at the time of the calculation) will lead to differences in valuations between those performed by Mr Gibb for the purpose of the Statement and those ultimately performed by the counterparties for the purpose of establishing their claims.
- 30** Similarly, the figures included in the Statement for each counterparty have been calculated on a net basis, on the assumption that netting and/or set-off can be applied to the entirety of the position between LBIE and its counterparties. It is possible, however, that this approach will produce

different valuations from those ultimately performed by the counterparties for the purpose of establishing their claims.

- 31** Further, there is significant legal uncertainty over the correct construction and effect of certain contractual provisions which appear in LBIE's standard form agreements. This uncertainty makes it impossible to value certain claims with any degree of confidence at this stage. For example, I am advised that the status of counterparties' claims in respect of cash proceeds arising from the redemption of client securities after the date of LBIE's administration is unclear. The Administrators intend to seek the Court's determination of this issue in due course. To the extent that it is determined that a counterparty has a proprietary claim in respect of the cash proceeds, such a claim will fall outside of the general estate of LBIE (although that counterparty might also be a general creditor, albeit for a different sum). Conversely, to the extent that it is determined that no proprietary claim remains, the counterparty will fall to be considered only a general creditor.
- 32** Mr Gibb has noted in the Statement that there are a number of factors which could have a material impact upon the accuracy of the valuations of creditors' claims which are contained in the Statement. Given the level of uncertainty surrounding the estimates of creditors' claims, the Administrators take the view that the public disclosure of such information could be materially misleading and may in fact cause more harm than good. The information cannot safely be relied upon and may cause undue concern amongst LBIE's counterparties, many of whom are likely to have a different expectation of the level of their claim (or may indeed believe they are a debtor whereas the Statement includes them as a creditor, or vice versa). In addition, those who invest in LBIE's counterparties, many of which are hedge funds, may base their investment strategy or take other key decisions based on the details of the claims provided in the Statement, which (as indicated above) might turn out to be materially inaccurate.

COUNTERPARTY CONCERNS

- 33** The success of any administration is dependent on there being a constructive dialogue between the administrators and the creditors. This is

absolutely essential when faced with a business of the scale and complexity of LBIE's. The Administrators are aware that there is concern amongst counterparties that the disclosure of their possible exposures to LBIE could impact on their businesses in an adverse manner.

- 34** In particular, any public disclosure of this information is likely to result in many enquiries being made of LBIE's counterparties regarding the details of exposures identified in the Statement. That in turn will require LBIE to commit substantial additional resources to assisting the counterparties concerned in dealing with their investor enquiries. Indeed, in certain instances, the Administrators are concerned that the disclosure may lead to a run on certain hedge fund clients who appear from the Statement to be substantial creditors to the estate, which in turn could increase the risk of consequential loss claims being made against LBIE.
- 35** The Court is already aware of the sensitivity that certain counterparties have expressed regarding the possible disclosure of the fact that they are creditors of LBIE and has made privacy and confidentiality orders in respect of the application made by four investment funds so as to keep private those four investment funds' positions. In that case, the Court will recall that the relevant funds were concerned that commercially sensitive information about their securities holdings would be available for inspection on the Court File. In particular, the funds noted that details of the securities they held were essentially investment positions and market competitors could seek to take commercial advantage in a number of ways including adopting contrary investment positions. Further, significant damage could be caused to the funds if it became public knowledge that a substantial part of their investments was placed with LBIE and therefore not immediately recoverable.
- 36** Ultimately, I am of the opinion that the disclosure of this information may endanger the presently stable position of the administration, which in turn will lead to further delays, costs and complexities in meeting the objectives of the administration. This matter was specifically raised with the Creditors' Committee at a meeting held with them on 10 March 2009. The Creditors' Committee was unanimous in sharing the view of the Administrators that


the disclosure of this information would be potentially prejudicial to the interests of LBIE and the conduct of the administration and that this application should be made.

CONCLUSION

- 37 Although the Administrators are mindful of the need to be transparent and open in their dealings, they believe this need should be balanced against the need to ensure that information provided is accurate and can be relied upon. The Administrators are sympathetic to the concerns of counterparties that the publication of sensitive information might harm their businesses. The Administrators are also mindful that potential prejudice to the conduct of the administration could be caused if counterparties were to form the view that the Administrators had failed to take reasonable steps to protect sensitive and/or confidential information, particularly in circumstances where such concerns were raised directly with the Administrators.
- 38 Given the uncertainty surrounding some counterparties' status as creditors and the values attributed to creditors' claims in the Statement, the concerns expressed by some counterparties in respect of the disclosure of such information and the duties of confidentiality referred to above, the Administrators believe that disclosure in the present circumstances is not appropriate. In all the circumstances, therefore, the Administrators respectfully invite the Court to make the Order sought.

STATEMENT OF TRUTH

I believe that the facts stated in this witness statement are true.

Signed: 

STEVEN ANTHONY PEARSON

8 May 2009