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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re	
LEHMAN BROTHERS, INC.,	Case No. 08-01420 (JMP) (SIPA)
Debtor.	

RESPONSE OF LEHMAN BROTHERS INTERNATIONAL (EUROPE) (IN ADMINISTRATION) TO TRUSTEE'S POSITION STATEMENT REGARDING THE OMNIBUS CUSTOMER CLAIM

February 24, 2012

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Lehman Brothers International (Europe) (in administration) ("**LBIE**"), acting by and through its Joint Administrators,[1] through its undersigned counsel, hereby responds to the Trustee's Position Statement Regarding the Omnibus Customer Claim of Lehman Brothers International (Europe) (January 13, 2012) [Docket No. 4865] (the "**Position Statement**"), which addresses the Trustee's determination of LBIE's Omnibus Claim[2] and that portion of LBIE's Failed Trades Claim[3] relating thereto (together, LBIE's "**Omnibus Claim**"), as that determination is described in the Notice of Trustee's Determination of Claim dated May 19, 2011 (the "**Letter of Determination**"). Except where otherwise specified, capitalized terms used but not defined herein have the meaning ascribed to them in LBIE's Objection to the Trustee's Determination of Claims (October 31, 2011) [Docket No. 4684] (the "**Objection**").

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1 By orders of the English High Court of Justice, Anthony Victor Lomas, Derek Anthony Howell, Steven Anthony Pearson, Paul David Copley and Russell Downs were appointed as Joint Administrators of LBIE (collectively, the "**Joint Administrators**").

2 Claim Numbers 900005782 (filed Jan. 30, 2009), 900007955 (filed May 29, 2009) and 900008199 (filed Sept. 10, 2010). Based on instructions from Epiq, these claims were also submitted by mail, and the first two claims were subsequently assigned alternate claim numbers: 900005953 (filed Feb. 2, 2009) and 900007941 (filed June 1, 2009). Copies of the Claims are in the Trustee's possession and will be made available on request to the Court and, subject to appropriate confidentiality protections, to other parties in interest.

3 Claim Numbers 900005783 (filed Jan. 30, 2009) and 900008003 (filed May 29, 2009). Based on instructions from Epiq, these claims were also submitted by mail and subsequently assigned alternate claim numbers: 900005951 (filed Feb. 2, 2009) and 000006027 (filed June 1, 2009). LBIE filed its Failed Trades Claim to protect its interests with respect to securities trades that were pending with LBI as of the date that LBIE entered administration in the U.K. The Trustee also issued a separate determination letter with respect to the Failed Trades Claim, denying the claim "except to the extent that the Failed Trades Claim was expressly allowed or the determination thereof deferred by the Trustee" in the Trustee's other determination letters, including the Letter of Determination.

PRELIMINARY STATEMENT

The heart of this dispute concerns what LBIE's more than 300 customers who transacted their U.S. securities business through LBIE, and LBIE in turn through LBI, will receive out of LBI's remaining fund of customer property. The Trustee and LBIE have opposing views on the correct manner in which to roll forward the roughly 200,000 trades of LBIE's customers that were pending at the start of the week of September 15-19, 2008 ("**Lehman Week**"). The consequence of the Trustee's chosen and erroneous methodology and his insistence on obtaining releases from underlying customers is that the Trustee will allocate to LBIE a dramatically different combination of securities and cash than LBIE's customers recognize as their aggregate entitlements. LBIE will in turn be left somehow to allocate these assets to its customers who have approximately $13 billion in unresolved claims against LBI, in exchange for releases that LBIE has no prospect of ever receiving. The outcome will be tortuous and drawn out for years.

In addition to these practical difficulties, the Trustee's determination of LBIE's Omnibus Claim, as explained in his Position Statement, has a fundamental legal defect: namely that the Trustee neglects the basic SIPA principle that a party acting in different capacities is a separate SIPA customer with respect to each capacity in which it acts. The Trustee acknowledges in both his Position Statement and filings in the House litigation that LBIE acted in both a House capacity (that is, for its own account) and in a representative "Omnibus" capacity on behalf of its underlying customers. But in the Letter of Determination and Position Statement, the Trustee ignores LBIE's separate capacities, incorrectly allocating to LBIE on behalf of its customers assets and liabilities that contractually and by the parties' longstanding practice should be allocated to LBIE in its House capacity, and *vice versa*.

If the Trustee's erroneous determination is upheld, many, if not most, of LBIE's customers will be expected to receive distributions that bear little relation to their cash and securities entitlements. Most of the securities positions claimed by LBIE for its customers, based on what was subcustodied at LBI for their benefit, do not correspond to those allowed by the Trustee in the Letter of Determination. The most striking example of this, of course, is the numerous negative securities positions that exist in the Trustee's Letter of Determination, despite that LBIE's customers have fully-paid long positions in such securities. Indeed, only a very small minority of LBIE's underlying customers would find that the securities allowed in the Letter of Determination match the entirety of their positions claimed by LBIE on their behalf. The mismatch between the Letter of Determination and the sum of the aggregate balances of LBIE's customers' entitlements threatens to undermine the ostensible purpose of the Trustee's allowance of a portion of LBIE's Omnibus Claim, which he states is intended to inure to the benefit of underlying public customers.

By its Objection, LBIE seeks to correct this fundamental error. Far from seeking to "have its cake and eat it too," Position Statement ¶ 10, LBIE merely seeks to compel the Trustee to acknowledge the separate capacities in which LBIE dealt with LBI, so that the assets to which LBIE is entitled on behalf of its customers in accordance with SIPA can be allocated to those customers. To properly reflect those entitlements, the Trustee must account for the contractual relationships between LBI and LBIE (in its House capacity and in its Omnibus capacity) and their longstanding course of dealing. The methodology used by LBIE in determining its claim comports with SIPA and is consistent both with LBIE's customers' entitlements and with Lehman's intercompany contractual relationships and performance

thereunder. Moreover, LBIE's methodology would actually facilitate – rather than hinder – LBIE's ability to make a meaningful distribution to its underlying customers.

In addition, the Letter of Determination is flawed in other significant respects, which LBIE pointed out in the Objection but with which the Trustee has failed to meaningfully join issue in his Position Statement. For example, in response to LBIE's objection that the conditions imposed on the allowance of the OCC Cash Balance are impermissible under SIPA, the Trustee cites no authority for his position that such OCC Cash Balance be distributed solely to LBIE's options customers. Instead, the Trustee simply refers to his arguments in the Trustee's Position Statement Regarding Proprietary Claims of Lehman Brothers International (Europe), Sept. 30, 2011 [Docket No. 4598] (the "**House Position Statement**"), even though the OCC Cash Balance arises directly from customer trading. Nor does the Trustee adequately address LBIE's objection to his requirement that LBIE obtain releases from all of the customers whose positions make up the Omnibus Claim. While SIPA may permit the Trustee to require a "claimant" to execute a release, nowhere does it authorize the Trustee to require a claimant – which the Trustee acknowledges is LBIE – to obtain releases from others. Rather than dealing with the plain language of the statute, the Trustee simply relies upon an unsupported conclusory assertion to the contrary.

Further, the Trustee barely addresses LBIE's arguments in its Objection regarding the timeliness of the Second Amended Omnibus Claim, which by the Trustee's own agreement and course of conduct was timely filed.

Finally, the Letter of Determination is flawed even under the Trustee's own approach because at least two significant cash and securities items ordinarily credited to LBIE's

Charge Omnibus Account were not allowed. The Trustee's approach, if consistently applied, would give LBIE an allowed Omnibus Claim worth substantially in excess of $8.3 billion.

For these reasons, and as set forth more fully herein and in the Objection, the Court should overturn the Letter of Determination with respect to the amounts of cash and securities set forth therein and require the Trustee to calculate LBIE's allowed Omnibus Claim in accordance with the parties' agreements and established course of dealing.

ARGUMENT

I. THE TRUSTEE IGNORES LBIE'S STATUS AS TWO SEPARATE CUSTOMERS IN ITS HOUSE AND REPRESENTATIVE CAPACITIES AND HAS DETERMINED LBIE'S NET EQUITY IN A MANNER THAT IS INTERNALLY INCONSISTENT

A. The Trustee Has Not Taken Into Account LBIE's Status as Two Separate Customers in its House and Representative Capacities in Determining LBIE's Net Equity

1. SIPA expressly states that "accounts held by a customer in separate capacities shall be deemed to be accounts of separate customers." 15 U.S.C. § 78lll(11); see also 17 C.F.R. §§ 300.100-300.105. As noted in the Position Statement, LBI maintained on behalf of LBIE four omnibus accounts – two of which held LBIE's customer positions and two of which held LBIE's proprietary positions. LBIE's customer omnibus accounts included a "charge" omnibus account, which held securities on behalf of LBIE's prime brokerage customers who granted LBIE a charge, or lien, over the securities that LBIE traded for them (the "**Charge Omnibus Account**"), and a "custody" omnibus account, which held securities on behalf of LBIE's customers for safekeeping (the "**Custody Omnibus Account**") (together with the Charge Omnibus Account, the "**Customer Omnibus Accounts**"). LBIE's proprietary omnibus accounts included a "title" omnibus account, which held securities for LBIE's prime brokerage customers who had entered into agreements pursuant to which title to their securities was

transferred to LBIE (the "**Title Omnibus Account**"), and a "house" omnibus account, which held LBIE's proprietary positions (together with the Title Omnibus Account, the "**House Omnibus Accounts**").[4] Position Statement ¶ 15; see also Objection ¶¶ 11-12 & n.16. Under the Clearing and Custody Agreement, LBI was required to maintain each of these accounts separately. Clearing and Custody Agreement § 3.2(A). In addition, the Trustee has taken the position that from LBI's perspective, each of these four accounts was "essentially" a single customer. Position Statement ¶¶ 2, 16. Accordingly, there can be no dispute that LBIE's House and Customer Omnibus Accounts, and the rights and obligations that are associated with those accounts, are separate for SIPA purposes. Because they are accounts of separate SIPA customers, the Trustee may not indiscriminately allocate assets or liabilities to one of those accounts that should properly be allocated to the other, any more than he can ignore the distinction between accounts held by unrelated entities. See, e.g., In re First State Sec. Corp., 34 B.R. 492, 499 (Bankr. S.D. Fla. 1983) (deeming an account held by an individual for his own benefit a separate account from one held by the same individual in his capacity as trustee for others); Ravis v. Labriola (In re Investors Sec. Corp.), 6 B.R. 415, 418-20 (Bankr. W.D. Pa. 1980). But this is exactly what the Trustee has done.

2. Although the Trustee correctly acknowledges that under SIPA customers are entitled to the "net equity" in their accounts, Position Statement ¶ 30, he fails to correctly compute net equity in determining LBIE's allowed Omnibus Claim. Further, by incorrectly commingling LBIE's House and Omnibus assets and liabilities to reach his desired result, the Trustee erroneously urges the Court to ignore the agreements and the course of dealing between

[4] The Customer Omnibus Accounts and the House Omnibus Accounts collectively comprise the Omnibus Accounts ("**Omnibus Accounts**"). The Trustee also notes that LBI held two "options" Omnibus Accounts ("**Options Omnibus Accounts**") used for LBIE's customers engaging in options transactions that cleared through the Options Clearing Corporation ("**OCC**"). Position Statement ¶ 15. LBIE understands that certain of its customers' assets were also held in an account on LBI's MTS system.

LBIE and LBI. But the agreements between LBIE and LBI define the scope and parameters of LBIE's separate capacities with respect to the House and Omnibus Claims, and the course of dealing between them prior to Lehman Week confirms that the parties intended those agreements to operate in a manner that respected LBIE's separate capacities. Far from being irrelevant for SIPA purposes, as the Trustee would have it, the Court must look to the contracts that define the parties' relationships to ascertain the proper allocation of assets and liabilities as between LBIE's House and Omnibus capacities in order to determine net equity under SIPA.[5] The contracts and the parties' course of dealing should be particularly relevant to the Trustee's determination of LBIE's Omnibus Claim because of the unprecedented complexity that the Trustee confronted in rolling forward LBI's books and records to account for approximately 200,000 LBIE-related

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[5] On a number of occasions, the Trustee has cited *dicta* in In re Bernard L. Madoff Investment Securities LLC, 654 F.3d 229 (2d Cir. 2011) to support the proposition that his discretion should be afforded broad deference by the Bankruptcy Court. See, e.g., Position Statement ¶ 59 (citing Madoff, 654 F.3d at 238 n.7); Second Motion for Order Approving the Trustee's Allocation of Property, Dec. 1, 2011 ¶ 63 [Docket No. 4760] ("**Second Allocation Motion**"). Madoff, however, does not aid the Trustee here. Madoff involved a Ponzi scheme, a pure fraud in which customer funds were never invested in securities and the "broker-dealer's" books and records were entirely fictitious. Crediting the fictional books and records in that case would, therefore, have "give[n] legal effect to [the Ponzi schemer's] machinations." Id. at 235. Under those circumstances, the Second Circuit stated in *dicta* that "[f]raud is endlessly resourceful and the unraveling of weaved-up sins may sometimes require the grant of a measure of latitude to a SIPA trustee." Id. at 238 n.7. The Second Circuit stated that where such circumstances exist and the Trustee exercises such discretion, a reviewing court should "accord a degree of deference to such an exercise of discretion" provided "the method chosen by the trustee allocates 'net equity' among the competing claimants in a manner that is not clearly inferior to other methods under consideration." Id.

The circumstances of this case are nothing like those found in Madoff. Here, two regulated broker-dealers undertook *bona fide* business for market participants pursuant to well-defined contracts and a regular course of dealing. There is no fraud in this case, and the books and records of each of the entities were kept according to usual standards and with regard to the regulations applicable to LBI and LBIE and the contracts and course of dealing between them. Under these circumstances, the Trustee's discretion in determining net equity claims should be appropriately constrained by the parties' contractual relationship and historical course of dealing. Unlike the trustee in Madoff, the Trustee simply cannot defensibly determine a net equity claim in a way that is at odds with the method by which Lehman accounted for customer activity prior to the commencement of LBI's insolvency proceeding. Id. at 238 (holding that in cases unaffected by fraud, "a customer's last account statement will likely be the most appropriate means of calculating 'net equity'," and noting that the "extraordinary facts" of the Madoff case made the Trustee's alternate approach appropriate, "whereas in many instances, it would not be."). In short, given the absence of pervasive fraud such as that found in Madoff, the Trustee's discretion is limited. Moreover, adherence to LBI's books and records, informed by the contracts and course of dealing between LBI and its counterparties, is plainly a superior method of determining net equity to the Trustee's ad hoc and result-driven deviation therefrom.

trades that were pending as of LBIE's entrance into administration. While it is true that SIPA often lacks the clarity that one might hope for with respect to a wide variety of increasingly complex issues that are confronted in the liquidation of a securities broker or dealer, a trustee must take into account contractual obligations and established course of dealing in arriving at a methodology for determining net equity claims in a situation as daunting as LBI's insolvency. See SEC v. Aberdeen Sec. Co., 480 F.2d 1121, 1123-26 (3d Cir. 1973).

3. The Clearing and Custody Agreement in effect between LBIE and LBI demonstrates that the parties agreed that LBIE would act in separate capacities with respect to trading in the Omnibus Accounts. For example, under the Clearing and Custody Agreement, LBI could use its own funds to settle transactions on behalf of LBIE or LBIE's customers see Clearing and Custody Agreement § 8.3, but to the extent it did so, such advances were deemed to be loans to LBIE, not to LBIE's underlying customers. Id. Accordingly, any advances of funds by LBI as a result of having settled trades in the Customer Omnibus Accounts during Lehman Week must properly be allocated to LBIE in its House capacity, and not deducted from the Omnibus Claim (which has the effect of improperly reducing the entitlements of LBIE's customers).

4. Other provisions of the Clearing and Custody Agreement further evidence LBIE's rights as against LBI in its separate capacities. For example, LBI was required to maintain at least two separate accounts – one for LBIE's own assets and one or more separate accounts for assets received by LBI and identified in writing by LBIE as held for LBIE's customers. Id. § 3.2(A). Further, LBI was required to ensure that assets held for LBIE and its customers were held in safe custody and on a segregated basis. Id. §§ 3.2(B), 3.3(B). LBI could assert no claim, nor grant to any person any interest, lien or similar right over the documents of

title, certificates or any other record evidencing or representing title, to securities held on behalf of LBIE and LBIE's customers except in respect of administrative or safekeeping charges or where LBIE had notified LBI that LBIE's customers had provided written consent. Id. § 3.2(E). In addition, LBI was not permitted to offset fully-paid long positions of LBIE's customers against short positions of other customers of LBIE. Id. § 8.5; see also 17 C.F.R. § 240.15c3-3(b)(1) ("A broker or dealer shall promptly obtain and shall thereafter maintain physical possession or control of all fully-paid securities and excess margin securities carried by a broker or dealer for the account of customers.").

5. Rather than observe the contractual and historical distinction between LBIE's House and Omnibus capacities, the Trustee instead has simply netted assets and indebtedness across the Customer Omnibus Accounts and the House Omnibus Accounts, disregarding the Clearing and Custody Agreement, the parties' course of dealing and LBIE's customers' legitimate expectations as to their cash and securities held at LBI. Given this fundamental flaw in the Trustee's "roll-forward" methodology, the Trustee's arguments for reducing LBIE's Omnibus Claim for "various forms" of indebtedness are wholly insufficient, as they fail to consider that LBIE incurred its indebtedness associated with Customer Omnibus Account activity in its House capacity. The Trustee's citations to SIPC v. Lehman Brothers Inc., 433 B.R. 127, 133 (Bankr. S.D.N.Y. 2010), as well as to In re Weis Securities, Inc., No. 73 Civ. 2332, slip. op., 2-3 (S.D.N.Y. Feb. 18, 1976), and to Alan N. Resnick & Henry J. Sommer, 6 Collier on Bankruptcy § 741.06[4] (16th ed. 2011) may support the unremarkable proposition that short sales are indebtedness for purposes of determining net equity, Position Statement ¶ 32, but these authorities are irrelevant with regard to how short sales are treated in the net equity

determination of LBIE's Omnibus Claim where LBIE acquired the relevant indebtedness in its House capacity.

6. Similarly, the Trustee cites In re John Muir & Co., 28 B.R. 946, 948 & n.3 (Bankr. S.D.N.Y. 1983) and 6 Collier on Bankruptcy § 741.06[1] to support treating as indebtedness "[s]ecurities that have not been paid for," and Harold S. Bloomenthal & Samuel Wolff, Securities and Federal Corporate Law 3D Sec & Fed. Corp. Law § 23:107 (2d ed. 2011); and William L. Norton Jr., Norton Bankruptcy Law and Practice, 4 Norton Bankr. L. & Prac. 3d §87:19, n.2 (2011) to justify treating as indebtedness "securities bought on margin that have not been paid for." Position Statement ¶ 32. But LBIE's customers whose positions were carried in the Customer Omnibus Accounts were not indebted to LBI to make such payments, and in fact, as between LBIE, on behalf of its customers, and LBI, all such positions were fully paid for at the time that LBIE entered administration. Rather, if LBIE's customers were indebted to anyone for having funded the purchase of their securities, they were indebted to LBIE, pursuant to their lending agreements with LBIE. See 6 Collier on Bankruptcy § 741.06[1] (noting that net equity "is a dollar figure calculated by determining what would have been realized by the customer had the securities credited to the customer account been liquidated on the filing date and by adding to that the sum any cash owed to the customer in the form of cash credit balances (free or otherwise). From this any indebtedness *owed to the stockbroker* on the filing date is subtracted.") (emphasis added).[6]

7. In sum, the Trustee's approach for reducing LBIE's net equity position in its Omnibus Claim fails to take into account the separate capacities in which LBIE incurred

[6] The Trustee argues further that, to the extent that LBIE claims LBI failed to perform during Lehman Week, transactions that could have been or would have been requested by LBIE and LBIE's customers do not give rise to a SIPA claim. Position Statement ¶ 36. The Trustee misunderstands (or mischaracterizes) LBIE's position. As set forth herein, LBIE seeks a determination of its net equity that properly accounts for the separate capacities in which LBIE incurred any indebtedness.

indebtedness, and the Trustee cannot simply refer to his discretion in order to remedy his disregard of statutory requirements. LBIE does not seek to "disassociate" indebtedness from equity – rather LBIE seeks a proper allocation of equity and indebtedness that reflects the different capacities in which they were incurred, as required by SIPA.[7]

B. The Trustee's Erroneous Treatment of Short Sales by LBIE's Customers

8. The Trustee's determination with respect to short sales by LBIE's customers does not account for the process historically used by LBIE and LBI to effectuate borrowing of stock pursuant to intercompany lending arrangements between LBIE and Lehman Brothers Luxembourg (S.A.) ("**LB Lux**") to cover such short sales. Further, the Trustee ignores LBIE's rights under the Clearing and Custody Agreement. As such, his determination is erroneous.

9. When one of LBIE's customers desired to sell short a particular stock, it would initiate the transaction by issuing a sale instruction. As between the customer and LBIE, short sales were typically governed by lending agreements pursuant to which, upon going short, the customer would owe securities to LBIE. On the trade date, LBIE would record the transaction in the customer's trading account ("**056 Account**") by debiting securities from the account (reflecting securities sold) and crediting cash (reflecting the proceeds of the short sale). As between LBIE and the customer, the customer had an obligation to return the borrowed securities or their equivalent to LBIE, plus a fee, when the short position was unwound.

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[7] The Trustee has taken the same approach where it suits him. In the very same way that the "underlying nature" (to use the Trustee's terminology) of the approximately $120.6 million of cash credited to the Charge Omnibus Account as of September 10, 2008 concerns LBIE House activity, and Lehman's past practices support reclassifying such amounts for consideration in LBIE's House Claim, Position Statement ¶ 63, the "underlying nature" of indebtedness improperly deducted from LBIE's Omnibus Claim similarly concerns House activity, and Lehman's past practices support reclassifying such indebtedness to LBIE in its House capacity. Such indebtedness did not previously, and should not now, be attributed to the customers on whose behalf LBIE is asserting the Omnibus Claim.

10. To prevent securities shortfalls from arising as a result of its customers' short sales, LBIE relied on a process to cover such short sales by borrowing stock from LB Lux pursuant to an Overseas Securities Lending Agreement ("**OSLA**") between LB Lux and LBIE. Such stock borrows ("**LB Lux Stock Borrows**") were effected by the New York equity financing desk (the "**Financing Desk**"). LBIE's stock borrowing requirements were determined daily on a net basis per stock line, with LB Lux lending securities to LBIE to cover LBIE's customers' short sales. As LB Lux Stock Borrows would be booked on the settlement date of the underlying customers' short sales, this process (the "**LB Lux Stock Borrow Process**") was designed to ensure that there would be sufficient securities to meet LBIE's customers' entitlements at all times.[8]

1. The Trustee's Erroneous Treatment of Certain Pre-Administration Short Sales

11. On occasion, there were breaks in the process of securities borrowings from LB Lux, resulting in either a securities deficit in the Charge Omnibus Account (i.e., "**Underborrows**"),[9] or an amount of securities in excess of that which was required to cover LBIE's customers' short sales (i.e., "**Overborrows**").

12. At the time LBIE entered administration, there were approximately $259 million in Underborrows in LBIE's Charge Omnibus Account. In his Letter of Determination, the Trustee reduced LBIE's Omnibus Claim to the extent of these Underborrows. Such treatment was erroneous.

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[8] When LBIE's customers closed out their short positions, the above process worked in reverse.

[9] LBI and LBIE would routinely resolve these discrepancies without adverse impact to LBIE's customers, including those customers whose short sales were associated with these discrepancies, as their 056 Accounts would nevertheless be credited cash and debited securities on the trade date.

13. As an initial matter, the Trustee's reduction of these securities amounts from LBIE's Omnibus Claim ignores the fact that these Underborrows arose due to unresolved breaks in the *intercompany* stock borrowing process (i.e., the LB Lux Stock Borrow Process) that was well known to LBI. As such, any unresolved obligations to "cover" client short sales are obligations attributable to LBIE in its House capacity. The Trustee's reduction of LBIE's Omnibus Claim by these amounts, however, treats these obligations as incurred by LBIE in its representative capacity – which is in error.

14. Moreover, the Trustee has applied an entirely inconsistent methodology in his treatment of Underborrows and Overborrows, even though both arose from and are related to the same LB Lux Stock Borrow Process. Specifically, while the Trustee has attributed Underborrows to LBIE in its Omnibus capacity (thereby reducing LBIE's Omnibus Claim by approximately $259 million in securities), he has attributed Overborrows (valued at approximately $1.1 billion) as assets in LBIE's House Claim (notwithstanding that these securities were credited to the Charge Omnibus Account). Given that the Trustee has denied customer status to LBIE's House Claim *in toto*, his inconsistent treatment of Underborrows and Overborrows serves only to minimize LBIE's recovery. The Trustee cannot have it both ways.

2. The Trustee's Erroneous Treatment of Post-Administration Short Sales

15. According to the Trustee, during Lehman Week, the LB Lux Stock Borrow Process ceased functioning. Position Statement ¶ 41. Nevertheless, during Lehman Week, LBI continued to settle pending short sale orders for LBIE's customers. It is unclear how LBI sourced the securities used to settle such trades (i.e., whether and to what extent LBI used securities from the Customer Omnibus Accounts, the House Omnibus Accounts, LBI's

proprietary or customers' accounts,[10] or whether LBI "bought-in" securities from the street). Regardless, in his roll-forward methodology, the Trustee has allowed cash to be credited to the Charge Omnibus Account, but has reduced LBIE's Omnibus Claim for fully-paid securities used to settle such trades. The Trustee's treatment was in error.

16. First, as with his treatment of LBIE's claims related to pre-administration short sales, the Trustee's allocation of indebtedness arising from short sales during Lehman Week ignores that it was LBIE's obligation, in its House capacity, to cover such short sales in order to prevent any resulting shortfalls. Thus, for the reasons described above, any corresponding indebtedness should be allocated to LBIE in its House capacity.

17. Second, by reducing the balance of securities in LBIE's Customer Omnibus Accounts, the Trustee has elected to treat all such trades, in effect, as having settled out of the Customer Omnibus Accounts. Such treatment is in violation of the segregation requirements of the Clearing and Custody Agreement which, as described above, required LBI to segregate the fully-paid long positions of LBIE's customers and precluded LBI from offsetting such positions against short positions in the same security. Clearing and Custody Agreement § 8.5; see also SEC Rule 15c3-3(b)(1).

18. Third, the Trustee complains that LBIE's proposed allocation of assets and indebtedness in connection with its claims for securities relating to short sales is inconsistent with SEC Rule 15c3-3, pursuant to which LBI was required to establish reserves on a net – not gross – basis, across LBIE's Customer Omnibus Accounts. Position Statement ¶ 43. The Trustee argues that if he were to "ignore" LBIE's customers' short positions and to allow their

[10] Given that the Trustee has attributed *negative* securities balances for certain lines of securities to LBIE's Omnibus Claim, it appears that LBI may have used securities from sources other than the Customer Omnibus Accounts to settle such trades.

gross long positions, "the property set aside to meet the obligations of LBI's customers as a whole could be insufficient," and that this would "expose all of LBI's customers to the risk of loss and benefit the LBIE Clients at the expense of LBI's other customers." Id. The Trustee's arguments are without merit for multiple reasons.

19. First, the Trustee has already acknowledged numerous failures by LBI in meeting its reserve requirements under SEC Rule 15c3-3 in the days leading up to the commencement of its SIPA proceeding, including failures to set aside sufficient assets to meet its obligations to LBIE's customers. See Second Allocation Motion ¶¶ 84-107. Moreover, the Trustee ignores the fact that, historically, the LB Lux Stock Borrow Process operated to ensure that shortfalls in the Omnibus Customer Accounts did not occur. Further, the risk of a shortfall in the customer property pool is a risk that must be shared by all customers on a *pro rata* basis. By attempting to shield LBI's other customers from such shortfalls, the Trustee would provide less protection to LBIE, and thereby LBIE's customers, than is provided for LBI's other customers, leading LBIE's customers to suffer disproportionately, in violation of SIPA. Last, in his Letter of Determination, the Trustee has effectively ignored billions of dollars of cash and securities positions that were or should have been credited to LBIE's Charge Omnibus Account, see supra ¶ 14 and infra ¶¶ 37-41, and as such, his emphasis on the importance of accounting for short positions against LBIE's artificially reduced Omnibus claim rings hollow.

C. The Trustee's Erroneous Treatment of the Sale of Lifted Securities

20. The Trustee's treatment of LBIE's Omnibus Claim with respect to the sale of lifted securities similarly ignores the separate capacities in which LBIE dealt with LBI. Further, it violates LBIE's rights under the Clearing and Custody Agreement and is contrary to the course of dealing between the parties. As such, it is erroneous.

21. As described in the Objection, under its prime brokerage agreements with its charge customers, LBIE had broad rights of use in respect of securities credited to its customers' accounts. Objection ¶ 11 n.18. This included the right to "lift" customers' securities to support LBIE's proprietary trading. Like the LB Lux Stock Borrow Process, the process of lifting customer securities was predominantly effected by the Financing Desk. Lifted securities could be used to cover proprietary short positions or could be financed to street counterparties through either LBIE or LBI.

22. When one of LBIE's customers issued a sell order for a lifted position, the process described above would work in reverse, with the Financing Desk arranging for the recall of securities lifted by LBIE. These securities recalls ordinarily would settle on or before the settlement date of LBIE's customer's sale. This process of lift reversals (the "**Lift Return Process**") was designed to ensure that there would be a sufficient quantity of securities to meet LBIE's customers' entitlements on the settlement date of each customer's sale.

23. As with the LB Lux Stock Borrow Process, there would occasionally be breaks in the Lift Return Process whereby recalls would fail to settle by the settlement date of the sale by LBIE's underlying customers. However, such breaks were routinely resolved by LBI and LBIE, acting in its House capacity, without any adverse impact on LBIE's customers.

1. The Trustee's Erroneous Treatment of Pre-Administration Lift Return Fails

24. In his determination, the Trustee has reduced LBIE's Omnibus Claim for positions that had purportedly failed to return under the Lift Return Process at the time that LBIE entered administration. Such treatment was erroneous.

25. As an initial matter, LBIE disputes whether such securities, in fact, failed to return and reserves its rights to challenge through discovery the Trustee's assertion that the

lifted positions did not return to LBI's possession. Further, the Trustee's treatment ignores the fact that LBIE lifted such positions to support its proprietary trading. As such, any obligations to return lifted positions were obligations incurred by LBIE in its House capacity. Accordingly, the proper treatment of any securities indebtedness arising from unresolved breaks in the Lift Return Process is to allocate such obligations to LBIE in its House capacity.

2. The Trustee's Erroneous Treatment of Post-Administration Lift Returns

26. According to the Trustee, the Lift Return Process, like the LB Lux Stock Borrow Process, ceased functioning during Lehman Week. Position Statement ¶ 46. Nevertheless, LBI continued to settle sell orders of lifted positions that were pending at the time LBIE entered into administration. As a consequence of his roll-forward methodology, the Trustee has allowed a credit for cash received in connection with such sales to LBIE's Omnibus Claim, but has reduced the Omnibus Claim to the extent of securities sold. This treatment was in error.

27. First, respecting the two different capacities in which LBIE traded with LBI, LBIE did not claim for positions lifted as of September 12, 2008 in its Original Omnibus Claim.[11] Thus, reducing the Omnibus Claim for securities sold (which were not originally claimed, and which the Trustee now asserts are time-barred), adversely affects the rights of LBIE's customers whose securities were used to settle the sale orders and prejudices the rights of LBIE's customers under the Omnibus Claim as a whole. Moreover, LBIE reserves its position as to whether the return of lifted positions, in fact, failed to occur in all instances during Lehman Week. Upon information and belief, certain positions which the Trustee has deducted from

[11] As indicated in its Objection, LBIE submitted a Second Amended Omnibus Claim on September 10, 2010 that in part reflected claims from its underlying customers that LBIE does not recognize in its books and records. Objection ¶ 18 & n.23. LBIE understands that some portion of that amendment reflects lifted positions, and the Trustee has denied the amendment in its entirety.

LBIE's Omnibus Claim on the basis of their having failed to return to the Charge Omnibus Account, in fact, were returned during Lehman Week.

28. Further, as with his treatment of pre-administration lifted securities, the Trustee's roll-forward methodology ignores the fact that LBIE's obligation to return lifted securities was an obligation that LBIE incurred in its House capacity. In addition, to the extent that the Trustee's roll-forward methodology used segregated, fully-paid long positions of one of LBIE's customers to offset sales of lifted positions of another one of LBIE's customers, such use was impermissible under the Clearing and Custody Agreement. See Clearing and Custody Agreement § 3.2.

29. In defending his roll-forward methodology and resulting reduction to LBIE's Customer Omnibus Claim (to the detriment of LBIE's underlying customers), the Trustee asserts that LBI did not track LBIE's underlying customer positions on an individual basis. That assertion is beside the point. LBI knew that both LBIE and LBI had controls in place, including the Lift Return Process and the LB Lux Stock Borrow Process, to prevent shortfalls in securities in LBIE's Customer Omnibus Accounts from occurring and to ensure appropriate segregation of LBIE's customers' assets. LBI had such knowledge because it had always played an integral role in carrying out those control functions. Accordingly, LBI must have known during Lehman Week that settling trades on behalf of LBIE's customers, without any functioning support processes to ensure that such sales did not result in a shortfall, would necessarily result in deficiencies in the securities balances in the Customer Omnibus Accounts. Last, LBIE reserves its right to challenge through discovery the Trustee's assertion that LBI did not track individual positions of LBIE's customers, as such assertion is belied by the fact that

LBI and LBIE shared data platforms which included details of LBIE's underlying customer positions.

D. The Trustee's Erroneous Treatment of Long Buys

30. During Lehman Week, LBI continued to settle orders for purchases of long positions ("**Long Buys**") that were pending at the time that LBIE went into administration. The Trustee has properly allowed LBIE's Omnibus Claim to the extent that such Long Buys settled. However, the Trustee has erroneously deducted from LBIE's Omnibus Claim cash that LBI used to effect such purchases. As explained supra, under the Clearing and Custody Agreement, cash advanced by LBI to settle securities transactions on behalf of LBIE's customers is to be deemed a loan between LBI and LBIE – not between LBI and LBIE's customers. Id. § 8.3. Thus, any cash indebtedness arising out of the purchase of such Long Buys should properly be allocated to LBIE in its House capacity. Moreover, as described in the Objection, as between LBIE and LBIE's relevant customers, LBIE, consistent with historical practice, has already deducted the purchase price of such Long Buys from LBIE's customers' margin position. By also deducting cash from LBIE's Omnibus Claim, the effect would be to charge LBIE's customers twice for these purchases.

E. The Trustee's Erroneous Treatment of Purchases of Securities to Close Out Short Positions

31. As described in the Objection, when one of LBIE's customers issued an order to close out a short position, an instruction would be issued to purchase securities in an amount equal to that which the customer owed LBIE. As between the customer and LBIE, the customer's 056 Account would be debited cash and the short position eliminated as of the trade date. To the extent a buy trade was issued by one of LBIE's customers to close out a short position prior to LBIE's administration, this is exactly what has occurred.

32. The Trustee asserts that LBI treated pending purchase orders to close out short positions in the same manner that it treated orders for Long Buys. In his roll-forward methodology, the Trustee has allowed LBIE's Omnibus Claim to the extent of the securities purchased, but has reduced the Omnibus Claim for cash used to effect such purchases. Such treatment was in error.

33. First, as described above, under the Clearing and Custody Agreement, any cash advances made by LBI to effect securities transactions on behalf of LBIE's customers is an obligation of LBIE in its House capacity. See id. § 8.3. Associated cash obligations arising out of these purchases should, therefore, be allocated to LBIE in its House capacity. Second, and consistent with the manner in which the LB Lux Stock Borrow Process was unwound, LBIE's customers have no expectation of receiving the purchased securities other than to satisfy their redelivery obligations to LBIE. Rather, it is LBIE in its House capacity that has the expectation of receipt of the purchased securities. Accordingly, securities purchased to close out the short positions of LBIE's customers should properly be allocated to LBIE in its House capacity.[12]

F. The Trustee's Roll-Forward Methodology is Internally Inconsistent and Seeks to Minimize the Recovery of LBIE's Customers

34. In addition to ignoring LBIE's separate capacities, the Trustee has not applied in a consistent manner his methodology that purports to do manually in liquidation what LBI would have done with regard to LBIE's accounts (mostly through automated systems) in normal, solvent operations prior to Lehman Week. Position Statement ¶ 4. Instead, while LBIE

[12] Once corrected for the errors described herein, the securities and cash positions that comprise LBIE's Omnibus Claim will match LBIE's view of the underlying entitlements of LBIE's customers to the financial assets that were or should have been subcustodied by LBI as of the Filing Date. LBIE's methodology, in addition to being consistent with SIPA's definition of net equity, also accords with section 78fff-3(a)(5) of SIPA, which provides for the underlying customers of a broker-dealer or bank to be eligible for SIPC protection as established by, among other things, the books and records of such broker-dealer or bank.

agrees that the Trustee has assiduously assessed *debits* against LBIE's Customer Omnibus Accounts, his characterization of the impact of the joint reconciliation process is simply wrong. If, in fact, the Trustee were to have allocated *both* debits and credits to LBIE's Customer Omnibus Accounts in a manner that is internally consistent, LBIE's allowed Omnibus Claim would have substantially exceeded the approximately $8.3 billion the Trustee has allowed in his determination. It is only through the application of the Trustee's flawed roll-forward methodology that the Trustee has managed to disregard (or recharacterize) billions of dollars of cash and securities positions that were historically (and properly) credited to the Customer Omnibus Accounts.

35. Two ways in which the Trustee's roll-forward methodology has, in effect, creatively and erroneously rewritten LBI's books are: (1) the Trustee's reduction of LBIE's cash claim by $627 million for amounts that the Trustee asserts involve lending activity (explained in further detail infra ¶¶ 37-41); and (2) the Trustee's treatment of approximately $1.1 billion of securities that otherwise had been credited to LBIE's Charge Omnibus Account as LBIE House positions. See infra ¶ 14. If the Trustee were faithfully adhering to his statement that the joint reconciliation process with LBIE was intended to replicate the ordinary operations of LBI's books and records, he would not have sought these adjustments.

G. The Trustee's Roll-Forward Methodology Disregards LBI's Obligation to Segregate LBIE's Customers' Custody and Charge Assets

36. In his Position Statement, the Trustee purports to have applied LBI's historical approach of netting debits and credits within each Omnibus Account to arrive at his determination. See id. ¶ 16. According to the Trustee, this is consistent with LBI's perspective that each Omnibus Account was "essentially a single customer" and with LBI's regulatory and segregation requirements, including those requirements imposed by SEC Rule 15c3-3. Position

Statement ¶ 16. Yet in his roll-forward methodology, the Trustee has disregarded the requirement that assets from the Charge Omnibus Account and the Custody Omnibus Account be held separately. In particular, in certain instances, the Trustee has sought to net securities deficits in the Charge Omnibus Account with securities held on a segregated basis for LBIE's customers in the Custody Omnibus Account – in effect, using Custody assets to fund shortfalls in the Charge Omnibus Account.[13] Such treatment is not only inconsistent with the Trustee's purported methodology of netting debits and credits within an Omnibus Account, but also disregards LBIE's contractual rights under the Clearing and Custody Agreement that assets held in the Charge Omnibus Account and the Custody Omnibus Account be segregated. See Clearing and Custody Agreement §§ 3.2(A), 8.5; SEC Rule 15c3-3(b)(1).

II. THE TRUSTEE HAS IMPROPERLY REDUCED LBIE'S OMNIBUS CLAIM BY OVER $627 MILLION IN CASH

37. As indicated above, the Trustee has improperly reduced LBIE's Omnibus Claim by over $627 million in cash credited to the Charge Omnibus Account for mark-to-market collateral adjustments relating to stock loans between LB Lux and LBIE. The Trustee's rationale

[13] In a number of instances, the Trustee's application of his roll-forward methodology has resulted in the reduction of securities positions in LBIE's allowed claim below the number of securities owed to LBIE's Custody customers who did not grant any Lehman entity the right to use any such securities. For example, in the Omnibus Claim, LBIE claimed for 247,524 fully-paid shares of eBay, Inc., (CUSIP 278642103) ("**eBay**"), 195,503 of which were held in the Custody Omnibus Account, and for which there were no pending sell orders as of LBIE's entry into administration. The Trustee's determination should – at a minimum – have captured these shares as owing to LBIE in its Omnibus capacity. Instead, the Letter of Determination shows a negative securities position (owing to LBI**)** of 18,240 shares. To arrive at this figure, the Trustee has netted the total of LBIE's Custody and Charge positions in eBay together with the movements in these positions during Lehman Week. Had the Trustee respected LBI's requirement to hold separately the Charge Omnibus Account and the Custody Omnibus Account, the Trustee's determination would have reflected LBI's obligation to return to LBIE (for Custody customers) the totality of the Custody Omnibus Account positions in eBay (i.e., 195,503 shares). In addition, had the Trustee properly allocated debits and credits associated with eBay movements that occurred during Lehman Week between LBIE's House and representative capacities where applicable, he would have allowed a total of 240,211 eBay shares in the Letter of Determination. Instead, the Trustee has used long positions in eBay held by Custody customers and fully-paid long shares in the Charge Omnibus Account to subsidize LBIE's House obligation to deliver eBay shares in violation of applicable segregation requirements. See Clearing and Custody Agreement § 8.5; see also SEC Rule 15c3-3(b)(1).

for the reduction is that: (i) that sum concerns a stock loan transaction with LB Lux, not LBIE or LBIE's customers; and (ii) even if LBIE were a proper claimant, persons who are involved in lending transactions with SIPC members are not entitled to customer protection. Position Statement ¶ 62. The Trustee's reasons for denying customer treatment for this $627 million cash claim are baseless.

38. LBIE routinely borrowed stock from LB Lux to support short selling by LBIE's customers and to ensure that sufficient securities would be held to meet its customers' entitlements. See supra ¶¶ 8-10 (describing the LB Lux Stock Borrow Process). In the ordinary course, LBIE was required to provide collateral to LB Lux for any securities borrowed under this arrangement.

39. LBI and LBIE would regularly review the margin requirements for LB Lux, and margin adjustments would be made accordingly. When the overall value of the borrowed shares exceeded the value of the cash collateral posted by LBIE, additional margin would be posted. Conversely, when the overall value of borrowed shares exceeded the value of the cash collateral securing the loans, excess collateral would be returned.

40. Shortly before LBIE entered administration, the Charge Omnibus Account was credited $627 million in cash representing the return of excess collateral used to secure existing stock loans from LB Lux. It is indisputable that this cash credit does not arise from any stock lending activity between LBIE (or LBIE's customers) and LBI, and as such, the authorities relied upon by the Trustee for his reduction of LBIE's Omnibus Claim by this amount are inapposite. See Ferris, Baker, Watts, Inc. v. Stephenson (In re MJK Clearing, Inc.), 286 B.R. 109, 132 (Bankr. D. Minn. 2002) ("courts have uniformly held that persons who are involved with *a SIPC member* in a lending transaction are not entitled to the special protections afforded

customers") (emphasis added), aff'd, Nos. 01-4257 RJK, 01-4275 RJK, Civ. 02-4775 RHK, 2003 WL 1824937 (D. Minn. Apr. 7, 2003), aff'd, 371 F.3d 397 (8th Cir. 2004); see also SIPC v. Exec. Sec. Corp., 556 F.2d 98, 99 (2d Cir. 1977) (denying customer protection where a claim arose from a lending arrangement between the claimant and the *debtor*); SEC v. F.O. Baroff Co., 497 F.2d 280, 284 (2d Cir. 1974) (denying customer status to claims for securities lent to the *debtor*).

41. The $627 million cash credit is excess margin cash returned and credited to the Charge Omnibus Account for LBIE's customers in the ordinary course of LBI's business as a broker-dealer. The cash is directly related to short selling activity by LBIE customers. Accordingly, the Trustee has no basis under SIPA to deny customer protection to this portion of LBIE's Omnibus Claim.

III. LBIE IS ENTITLED TO AN UNCONDITIONAL ALLOWANCE OF ITS OCC CASH BALANCE[14]

42. While the Trustee admits that "on its face" the OCC Cash Balance was held in Options Omnibus Accounts, which were "customer-coded" and subject to SEC Rule 15c3-3 reserving requirements, the Trustee asserts that the operation of those accounts has "raised a question as to how much of the balance is owed to underlying customers." Position Statement ¶ 69. Further, the Trustee asserts that "it does not appear that the margin posted by LBIE, in satisfaction of the OCC's margin requirements, was demanded by LBIE from the LBIE Clients," and as such, it is "unclear" what portion, if any, of the OCC Cash Balance represents amounts due back to LBIE customers. Id. ¶ 70. According to the Trustee, LBIE's claim for the OCC Cash Balance (whether included in the Omnibus Claim or the House Claim) is really a

[14] LBIE refers to its approximately $1.3 billion claim to cash held by LBIE arising from options trading by LBIE's options customers as the "**OCC Cash Balance**."

claim by LBIE in its House capacity, and, therefore, should be denied for the same reasons he denied LBIE's claim for the OCC Cash Balance in the context of LBIE's House Claim. See id. For that reason, the Trustee justifies his condition that LBIE demonstrate that the OCC Cash Balance represents the proceeds of LBIE's customers' options transactions or margin posted by such customers as designed to limit LBIE from recovering where the benefits of such recovery would accrue to only LBIE itself. Id.

43. As an initial matter, while LBIE agrees that it is LBIE's burden to prove that it has a customer claim under SIPA, LBIE disputes any suggestion by the Trustee that in order to qualify as a customer under SIPA, it first must demonstrate that it will distribute the proceeds of its claim to any particular class of underlying customers. As the Trustee has noted, the OCC Cash Balance is held in customer-coded omnibus accounts that were established for LBIE's customers and were subject to SEC Rule 15c3-3 reserve requirements. Thus, even if, as the Trustee has insinuated, SEC Rule 15c3-3 defines the outer limit of customer status, see House Position Statement ¶¶ 57-58, which it does not, see Response of Lehman Brothers International (Europe) (in administration) to the Trustee's Position Statement, Nov. 15, 2011 [Docket No. 4723] ¶¶ 15-19, LBIE has demonstrated, *prima facie*, that such cash is entitled to customer protection.

44. For similar reasons, the Trustee's assertion that LBIE's claim to the OCC Cash Balance made in its Omnibus capacity should be denied for the same reasons he denied such a claim asserted by LBIE in its House capacity is also spurious. Position Statement ¶ 70 (citing House Position Statement ¶¶ 37-46). In the House Position Statement, the Trustee defended his denial of LBIE's House Claim in its entirety on the basis that LBIE was not a "public customer"; LBI did not hold LBIE's "proprietary accounts" on a fiduciary basis; LBIE's

House Claim included claims to LBI's "capital"; and more generally, allowance of LBIE's House Claim would thwart the purposes of SIPA, which is to protect investors and the securities market as a whole. House Position Statement ¶¶ 37-46. Yet the OCC Cash Balance is cash arising from options trading solely by LBIE options customers and was available to be used to satisfy the OCC margin requirements of those customers – not LBIE. As such, the OCC Cash Balance was held by LBI, for LBIE's options customers, and in the ordinary course of its business as a broker-dealer. Accordingly, LBIE's claim to the OCC Cash Balance is entitled to customer protection. See 15 U.S.C. § 78lll(2).

45. Further, insofar as the Trustee harbors doubts about whether margin "was demanded by LBIE from the LBIE Clients", Position Statement ¶ 69, such doubts are unfounded. Indeed, broker-dealers require margin from their customers to cover risk exposure as a matter of routine practice. Moreover, LBIE asserts, and discovery will show, that the OCC Cash Balance is comprised of proceeds derived from LBIE's customers' options trading activity and includes margin posted by LBIE on behalf of those customers in keeping with conventional market practice. When LBIE posted margin on behalf of an options customer, such advances were accounted for between LBIE and the options customer in accordance with LBIE's margin requirements for that customer. The Trustee implies that a one-to-one correspondence is necessary between the margin required by LBIE of customers and the margin posted by LBIE to LBI as its broker for OCC cleared options trades. As LBI well knew, LBIE would have demanded margin from its options customers that was, in the aggregate, greatly in excess of amounts actually posted by LBIE to LBI for its customers' options trading at OCC. Last, to the extent that LBIE has already made whole its options customers with respect to the OCC Cash Balance, LBIE is subrogated to the rights of its options customers, as "customers" within the

meaning of SIPA, in pursuing such claims. See Chem. Bank v. Meltzer, 712 N.E.2d 656, 661 (N.Y. 1999) (subrogation affords "a person who pays a debt that is owed primarily by someone else every opportunity to be reimbursed in full.").

IV. THE TRUSTEE EXCEEDED THE PROPER LIMITS OF HIS DISCRETION UNDER SIPA BY REQUIRING LBIE TO OBTAIN RELEASES FROM ALL OF ITS UNDERLYING CUSTOMERS

46. In his Position Statement, the Trustee does not address LBIE's explanation in its Objection that while the plain language of SIPA permits the Trustee to require a "claimant" to execute a release, nothing in the Act permits the Trustee to require a claimant to obtain releases from others. Instead, the Trustee makes the conclusory assertion that requiring releases from LBIE's underlying customers is "directly permitted under SIPA," but cites no "direct" language of SIPA or any other legal support for this position.[15] Position Statement ¶ 64.

47. While the Trustee may exercise his discretion to request releases from a claimant, requiring releases from each of LBIE's underlying customers far exceeds the scope of such discretion. A claimant is one "who asserts a right or demand, esp. formally." Black's Law Dictionary 282 (9th ed. 2009). Where, as here, LBIE is asserting the claim on behalf of its customers, LBIE is the claimant under SIPA. LBIE is the party formally asserting a right to recovery of property in this case, and as such, is the claimant for purposes of signing any release or fulfilling any conditions requested by the Trustee. The Trustee has acknowledged that LBIE is the proper claimant by denying various direct claims of LBIE's customers against the LBI

[15] The Trustee cites Peskin v. Picard, 440 B.R. 579 (Bankr. S.D.N.Y. 2010) for the assertion that releases are directly permitted under SIPA, but reliance on this case is misplaced. Peskin stands for the proposition that a trustee may require "the customer to sign a *partial* assignment and release, *to the extent of the payment to be made*." Id. at 586 (emphasis added) (further stating that a trustee should be permitted "to require a claimant to waive [its] claim *to the extent of an advance [it] receives on account of the claim.*") (emphasis added). The Peskin court does not state that a SIPA trustee is allowed in all instances to require releases for all amounts, nor does it state that the Trustee has the discretion to require releases from underlying customers. In fact, the Peskin court specifically notes that limits on the Trustee's discretion exist. For example, the Peskin court states that the release signed in this case did not prevent the claimant from "seeking a redetermination of the amount of her remaining claim." Id. at 587 n.1.

estate on the grounds that they are duplicative of the claim asserted by LBIE, as the claimant, on their behalf. Therefore, in accordance with 15 U.S.C. § 78fff-2(b),[16] the Trustee may properly obtain a release from LBIE and only from LBIE.

48. Further, one of a trustee's main duties is to distribute property "in an efficient manner." Dieffenbach v. Haworth (In re Haworth), Civ. A. No. 3:06CV403 (CFD), 2008 WL 4755851, at *4 (D. Conn. Oct. 29, 2008) (noting that "[a] trustee is the fiduciary of all of the creditors"), aff'd, 356 F. App'x 529 (2d Cir. 2009), cert. denied, 131 S. Ct. 140 (2010); see also Pereira v. Foong (In re Ngan Gung Rest.), 254 B.R. 566, 577 (Bankr. S.D.N.Y. 2000) (stating that "[a] trustee must be independent, vigorous and efficient") (citations omitted).[17] A SIPA trustee also has an obligation to "deliver securities to or on behalf of customers to the maximum extent practicable." 15 U.S.C. § 78fff-1(b); see also In re Ngan Gung Rest., 254 B.R. at 577 (a trustee has a duty to "maximize distributions to creditors."). Not only is requiring a release from each and every one of LBIE's underlying customers in relation to the return of specific, underlying assets inefficient, requiring a release from each of LBIE's underlying customers will hinder LBIE's ability to use the allowed claim to properly satisfy its customers' entitlements. See Objection ¶ 46.

49. The Trustee's arguments that a release by LBIE is of little value and may expose the LBI estate to further litigation are meritless. As LBIE explained in its Objection, the Trustee's acceptance of a release solely from LBIE will maximize LBIE's ability to satisfy the claims of its customers, and thereby *decrease* any potential for further litigation. In fact, the

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[16] 15 U.S.C. § 78fff-2(b) provides in pertinent part "Any payment or delivery of property pursuant to this subsection may be conditioned upon the trustee requiring *claimants* to execute . . . appropriate receipts, supporting affidavits, releases, and assignments." (emphasis added).

[17] While In re Haworth and In re Ngan Gung Restaurant discuss the duties of a trustee in a chapter 7 context, SIPA expressly acknowledges that a SIPA trustee has the same duties. See 15 U.S.C. § 78fff-1(b) ("a trustee shall be subject to the same duties as a trustee in a case under chapter 7 of Title 11").

Trustee himself admits that LBIE's customers "would have no need to press their individual claims against the Trustee if these largely duplicative claims are fully and finally resolved through the Trustee's allowance of the Omnibus Customer Claim." Position Statement ¶ 66.

50. In addition, there is an inherent contradiction in the Position Statement of the Trustee's overall treatment of LBIE's claims and his demand for releases from each of LBIE's customers. The Trustee asserts that LBIE, as the customer, "is entitled to the 'net equity' in its accounts." Id. ¶ 30 (citing 15 U.S.C. § 78fff(a)(1)(B) (2006) and 15 U.S.C. § 78fff-2(c)(1)(B)). Thus, on one hand, the Trustee argues that LBIE is entitled to recover cash and securities on a net, rather than on a customer-by-customer basis, thereby treating LBIE as the sole claimant in this case. On the other hand, the Trustee is placing a condition on the distribution in respect of the Omnibus Claim by requiring a release from each of LBIE's individual customers. The Trustee's position is internally inconsistent.

51. Finally, upholding the Letter of Determination, including the requirement that releases be obtained from each of LBIE's underlying clients, would greatly frustrate the Trustee's efforts to wind up LBI's estate. In particular, LBIE's customers who have also filed direct claims against LBI would be incentivized to pursue their direct claims against LBI rather than provide a release in exchange for assets that bear little resemblance, if any, to their actual entitlements. This prospect of piecemeal litigation between LBIE's customers and LBI could add years of delay to the resolution of this SIPA proceeding.

V. THE TRUSTEE ERRED BY DENYING THE SECOND AMENDED OMNIBUS CLAIM IN ITS ENTIRETY

52. In his Position Statement, the Trustee fails to address any of the substantive arguments set forth in LBIE's Objection regarding his improper disallowance of the Second Amended Omnibus Claim in its entirety. Rather, the Trustee simply asserts that the

inclusion of the phrase "as broadly as permitted by applicable law" in the Claims Filing Agreement did not give "LBIE an open invitation to file new or different claims long after the bar date." Position Statement ¶ 71. That assertion entirely ignores the purpose of, and would render meaningless, key provisions of the Claims Filing Agreement. The Trustee may not simply walk away from the agreement that he and SIPC willingly entered into by taking a position that would have rendered the agreement unnecessary.

53. The Claims Filing Agreement expressly provided that LBIE had a right to supplement or amend its Omnibus Claim, and made clear that any supplements and amendments "shall relate back to the date of the originally filed claim." Claims Filing Agreement ¶ 9. Further, the final clause in the Claims Filing Agreement noted that it did not limit the Trustee's ability to object to the LBIE claims "on any basis *other than timeliness*." Id. ¶ 14 (emphasis added). To now deny LBIE's Second Amended Omnibus Claim on timeliness alone would make the permissive supplementation and amendment provision in the Claims Filing Agreement entirely useless. The Claims Filing Agreement expressly recognized that LBIE and the Trustee faced challenges in reviewing and reconstructing the huge volume of relevant data, and in light of these challenges, provided that LBIE could amend and supplement its claim in order to claim broadly on behalf of *all* of LBIE's customers. Thus, the Claims Filing Agreement provided that LBIE could supplement and amend its claims, and that "such supplements and amendments may, *among other things*, include amendments to the amount of such claim, the composition of assets underlying each claim . . . or to correct any mistake relating to such claim." Id. ¶ 9 (emphasis added).

54. Notwithstanding the explicit terms of the Claims Filing Agreement, the Second Amended Omnibus Claim was a proper amendment under traditional relation-back

principles. As a threshold matter, the court must determine whether the initial claim provided the Trustee with reasonable notice of the later amendment to the claim. See In re McLean Indus., 121 B.R. 704, 708 (Bankr. S.D.N.Y. 1990). Here, there was not one, but two, prior assertions by LBIE of its Omnibus Claim (the Original Omnibus Claim and the First Amended Omnibus Claim), which evidenced LBIE's intention to claim broadly on behalf of all of its customers and to supplement or amend the LBIE Omnibus Claim as soon as practicable as IT systems were restored and additional customer information became available.

55. A claim that "relates back" to an earlier filed claim will be deemed an amendment rather than a new claim, if it (i) corrects a defect of form in the original claim; (ii) describes the original claim with greater particularity; or (iii) pleads a new theory of recovery on the facts set forth in the original claim. See Integrated Res., Inc. v. Ameritrust Co. Nat'l Ass'n (In re Integrated Res., Inc.), 157 B.R. 66, 70 (S.D.N.Y. 1993). LBIE's Second Amended Omnibus Claim, including the $312 million posted by LBIE customers as security for their obligations under various swap agreements, serves to describe the original claim – which was a claim on behalf of all LBIE customers – with greater particularity and, therefore, relates back to the Original Omnibus Claim. The $3.87 billion claim for securities set out in the Second Amended Omnibus Claim also relates back to the Original Omnibus Claim for the same reason. In addition, and as the Trustee himself has admitted, both LBIE and the Trustee have faced significant challenges in reviewing and analyzing the huge volume of relevant data, and this process is still ongoing. That LBIE stated it was having difficulty ascertaining the source of the $3.87 billion claim does not mean that the claim should be disallowed outright as an improper

amendment.[18] Further, LBIE has agreed to reduce duplicative claims, and will do so with regard to this (or any) amount if redundancies arise. See Objection ¶18 n.21, 23, 25.

56. It is clear that the Trustee did not conduct adequate due diligence before denying allowance of the Second Amended Omnibus Claim in its entirety. As noted above, LBIE's prior claim filings put the Trustee on general notice that LBIE was asserting a broad claim on behalf of all of its customers. The Trustee was also given specific notice with respect to certain customers that were part of the Second Amended Omnibus Claim, as those customers were explicitly referenced in the earlier claims[19] or had filed direct objections on a timely basis. The Trustee, therefore, disallowed portions the Second Amended Omnibus Claim even though he was on notice of those claims and the amendment served to describe the previous claims with greater particularity.

57. An amendment to a claim is liberally granted once it is established that the amendment relates back to the timely filed claim, unless there is an overriding equitable concern. See McLean, 121 B.R. at 708. The Trustee does not assert that LBIE is acting in bad faith or that LBI will be unduly prejudiced by the Second Amended Omnibus Claim. There are, therefore, no overriding equitable concerns that would justify disallowance of the Second Amended Omnibus Claim. Rather, the Trustee should be equitably estopped from repudiating the Claims Filing

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[18] The Trustee had additional notice of the $3.87 billion claim from the various direct claims made by individual customers of LBIE for these securities, which the Trustee has disallowed, reasoning that they are duplicative of LBIE's Omnibus Claim.

[19] For instance, one of LBIE's customers was claimed for in the First Amended Omnibus Claim by account name and DTC depot number 0636, after the customer had attempted to bring suit against both LBIE and LBI for recovery of its collateral. The First Amended Omnibus Claim included a statement that LBIE believed that securities were being held in DTC account 0636 on behalf of its customers, that LBIE did not have access to the books and records relating to this account, and it had no visibility of its contents. Further, LBIE stated that it expected to work with the Trustee to identify and reconcile these securities, which is what in fact occurred over the subsequent months as the Trustee and LBIE continued to share information regarding the MTS collateral positions in DTC depot 0636. After these reconciliations, LBIE was able to claim for the MTS collateral with more specificity, including on behalf of the customer that was previously identified in the First Amended Omnibus Claim.

Agreement. Objection ¶ 51. As LBIE has explained, it relied upon the express provisions clearly allowing for "amendments and supplements" to the original, necessarily estimated, claim. The Trustee should not be able to benefit by ignoring the contract now and thereby harm LBIE's customers and rightful claimants by refusing to return assets to which they are entitled.

CONCLUSION

For the foregoing reasons, LBIE respectfully submits that the Letter of Determination be overturned, and the Trustee ordered to properly reflect the entitlements of LBIE's customers in a revised determination, as set forth herein.[20]

[20] In addition, LBIE hereby incorporates by reference its Reservation of Rights as set forth in paragraph 57 of its Objection, including its rights with respect to its claim for CNS securities. See Objection ¶ 41.

Dated: New York, New York
February 24, 2012

Respectfully submitted,

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