

IN THE HIGH COURT OF JUSTICE

No. 7942 of 2008

CHANCERY DIVISION

COMPANIES COURT

**Before the Honourable Mr Justice Briggs
Tuesday the 15th day of December 2009**

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN:

LEHMAN BROTHERS INTERNATIONAL (EUROPE) (in administration)

- and -

- 1. CRC CREDIT FUND LIMITED**
- 2. CLAREN ROAD CREDIT MASTER FUND LIMITED**
- 3. LEHMAN BROTHERS INC.**
- 4. LEHMAN BROTHERS FINANCE AG**
- 5. GLG INVESTMENTS PLC: SUB-FUND GLG EUROPEAN EQUITY FUND**
- 6. GOLDMAN SACHS GSIP MASTER COMPANY (IRELAND) LIMITED**
- 7. PARAGON CAPITAL MANAGEMENT FUND LIMITED**
- 8. HONG LEONG BANK BERHAD**
- 9. LEHMAN BROTHERS HOLDINGS INC.**



ORDER

UPON THE HEARING OF THE APPLICATION of Anthony Victor Lomas, Steven Anthony Pearson, Michael John Andrew Jervis and Dan Yoram Schwarzmann of PricewaterhouseCoopers LLP, Plumtree Court, London EC4A 4HT (the “Administrators”), the Administrators of Lehman Brothers International (Europe) (in administration) (“LBIE”) by Ordinary Application dated 1 May 2009 (the “Application”) made pursuant to paragraph 63 of Schedule B1 to the Insolvency Act 1986 and heard between 9 and 24 November 2009

AND UPON HEARING Counsel for the Administrators, CRC and Claren Road, LBI, LBF, GLG, Paragon, GSIP, HLBB, LBHI and the FSA

AND UPON READING the SAF and the witness statements made by Andrew Peter Clark on 14 May 2009, 17 September 2009 and 28 October 2009

AND UPON THE APPLICATION OF LBHI for an order as to its costs of and occasioned by the Application

AND UPON THE APPLICATIONS OF EACH OF CRC, LBI, LBF, GSIP, Paragon and LBHI for permission to appeal

AND UPON THE APPLICATIONS OF EACH OF CRC, GSIP and Paragon for a pre-emptive costs order in respect of the costs of and occasioned by an appeal

IT IS ORDERED that:

1. For the purposes of this Order, the following defined terms shall bear the following meanings:

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| Administrators | Steven Anthony Pearson, Anthony Victor Lomas, Michael John Andrew Jarvis and Dan Yoram Schwarzmann, each of PricewaterhouseCoopers LLP; appointed by the order of Mr Justice Henderson |
| Affiliates | Members (other than LBIE) of the Lehman Group immediately prior to the PPE |
| Annex 1 | To CASS Chapter 7 |
| Bankhaus | Lehman Brothers Bankhaus AG |
| Claren Road | Claren Road Credit Master Fund Ltd |
| Client money claimants or "CM claimants" | Clients of LBIE who are entitled to share in a distribution from the CMP |
| CASS | Client Assets sourcebook of the FSA |
| Chilton | Chilton New Era Partners LP |
| CMP | The notional pool of client money constituted, by CASS 7.9.6R, on the occurrence of a primary pooling event |
| CRC | CRC Credit Fund, Limited (formerly known as CRC Global Structured Fund, Ltd) |

| | |
|-----------------------------------|--|
| Depot Break | A shortfall (or perceived shortfall) in particular securities which LBIE should have been holding for a client or clients. |
| FSA | Financial Services Authority |
| Further Issues, the | Those issues on which the court will hear further (written) submissions, set out in paragraph 11 below. |
| GLG | GLG Investments plc: sub-fund GLG European Equity Fund |
| GSIP | Goldman Sachs GSIP Master Company (Ireland) Ltd |
| HLBB | Hong Leong Bank Berhad |
| Issues, the | The Issues considered on the Application, which are set out, together with the answers supplied by the Court, in the Schedule to this order |
| Judgment | The judgment of Mr Justice Briggs handed down on 15 December 2009 |
| LBF | Lehman Brothers Finance AG |
| LBHI | Lehman Brothers Holdings Inc. |
| LBI | Lehman Brothers Inc. |
| LBIE | Lehman Brothers International (Europe) (in administration) |
| Lehman Group | The global investment banking group of which the ultimate parent company was LBHI |
| MiFID business | Investment services and activities carried on by a firm to which the Markets in Financial Instruments Directive (2004/39/EC) applies |
| Paragon | Paragon Capital Management Fund Limited |
| Point of Last Segregation, or PLS | Close of business on 11 September 2008, being the time at which the figures used in the last reconciliation and segregation exercise in respect of client money carried out by LBIE prior to the appointment of the Administrators were taken. |
| Primary Pooling Event or PPE | 7.56am on 15.09.08 |
| Representative Respondents | Collectively, CRC, Claren Road, GLG, GSIP, Paragon and HLBB |
| SAF | Statement of Assumed Facts |
| Time of Appointment | 7.56am on 15.09.08 |

AND IT IS DIRECTED AND DECLARED that:

2. The directions of the Court on the detailed questions raised by the Application are set out in the Schedule to this Order.
3. The statutory trust created by CASS 7 takes effect upon the receipt, rather than only upon the segregation, of client money.
4. Pending segregation of client money, a firm is obliged to take reasonable steps to ensure that, in relation to client money mixed in house accounts with the firm's own money, clients' rights in relation to that client money are not put at risk, or the client money used for the firm's own purposes.
5. The CMP which arises on the happening of a PPE consists only of client money in the firm's segregated client accounts. Client money in other accounts of the firm may nonetheless be identified by the application of the established principles of tracing.
6. CASS7 makes no provision for the pooling or distribution of identifiable client money (if any) in the firm's non-segregated accounts, outside the CMP. The general law permits clients to pursue proprietary claims in relation to any such identifiable client money, in accordance with the established principles of tracing.
7. Neither the CASS rules nor the general law require or permit a shortfall in the CMP as at the time of the PPE to be topped up, either from identifiable client money outside the CMP, or from the general assets of an insolvent firm, such as LBIE, in administration or liquidation.
8. The basis for a client's right to share in the CMP (the client money entitlement) is by reference to the amount of client money which was in fact segregated by the firm for each client, not the amount (if different) which should have been segregated for each client. Certain adjustments are to be made to the client money entitlements thus identified, mainly to ensure that a client money entitlement does not get paid or satisfied twice over.
9. The clients' respective client money entitlements are to be calculated as at the date of the PPE, not the date of distribution.
10. The firm's claims against clients cannot be set-off against clients' entitlements to share in the CMP, nor used as the basis for a retainer by the firm. This is without prejudice to any security which the firm may have over clients' entitlements.

AND IT IS ORDERED THAT:

Further submissions

11. The Court shall consider written submissions on the Further Issues, being:

a. Depot breaks

Where LBIE had, at the PPE, segregated client money in its segregated client money accounts in respect of a Depot Break or Depot Breaks on a stock line basis and it is possible to identify from LBIE's books and records (and/or from information provided by the relevant client(s)) client(s) whom LBIE intended to protect by segregating that client money, is the client money entitlement of those clients calculated by reference to an appropriate portion of the amount segregated, even though LBIE had not at the time of segregation specifically identified the particular clients for whom that client money was held?

If so, is the relevant client's client money entitlement reduced or extinguished upon the securities in question (or part thereof) being delivered to the client?

b. Unapplied credits

Do clients for whom client money was paid to LBIE (whether by the clients themselves or by a third party on their behalf):

(i) in the three business days ending at the PLS, which client money was not specifically segregated by LBIE, have client money entitlements to the extent that LBIE is able to allocate to those clients an appropriate portion of the amount which LBIE had segregated as at the PPE by way of buffer in respect of unapplied credits?

(ii) more than three business days prior to the PLS, which client money was segregated by LBIE as an unapplied credit, have client money entitlements to the extent that LBIE is able now to identify the clients to whom those credits relate?

12. Each party wishing to file written submissions on any of the Further Issues do file and serve such submissions by 4.30pm on 21 December 2009.

Service of this Order

13. By 4.30pm on 13 January 2010 the Administrators do make a copy of this Order available on the Lehman section of the PricewaterhouseCoopers LLP website (http://www.pwc.co.uk/eng/issues/lehman_updates.html).

Costs

14. The Administrators' costs, fees and expenses of and occasioned by the Application are to be paid:-
- a. as to 50% from the CMP in priority to the claims of the CM Claimants; and
 - b. as to 50% as an expense of the administration.
15. The costs of each of CRC, Claren Road and Chilton of and occasioned by the Application (as agreed or assessed on the indemnity basis) are to be paid:-
- a. as to 25% from the CMP in priority to the claims of the CM Claimants; and
 - b. as to 75% as an expense of the administration.
16. The costs of each of GLG and HLBB of and occasioned by the Application (as agreed or assessed on the indemnity basis) are to be paid:-
- a. as to 50% from the CMP in priority to the claims of the CM Claimants; and
 - b. as to 50% as an expense of the administration.
17. The costs of each of GSIP and Paragon of and occasioned by the Application (as agreed or assessed on the indemnity basis) are to be paid from the CMP in priority to the claims of the CM Claimants.
18. The costs of and occasioned by the Application shall include the costs of assessment, subject to the power of the Costs Judge to exclude such costs of assessment as he considers to have been unreasonably incurred.
19. LBHI's application for costs is hereby refused.
20. There be no order as to the costs incurred by LBI, LBF and LBHI.

Permission to appeal

21. Each of CRC, LBI, LBF, GSIP, Paragon and LBHI have permission to appeal in respect of paragraphs 3 to 9 above on condition that any person wishing to pursue an appeal pursues it expeditiously.
22. The period for filing an Appellant's Notice under CPR Part 52.4 shall be deemed to commence on the date of this order and the time for filing of Appellants' Notices (without skeleton arguments) shall be extended to 15 January 2010.
23. In the event that the Administrators consider it appropriate to respond to one or more appeals, including in a neutral capacity, the Administrators' costs of and occasioned in so responding shall be paid:-
 - a. as an expense of the administration of LBIE; or
 - b. from the CMP in priority to the claims of CM Claimants; or
 - c. in part as an expense of the administration and in part from the CMP;in such proportions as shall be ordered by the Court of Appeal.
24. In the event that the Administrators consider it appropriate that HLBB or GLG appear as a representative respondent to respond to one or more of the appeals, the costs of each entity so appearing (subject to detailed assessment on the indemnity basis if not agreed) of and occasioned by so acting shall be paid:-
 - a. as an expense of the administration of LBIE; or
 - b. from the CMP in priority to the claims of CM Claimants; or
 - c. in part as an expense of the administration and in part from the CMP;in such proportions as shall be ordered by the Court of Appeal.
25. The applications of each of CRC, GSIP and Paragon for a pre-emptive costs order in respect of the costs of and occasioned by an appeal are hereby refused, without prejudice to the right of the applicant in each case to apply to the Court of Appeal if it becomes apparent that the applicant would not wish to pursue the appeal without such a pre-emptive costs order.

Permission to apply

26. The Administrators have permission to apply, on 3 days' notice to the parties and to the FSA.

ScheduleConstitution of the CMPWhich accounts?Question

1. Does the term 'client bank account' include:
 - (a) the core bank accounts in relation to which LBIE operated its client segregation system;
 - (b) those bank accounts and money market deposits which were identified by LBIE's designation of the account as a client cash segregated account or alternatively were designated in LBIE's books and records as such and:
 - (i) in relation to which LBIE complied with CASS 7.8.1R;
 - (ii) in relation to which LBIE did not comply with CASS 7.8.1R;
 - (c) a bank account other than an account falling within the description in (a) or (b) above which included only client money (whether or not LBIE appreciated this);
 - (d) a bank account other than an account falling within the description in (a), (b) or (c) above which contains identifiable client money, and if so, to the extent of that identifiable client money, or to some other extent;
 - (e) any other bank account, and if so, which account(s), and to what extent?

Answer

The term 'client bank account' includes the core bank accounts in subparagraph (a), but no other accounts. It does not therefore include the accounts identified in subparagraphs (b) to (e).

Question

2. Do the answers to question 1 above change where the accounts in question are held not in LBIE's name but in the name of a nominee of LBIE?

Answer

The answers to question 1 above do not change in those circumstances.

Question

3. Does the term 'client transaction account' include:
 - (a) those accounts maintained by LBIE with an exchange, clearing house or intermediate broker, as the case may be, in respect of transactions in contingent liability investments undertaken by LBIE solely with or for its clients;
 - (aa) transaction accounts of clients maintained in LBIE's books, not being accounts maintained by LBIE with an exchange, clearing house or intermediate broker;
 - (b) any other account, and if so, which account(s)?

Answer

The term 'client transaction account' includes those identified in question 3(a) but not those identified in question 3(aa) or any other account. For the purposes of the accounts referred to in question 3(a) it matters not whether the transactions in respect of which LBIE maintained those accounts were entered into by LBIE expressly as agent for the clients concerned, or on a principal to principal basis for the purpose of entering into a position for the client at the client's request.

Question

4. Does the reference to 'client money accounts' in CASS 7.9.6R(1) include:
 - (a) the client bank accounts that LBIE maintained as at the Time of Appointment;
 - (b) the client transaction accounts that LBIE maintained at the Time of Appointment;
 - (c) any other account, and, if so, which account or accounts, and to what extent?

Answer

The reference to client money accounts in CASS7.9.6R(1) includes the client bank accounts referred to in question 4(a) and the client transaction accounts referred to in question 4(b), but not any other accounts.

Question

- 4A. When LBIE was obliged to segregate money in respect of a debt due from LBIE to a client but failed to do so, does the client, without more, have a proprietary interest in a sum in the amount of the debt?

Answer

The client does not have a proprietary claim, in the absence of any relevant receipt of client money from, on behalf of or for that client, merely because LBIE was obliged, but failed, to segregate a sum of money from its own resources in respect of a debt due to that client.

Question

- 4B. When LBIE opens a back to back position on a principal to principal basis with a third party, and funds its margin obligation to the third party with money which had been paid to LBIE by its clients as margin for their positions with LBIE (and assuming that LBIE has not already reimbursed the client or otherwise segregated client money for the client in respect of such transaction):
- (a) is the corresponding balance on a transaction account held at that third party in connection with that back to back position held on trust by LBIE for the client?
 - (b) is a payment received by LBIE from the third party from a transaction account held at the third party in connection with that back to back position held on trust by LBIE for the client?

Answer

The balances and payments received referred to in subparagraphs (a) and (b) are both held on trust by LBIE for the client.

Question

5. If there are accounts containing client money which is not pooled pursuant to CASS 7.9.6R, is LBIE obliged to transfer any such identifiable client money held by it at the Time of Appointment to the client for whom it was held pursuant to CASS 7.7.2R(2) (subject to an appropriate deduction for costs in accordance with CASS 7.7.2R(4))?

Answer

The statutory trust created by CASS7.7.2R (including subparagraph (2)) does apply to identifiable client money held by LBIE at the Time of Appointment otherwise than in the segregated accounts which constitute the CMP. Accordingly, LBIE is obliged upon request to transfer such client money as is identifiable in non-pooled accounts to the client or clients entitled to it, even though the distribution rules in CASS7.9.6 and following do not apply to it.

Question

- 5A. Is the success of any proprietary claim founded on conventional equitable principles dependent upon (inter alia) the claimant establishing:
- (a) the existence of a prior beneficial interest in money or property;
 - (b) the money (or some part of it in the case of its payment into a mixed fund) or property in question or any substitute property being acquired with the same still being identifiable?

Answer

The claimant to any proprietary interest in client money in a non-pooled account must, by reference to conventional equitable principles, establish both the existence of a prior beneficial interest in money or property, and that the money or property in question, or any substitute property acquired with the same, is still identifiable.

Question

- 5B. In connection with Issue 5A, is the burden on the client to prove:

- (a) in which money or property the client has a beneficial interest; or
- (b) to which money or property an equitable charge attaches?

Answer

In both the respects contemplated by subparagraphs (a) and (b), the burden of proof is on the clients. That is however no reason why the Administrators should not cooperate with clients in connection with their reasonable endeavours to discharge that burden.

Question

- 5C. In connection with Issue 5A, is it sufficient for the purposes of establishing a prior beneficial interest for the client to establish that LBIE was obliged to segregate money in respect of a debt due to that client but had failed to do so?

Answer

A failure by LBIE to appropriate property of its own in satisfaction of a client money obligation is not by itself sufficient for the purposes of establishing a prior beneficial interest.

Question

- 6. Is money which was due to LBIE or which LBIE would have been entitled to withdraw from the CMP at the Time of Appointment and which would, in the ordinary course, have been swept into LBIE's house accounts during a daily reconciliation in due course, had the administration not intervened, notionally pooled pursuant to CASS 7.9.6R or should it be excluded from the notional pooling?

Answer

Money of the type referred to in this question is notionally pooled pursuant to CASS7.9.6R.

Adjustment of the CMP

Adjustments in respect of events occurring prior to the Time of Appointment

Question

8. Is LBIE required to adjust the CMP (whether by way of segregating funds standing to the credit of LBIE's general accounts or by transferring sums from the CMP to LBIE's general accounts) to take account of:-
- (a) movements in the notional value of margined transactions between the close of business on 11 September 2008 (by reference to which LBIE conducted its final daily reconciliation exercise prior to the Time of Appointment) and the Time of Appointment; and/or
 - (b) a client's equity balance as at the Time of Appointment, in circumstances where LBIE had previously wrongly not segregated any client money for the client?

Answer

LBIE is not required (or entitled) to adjust the CMP to take account of any of the matters referred to in this question.

Question

9. Save as required by the answer to question 8 above, is LBIE not now required to adjust the CMP (whether by way of segregating funds standing to the credit of LBIE's general accounts or by transferring sums from the CMP to LBIE's general accounts) to take account of events between the close of business on 11 September 2008 (by reference to which LBIE conducted its final daily reconciliation exercise prior to the Time of Appointment) and the Time of Appointment which, in the ordinary course absent administration, would have led to an adjustment by LBIE of the amount of money segregated by it as client money?

Answer

LBIE is neither required nor entitled to adjust the CMP by reference to any of the matters referred to in this question.

Question

10. Save as required by the answers to questions 8 and/or 9 above, is LBIE not now required to adjust the CMP to take account of any money which, prior to administration, LBIE should already have segregated as client money but had not?

Answer

LBIE is not now required to adjust the CMP to take account of any prior failure to segregate.

Question

- 10A. In relation to any payments which LBIE is required to make into the CMP pursuant to the answers to questions 8 and/or 9 and/or 10 above:
- (a) is the payment payable as an expense of LBIE's administration within the meaning of Rule 2.67(1)(a) or Rule 2.67(1)(f) of the Insolvency Rules 1986 and, if so, which Rule;
 - (b) is any payment LBIE is obliged to make:
 - (i) subject to CASS 7.9.6R(1);
 - (ii) to be paid to the client for whom the money should have been held pursuant to CASS (subject to an appropriate deduction for costs in accordance with CASS 7.7.2R(4))?

Answer

In the light of the answers to questions 8, 9, and 10 above, this question does not arise.

Question

7. If the answer to question 6 or 8 or 9 above is that such money should be excluded from the notional pooling or removed from the CMP:-
- (a) is the amount which may be withdrawn from the client money accounts on account of such sums:
 - (i) the full amount of the money;
 - (ii) the traceable amount (if any) of such money; or
 - (iii) a pro-rata proportion (taking into account any shortfall in the CMP), and, if so, of the entire amount, of the traceable amount, or of some other amount; or
 - (iv) some other amount and, if so, what amount; and
 - (b) is LBIE obliged or permitted to transfer the sum or sums established by the answers to question 7 above from the client money account in which it is at present held to a general account of LBIE (such that such sums become available to the general estate)?

Answer

In the light of the answers to questions 6, 8 and 9, this question does not arise either.

*Adjustments in respect of events since the Time of Appointment*Question

11. Is LBIE not now required to adjust the CMP or to segregate further funds to take account of any events (including fluctuations in rates of exchange between the currency in which client money is held and the currency of receipt (or LBIE's liability, if different)) occurring since the Time of Appointment which, absent administration, would otherwise have led to an adjustment by LBIE of the client money segregated by it?

Answer

LBIE is not required or entitled to make any adjustment to the CMP by reason of events occurring since the Time of Appointment even though, but for the PPE, it might have done so in the ordinary course of business.

Question

12. In relation to any payments which LBIE is required to make into the CMP pursuant to the answers to question 11 above:
- (a) is the payment payable as an expense of LBIE's administration within the meaning of Rule 2.67(1)(a) or Rule 2.67(1)(f) of the Insolvency Rules 1986 and, if so, which Rule;
 - (b) is any payment LBIE is obliged to make:
 - (i) subject to CASS 7.9.6R(1);
 - (ii) to be paid to the client for whom the money should have been held pursuant to CASS (subject to an appropriate deduction for costs in accordance with CASS 7.7.2R(4))?

Answer

The answer to question 11 means that the matters raised in question 12 do not arise.

Question

- 12A. If the answer to question 11 above is that money should be transferred from the CMP:
- (a) is the amount which may be withdrawn from the client money accounts on account of such sums:
 - (i) the full amount of the money;
 - (ii) the traceable amount (if any) of such money; or
 - (iii) a pro-rata proportion (taking into account any shortfall in the CMP), and, if so, of the entire amount, of the traceable amount, or of some other amount; or
 - (b) some other amount and, if so, what amount; and
 - (c) is LBIE obliged or permitted to transfer the sum or sums established by the answers to question 11 above from the client money account in which it is at present held to a general account of LBIE (such that such sums become available to the general estate)?

Answer

In the light of the answer to question 11, the matters raised by this question do not arise.

Primary and secondary poolingQuestion

- 11A. Is the firm obliged ahead of the unsecured creditors to make good the shortfall arising from what would, but for CASS 7.9.13R, have been a secondary pooling event within CASS 7.9.14R (“the secondary pooling event”), and does that, in turn, depend on:-
- (a) whether the secondary pooling event occurred before or after the primary pooling event; or
 - (b) whether the firm had failed to exercise due diligence in connection with the transfer of client money held by the firm to a third party pursuant to CASS 7.4.1R(1) to CASS 7.4.1R(2) or CASS 7.5.2R?

Answer

In the present case, the secondary pooling event occurred after the PPE constituted by LBIE’s going into Administration. On those facts, the firm is not obliged, in derogation of the

rights of its unsecured creditors under the insolvency code triggered by the Administration Order, to make good any shortfall arising in the CMP by reason of the secondary pooling event constituted by the Bankhaus failure.

Question

- 11B. Second, if the firm is not obliged to make good the shortfall ahead of unsecured creditors, do the clients affected by the shortfall have personal claims against the firm for the shortfall, or does that depend on whether the firm had failed to exercise due diligence in connection with the transfer of client money held by the firm to a third party pursuant to CASS 7.4.1R(1) to CASS 7.4.1R(2) or CASS 7.5.2R?

Answer

The personal claims against the firm in respect of damage caused to clients arising out of the failure of a bank at which the firm had deposited client money will depend upon the terms of the clients' contracts with the firm and upon the question whether the clients can establish any relevant breach of statutory duty by the firm, including its duties in connection with the choice and monitoring of client account banks, to the extent that a breach of those duties constituted a cause of the clients' loss.

Existence and scope of client money entitlement

Question

15. Does a client for whom LBIE should have held client money on a segregated basis have a client money entitlement in relation to:-
- (a) a position or instrument in respect of which there is client money in the CMP as constituted according to the directions given by the Court on this Application;
 - (b) a position or instrument in respect of which there is no client money in the CMP as constituted according to the directions given by the Court on this Application and in relation to which LBIE has at no time held client money on a segregated basis;
 - (c) a position or instrument in respect of which there is no client money in the CMP as constituted according to the directions given in relation to Issues 1 to

4 above but in relation to which LBIE at one time held client money on a segregated basis.

Answer

A client for whom LBIE should have held client money on a segregated basis has a client money entitlement in relation to the positions or instruments identified in subparagraph (a), but not in relation to the positions or instruments identified in subparagraphs (b) or (c).

Question

16. Does a client for whom LBIE was neither required nor had agreed to hold client money on a segregated basis but for whom LBIE had segregated money in its client money accounts at the Time of Appointment have a client money entitlement in relation to:-
- (a) a position or instrument in respect of which there is money in the CMP as constituted according to the directions given by the Court on this Application;
 - (b) a position or instrument in respect of which there is no money in the CMP as constituted according to the directions given by the Court on this Application and in relation to which LBIE has at no time held client money on a segregated basis;
 - (c) a position or instrument in respect of which there is no money in the CMP as constituted according to the directions given in relation to Issues 1 to 4 above but in relation to which LBIE at one time held client money on a segregated basis.

Answer

A client for whom, without obligation or agreement, LBIE had segregated money in its client money accounts by the Time of Appointment has a client money entitlement in relation to positions or instruments referred to in subparagraph (a), but not in relation to positions or instruments referred to in subparagraphs (b) and (c).

Question

- 16A. If the client for whom the money was segregated does not have a client money entitlement in respect of it, what is the client's right?
- (a) Is the money held on trust for him outside the CMP or is the money part of the CMP?

- (b) If money is held on trust for him outside of the CMP, is the client entitled to payment in the full amount of the money segregated for him?
- (c) If the money forms part of the CMP, does the client have a proprietary interest in, and is he entitled to receive a distribution from, the CMP and, if so, how should the Administrators give effect to that interest? In particular, does the client share in the shortfall on the CMP? Or does the client have no more than a personal claim in debt?

Answer

In the light of the answer to question 16, this issue does not arise.

Question

- 20. Does a client for whom LBIE should have held client money on a segregated basis but did not in respect of that client's proprietary positions, but for whose underlying clients LBIE did hold client money on a segregated basis, have a client money entitlement in respect of its proprietary positions?

Answer

A client of the kind contemplated by question 20 does not have a client money entitlement in respect of its own proprietary positions, merely because LBIE held client money on a segregated basis for one or more of that client's underlying clients.

Calculation of client money entitlements

Question

- 21. Is LBIE obliged to calculate client money entitlements as at the Time of Appointment, and, if not, at what time should client money entitlements be calculated?

Answer

LBIE is obliged to calculate client money entitlements (that is entitlements to share in the CMP) as at the Time of Appointment.

Question

22. Is LBIE permitted to calculate client money entitlements (and consequently the rateable share to which each client entitled to a distribution from the CMP is entitled) in a common currency of its choice, by applying a spot exchange rate as at close of business on the date of administration or alternatively at the Time of Appointment?

Answer

The Administrators must calculate client money entitlements (in terms of shares in the CMP) in a common currency. The Administrators are in principle entitled to identify an appropriate common currency, subject to any direction by the court that a particular chosen currency is inappropriate. They should convert all different currencies of entitlement to the common currency at the spot rate prevailing as at the Time of Appointment. If necessary, where no published spot rate is available as at that moment, they must do so by interpolation from the most appropriate proximate spot rates.

Question

23. Is the client money entitlement of a client entitled to a distribution from the CMP calculated by reference to or affected by the amount in fact contained in the notional CMP in respect of him at the Time of Appointment and/or subsequently transferred to the CMP as required by the answers to the questions above? If so, what is the client money entitlement of a client in respect of whom there is no client money contained in the notional CMP at the Time of Appointment or subsequently transferred to the CMP as required by the answers to the questions above?

Answer

The client money entitlement of a client to share in the CMP needs to be calculated by reference to the amount in fact contained in the CMP in respect of him as at the Time of Appointment. That amount will generally be apparent from LBIE's last internal client money reconciliation carried out as at the PLS. Subject to one exception, a client for whom no money was shown in that reconciliation as contained in the segregated accounts, and therefore in the notional CMP as at the Time of Appointment, has no client money entitlement.

The exception consists of clients with open positions for whom, although no credit in a client transaction account was attributable as at the PLS, acquired a credit by virtue of an increase in the value of their open positions by the time of the PPE, with a consequential automatic adjustment of the relevant client transaction account.

Question

- 23A. How is each client's client money entitlement (as referred to in CASS 7.9.6R) to be calculated? In particular, is it to be calculated, for each client, as:-
- (a) the aggregate of (i) in the case of the core bank accounts, the amount which represented the funds in fact segregated for or on behalf of that client immediately following the Point of Last Segregation; and (ii) in the case of any other client money account (as determined in accordance with Q1-4 above), the amount which represented the funds standing to the credit, or paid into, the account on behalf of that client as at the Time of Appointment, in each case including any adjustment to the CMP as required by the answer to the questions above; or
 - (b) the amount which would have been segregated (or otherwise held in a client bank account determined in accordance with Q1-4 above) for or on behalf of that client if a calculation of the amount which LBIE was required to hold as client money for or on behalf of that client had taken place as at the Time of Appointment; or
 - (c) the amount which would or ought to have been segregated for that client if a calculation of the amount which LBIE was required to hold as client money for that client had taken place as at the Time of Appointment as though all such client's open positions at that time had been liquidated and closed at the closing or settlement prices published by the relevant exchange or other appropriate pricing source at the Time of Appointment; or
 - (d) on some other, and if so what, basis?

Answer

Each client's money entitlement (as referred to in CASS 7.9.6R) is to be calculated on the contributions basis set out in paragraphs 227 to 275 of the Judgment.

In particular, it is to be calculated in accordance with the method proposed in subparagraph (a) of this question, in relation to the core bank accounts but, in the light of the answer to question 1, there are no other relevant client bank accounts. The calculation will also take

into account attributable credits in the client transaction accounts. No adjustments to the CMP are required or permitted. Clients will be required to give credit for receipts in respect of client money entitlements from the firm's house accounts between the PLS and the PPE, and in respect of certain other post PLS events, such as pre PLS fails which have since then been resolved. There may have to be a downward adjustment pursuant to CASS7.9.7R: see question 23B below.

Question

- 23B. How, if at all, do the provisions of CASS 7.9.7R affect the calculation of client money entitlement in accordance with CASS 7.9.6R?

Answer

The provisions of CASS7.9.7R affect the calculation of client money entitlement by way of a reducing mechanism as described in paragraphs 255 to 262 of the Judgment. In short, CASS7.9.7R requires the client money entitlements for sharing in the CMP to be recalculated downwards if, but only if, LBIE did not avail itself prior to the PPE of the Reduced client money requirement option conferred by paragraphs 18 and 19 of Annex 1. If by contrast LBIE did avail itself of the Reduced client money requirement option, then no adjustment pursuant to CASS7.9.7R will be necessary.

Question

- 23C. (a) What is the individual client balance to which CASS 7.9.7R refers?
- (i) Is it the individual client balance defined at paragraph 6(1)(a) of Annex 1?
 - (ii) If not, what is it?
- (b) If it is the individual client balance defined at paragraph 6(1)(a) of Annex 1, is it subject to paragraph 12(2)? If so, is the debt to which paragraph 12(2) refers any debt or is it confined to debts arising in the course of MiFID business?

- (c) If such a debt is not to be taken into account in the calculation of individual client balance should the debt nevertheless be taken into account by way of set-off or retention (see Issues 23D to F below)?

Answer

- (a) The individual client balance is that defined at paragraph 6(1)(a) of Annex 1.
- (b) It is not subject to paragraph 12(2) of Annex 1.
- (c) The debt to which paragraph 12(2) refers should not be set-off against the client's client money entitlement against the CMP, nor should an amount equivalent to that debt be retained by LBIE.

Question

- 23D. To what extent, and at whose behest, can a debt owed by a client with a client money entitlement to LBIE be set-off against that client's claim against the CMP or an amount equivalent to that debt be retained by LBIE?

Answer

There can be no set-off or retainer in relation to claims by clients to a share in the CMP in respect of debts owed by the client to LBIE.

Question

- 23E. Does the set-off or retention operate between the debt and:-
- (a) the client's total claim against LBIE;
 - (b) the client's client money entitlement;
 - (c) the amount of the client's distribution from the CMP;
 - (d) some other sum, and, if so, what?
- 23F. Should the sum so set-off or retained:-
- (a) be distributed amongst those clients with a client money entitlement;

- (b) accrue to the benefit of the General Estate; or
- (c) be held by LBIE and not distributed by the Administrators pending the application of IR 2.85, IR 4.90 or further order of the Court?

Answer

In the light of the answer to question 23D, these two questions do not arise.

Question

- 13. Should LBIE recalculate a client's client money entitlement by reference to, or take into account in calculating the amount to be distributed to a particular client, events occurring since the Time of Appointment which, absent administration, would otherwise have led to an adjustment by LBIE of the client money segregated by it?

Answer

In the general terms in which this question is asked, the answer is no. Nonetheless, specific adjustments are required in relations to fails and may be required in relation to depot breaks.

Question

- 14. If the answer to question 13 above is "no":
 - (a) Is a client money entitlement defeasible by reason of events occurring since the Time of Appointment?
 - (b) Can delivery of a security discharge the obligation on LBIE to pay (in whole or in part) a distribution from the CMP?

Answer

(a) A client money entitlement may be (*pro tanto*) defeasible by reason of the resolution since the Time of Appointment of fails for which a specific amount had previously been segregated for the relevant client. Apart from that, no client money entitlement is defeasible by reason of events occurring since the Time of Appointment.

- (b) Delivery of a security by way of resolution of a fail may therefore discharge the obligation on LBIE (or other trustee of the CMP) to pay a distribution from the CMP, to the extent of the amount previously segregated in respect of that fail.

Distribution of client money

Question

24. Is LBIE obliged or permitted to make a distribution from the CMP to those clients entitled to receive one in the currency of its choice and, if not, in what currency or currencies should distribution be made?
25. If LBIE is obliged or permitted to make a distribution from the CMP to those clients entitled to receive one in the currency of its choice, is LBIE obliged or permitted to calculate the amount to be paid to each such client as follows:
- (a) by applying his rateable share of the CMP as established in accordance with the procedure proposed in question 22 above to the value of the CMP as at the date of distribution;
 - (b) by establishing the value of the CMP as at the date of distribution by reference to a spot exchange rate on that day.

Answer

LBIE is entitled in its discretion to make distributions from the CMP in any appropriate currency, provided that it thereby distributes each client's share in an amount referable to the common currency referred to in question 22 above, converted to the currency of distribution (if different from the common currency) at the rate prevailing at the time of distribution. In so doing, LBIE will apply the rateable share of the CMP as established in accordance with the procedure proposed in question 22 above to the value of the CMP as at the date of distribution.

Question

- 25A. Where a client money entitlement is referable to an underlying obligation of LBIE (for example where, at the Time of Appointment, LBIE owed money to

the client (“the Debt”) but had segregated a sum equal to the amount of the Debt, does the client’s distribution from the CMP discharge the Debt:

- (a) to the full extent of the client entitlement referable to the Debt;
- (b) to the extent of the distribution made in respect of such entitlement;
- (c) not at all; or
- (d) to some other and, if so, what extent?

Answer

The answer to this question depends upon the precise terms of the contracts between LBIE and its clients pursuant to which the Debt (as defined) was created. None of those contracts have been examined in the course of this application.

Subject to that, and in the absence of any contractual provision to the contrary, the starting point should be that a client’s personal claim in debt against LBIE would be abated only to the extent of the amount actually distributed to that client from the CMP in respect of the debt in question.

Affiliates

Question

- 26. Is LBIE obliged under CASS7 to treat money held for an affiliated company as money held in the course of or in connection with its MiFID business?
- 26A. Does it make any, and if so what, difference if the affiliated company has a contractual entitlement that money held for it will be held as client monies?

Answer

It is agreed that question 26 should be answered in the affirmative, so that question 26A does not arise.

The answer to question 26 is without prejudice to any contractual provision between LBIE and a relevant affiliate to the contrary, or to the consequences of any aspect of the course of

their mutual dealings which might adversely affect the affiliate's right to insist upon the performance of that obligation.

IN THE HIGH COURT OF JUSTICE

No. 7942 of 2008

CHANCERY DIVISION

COMPANIES COURT

Before the Honourable Mr Justice Briggs
Tuesday the 15th day of December 2009

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

BETWEEN:

LEHMAN BROTHERS INTERNATIONAL (EUROPE) (in administration)

- and -

- 1. CRC CREDIT FUND LIMITED**
- 2. CLAREN ROAD CREDIT MASTER FUND LIMITED**
- 3. LEHMAN BROTHERS INC.**
- 4. LEHMAN BROTHERS FINANCE AG**
- 5. GLG INVESTMENTS PLC: SUB-FUND GLG EUROPEAN EQUITY FUND**
- 6. GOLDMAN SACHS GSIP MASTER COMPANY (IRELAND) LIMITED**
- 7. PARAGON CAPITAL MANAGEMENT FUND LIMITED**
- 8. HONG LEONG BANK BERHAD**
- 9. LEHMAN BROTHERS HOLDINGS INC.**

ORDER

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