

Applicant  
David Philip Ereira  
Second Statement  
"DPE2"  
14 July 2009

**IN THE HIGH COURT OF JUSTICE**

**No. 7942 of 2008 and**

**CHANCERY DIVISION**

**Claim No: 16389/09**

**COMPANIES COURT**

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

**AND IN THE MATTER OF THE INSOLVENCY ACT 1986**

**AND IN THE MATTER OF THE COMPANIES ACT 2006**

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**WITNESS STATEMENT OF  
DAVID PHILIP EREIRA**

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I, DAVID PHILIP EREIRA, of Linklaters LLP, One Silk Street, London EC2Y 8HQ, state as follows.

**A. INTRODUCTION**

**1** I am a solicitor and a partner in Linklaters LLP ("**Linklaters**"), a law firm at the above address. Linklaters acts for the joint Administrators of Lehman Brothers International (Europe) ("**LBIE**") (in administration) (the "**Administrators**"). I have been working with the Administrators since the commencement of LBIE's administration on 15 September 2008. I am duly authorised to make this witness statement on behalf of LBIE and the Administrators. I make this witness statement in support of the Administrators' Application pursuant to paragraph 63 and/or paragraph 68(2) of Schedule B1 to the Insolvency Act 1986 and LBIE's Part 8 Claim which both seek, among other things, declarations:

- (a) that each person who is a Scheme Creditor as defined in the document exhibited to this witness statement summarising the terms of a proposed scheme of arrangement (the "**Scheme Summary**") is a creditor of LBIE within the meaning of section 895(1)(a) of the Companies Act 2006; and
  - (b) that a scheme of arrangement under Part 26 of the Companies Act 2006 in substantially the form of that summarised in the Scheme Summary (the "**Scheme**") is capable of effecting the release of the Scheme Creditors' Released Claims (as that term is defined in the Scheme Summary) in the manner and to the extent set out in the Scheme Summary.
- 2 Where I give no indication of the source of my information or belief, the contents of this witness statement are derived from facts and matters which are within my knowledge and belief. As regards section B, the description of the contractual relationships is based on information and analysis provided to me by various of my partners and colleagues at Linklaters who have, since LBIE's administration, been conducting a detailed review of LBIE's contractual documentation.
- 3 There is now shown to me a paginated bundle of copy documents, marked "**DPE2**", to which I refer in this witness statement.
- 4 Nothing in this witness statement is intended to waive privilege in respect of any matter referred to and privilege is not being waived.
- 5 Unless otherwise defined, capitalised terms have the meanings ascribed to them in the Scheme Summary.
- 6 The remainder of this witness statement is divided into the following sections:
  - 6.1 B Contractual framework and proprietary rights;
  - 6.2 C Obstacles faced by the Administrators;
  - 6.3 D How claims have been dealt with to date;
  - 6.4 E The need for a scheme of arrangement;
  - 6.5 F Scheme overview;

6.6 G No viable alternative; and

6.7 H Conclusion.

**B. CONTRACTUAL FRAMEWORK AND PROPRIETARY RIGHTS**

7 As explained in section F below it is proposed that, in order to be a Scheme Creditor, a person must (subject to certain exceptions) be a person who had a claim against LBIE in trust or in equity at 7.56am (London time) on 15 September 2008 (the "**Time of Administration**") for or in respect of Segregated Assets (as defined in the Scheme Summary, which is exhibited to this statement at **pages 1 to 86 of DPE2**) which was capable of being satisfied (in whole or in part) by the delivery (in whole or in part) of such Segregated Assets. In this section of my witness statement I therefore describe the principal relationships between LBIE and its clients that could result in clients retaining proprietary rights in assets that they had transferred to LBIE or which had been delivered to LBIE for the account of the client concerned.

8 One of LBIE's major business areas was prime services, where LBIE acted as prime broker to institutional clients, mostly hedge funds. As prime broker, LBIE provided a broad range of services, including execution of securities and derivatives trades, clearing and settlement of trades (whether executed by LBIE or by other executing brokers on its behalf), custody, financing, foreign exchange, stocklending, and valuation and reporting for the client's portfolio. LBIE's clients would often actively trade in securities and derivatives on many markets globally, taking both long and short positions, and would also require stock borrowing and financing facilities and foreign exchange services. Hedge funds do not have substantial back office functions themselves and therefore require a third party to arrange for custody of the hedge fund's portfolio and to provide the fund with consolidated valuations of the portfolio on a regular basis. They therefore look to one or more major financial institutions (their "prime broker") to provide them with trade execution, clearing and settlement, custodial and reporting services, to enter into "over-the-counter" derivatives with the fund, and to lend cash and securities to them. Financing provided to the hedge

fund is usually secured against the assets of the hedge fund that are held by or through the prime broker.

- 9** LBIE's prime services clients comprise the majority of entities which, as a result of the contractual arrangements described below, have proprietary interests in assets held by or on behalf of LBIE. Other persons with such interests include clients who placed securities with LBIE by way of safe custody, private individuals whose accounts were dealt with by the Private Investment Management ("PIM") division of LBIE, market counterparties who posted collateral with LBIE pursuant to derivatives trades otherwise than on a title transfer basis (such as other investment banks) and LBIE's affiliates within the Lehman group of companies.
- 10** Clients generally retained a proprietary interest in assets if the assets were transferred to LBIE to hold as custodian for the client or if a particular agreement required the client to transfer assets to LBIE as security for its obligations to LBIE and such assets were not transferred by way of title transfer. Where title was not transferred to LBIE, the assets would nonetheless ordinarily be the subject of a security interest / lien or a right of retention granted by the client in favour of LBIE.
- 11** LBIE did not hold assets itself but did so through depositories, exchanges, clearing systems and sub-custodians. The method used depended on the types of assets being held, the systems through which they were traded, the currencies involved and regulatory requirements.
- 12** The principal contracts entered into by LBIE and which would have been consistent with clients and counterparties retaining a proprietary interest in assets transferred to LBIE are:

  - 12.1** International Prime Brokerage Agreement (charge version);
  - 12.2** Master Custody Agreement;
  - 12.3** Margin Lending Agreement; and
  - 12.4** Credit Support Annex (New York law version) to the ISDA Master Agreement.

- 13** LBIE's standard Terms of Business also provide terms on which LBIE may hold assets for the client and contain a security interest / lien in favour of LBIE in respect of such assets. However, it is my understanding that when LBIE held assets for a client, it would normally have entered into one or more of the contracts referred to above with the client, the terms of which prevail over the standard Terms of Business in the event of any inconsistency.
- 14** In the months since LBIE entered administration, certain of my colleagues have reviewed many agreements that LBIE entered into with its clients. The template agreements that LBIE used as the starting point for any negotiations with a client changed over time. Moreover, depending on the client, the agreements were usually subject to some degree of negotiation. What follows in this Section B is a description of the versions of the agreements exhibited to this witness statement, based on information provided by certain of my colleagues. The versions of the agreements exhibited are those which can best be described as the pro-formas or standard terms in use at the time LBIE went into administration or versions which were regularly entered into by LBIE. Where possible I have indicated which provisions tended to be the subject of negotiation. Before considering each of the relevant contracts, I briefly summarise the relevant regulatory background.
- 15** As a firm regulated by the Financial Services Authority ( the "FSA") in the UK, LBIE is subject to the FSA's rules on the categorisation of clients and on client documentation, as well as its rules relating to the custody of client assets, and to the handling of client money. As applicable, LBIE's documentation with its clients reflects these regulatory requirements. These rules have changed a number of times over the years, most recently to reflect the introduction in the United Kingdom of the EU Directive on Markets in Financial Instruments ("MIFID") in November 2007.
- 16** As required under the FSA's rules, LBIE categorised its clients into various regulatory categories. Before the implementation of MIFID, the relevant categories were market counterparties, intermediate customers and private customers. Since November 2007, the categories are eligible

counterparties, professional clients and retail clients. I understand that most of LBIE's prime services clients would have been intermediate customers, and are now professional clients. I understand that, at the time of the implementation of MIFID, letters were sent to clients setting out their new regulatory categorisation.

**(i) Terms of Business**

- 17** I understand that LBIE provided standard Terms of Business to all clients (see **pages 87 to 108 of DPE2**). There were various different versions of these Terms of Business for retail/private clients and for professional clients/intermediate customers, respectively. I understand that each set of Terms of Business was modified over the years in light of FSA rule changes, most recently to give effect to MIFID. I understand that Terms of Business were sent to clients when they became clients and that, if this was prior to November 2007, revised MIFID-compliant Terms of Business were sent to them in November 2007. It is my understanding that the Terms of Business were not negotiated.
- 18** Where there are other agreements or documentation between LBIE and the relevant client relating to the same business, the Terms of Business supplement and should be read in conjunction with such agreements and documentation. If there is any inconsistency or conflict between the Terms of Business and the terms of any other agreement or documentation, condition 14(B) of the Terms of Business provides that such other agreement and/or documentation will prevail.
- 19** **Custody:** As regards custody of assets, the Terms of Business provide that (Condition 3(D)) LBIE may, upon request, provide such custody services as LBIE may agree with the client and that where custody services are to be provided the client may be required to execute a Master Custody Agreement or other custody agreement. The Terms of Business also summarise the basis on which safe custody investments will be held in the absence of any other custody agreement, reflecting FSA's requirements as regards segregating client assets from LBIE's own assets.

**20 Security/lien:** The Terms of Business provide that LBIE has a general lien on all investments held in custody until the satisfaction of all liabilities and obligations of the client (whether actual or contingent) owed to LBIE or any Lehman Brothers entity. In the event of any failure to discharge such liabilities and obligations when due, and subject to a three-day grace period, the Terms of Business provide (Condition 3(D)(c)), that LBIE is entitled, after notice to the client, to sell, in a commercially reasonable manner using its reasonable endeavours to obtain the best result in respect of any such sale, or otherwise realise, any safe custody investment and to apply any monies deposited with LBIE and the proceeds of any such sale or realisation to the satisfaction of such liabilities and obligations.

**(ii) International Prime Brokerage Agreements**

**21** LBIE acted as prime broker to clients under the International Prime Brokerage Agreement (“**IPBA**”) in respect of acquisitions and disposals of securities for the client, lending securities and advancing cash. Some versions of the IPBA provide for outright transfer of title to LBIE of all cash and securities held by LBIE as prime broker (the “**IPBA (Title Transfer)**”). However most IPBAs entered into by LBIE provide for the outright transfer of cash only, and for all securities to be held by LBIE as custodian subject to a security interest / lien in favour of LBIE and subject to LBIE having a right to use the securities (the “**IPBA (Charge)**”). Under the IPBA (Title Transfer) the client does not retain any proprietary interest in the cash or securities transferred to LBIE. In the paragraphs that follow I therefore consider only the IPBA (Charge) (a copy of which is at **pages 109 to 158 of DPE2**).

**22** In the months since LBIE entered administration certain of my colleagues have reviewed many versions of the IPBA (Charge). I am informed that the IPBA (Charge) was not usually heavily negotiated. From my colleagues’ review, the only provisions that were regularly negotiated were those relating to (i) whether any cash held by LBIE would be treated as client money pursuant to the rules contained in the Client Asset Sourcebook issued by the FSA and (ii) the limit, if any, on LBIE’s ability to use (or “re-

hypothecate”) any assets delivered to it pursuant to the terms of the IPBA (Charge).

- 23** In addition to the IPBA (Charge), the client and LBIE, or the client and another Lehman Company (as defined in the IPBA (Charge)), may have entered into an ISDA Master Agreement, a Contracts for Differences Master Agreement, a Stock Lending Agreement or a Master Institutional Futures Customer Agreement or other agreement(s) (each a “**Customer Agreement**”). As noted below the IPBA (Charge) facilitates the transfer of margin between the IPBA (Charge) and the other Customer Agreements and includes cross-default provisions. In addition the security interest / lien under the IPBA (Charge) applies in respect of liabilities owing to LBIE and other Lehman Companies under (amongst other things) Customer Agreements and security is granted by the client over any net close-out amount owing to the client under any Customer Agreement.
- 24 Right of use:** Pursuant to clause 11 of the IPBA (Charge), LBIE has a broad right of use in respect of securities and may borrow, lend, charge, hypothecate, dispose of or otherwise use for its own purposes any securities by transferring such securities to itself or to another person without giving notice of such transfer to the client. Sometimes the agreement was amended to set a limit on the extent to which securities could be hypothecated. I understand that any such limit was usually expressed as a percentage (often 140%) of the client’s indebtedness to LBIE. Where the right of use was exercised, the client would cease to have a proprietary interest in the securities concerned. LBIE would instead be contractually obliged to transfer “securities equivalent to those securities” to the client upon request.
- 25 Security/lien:** Pursuant to the IPBA (Charge), the client charges in favour of LBIE (i) all securities which are held by LBIE on behalf of the client, (ii) all securities held by any other Lehman Company; (iii) all cash held by LBIE on behalf of the client and (iv) any net close-out amount payable to the Client by LBIE under any Customer Agreement. These charges are given as security for all liabilities of the client to LBIE, or to any Lehman



Company, under the IPBA, the Customer Agreements, any other contracts or otherwise.

- 26 Management of margin:** Pursuant to clause 5.1 of the IPBA (Charge), LBIE has a right to combine accounts. It may also transfer any margin excess under the IPBA (Charge) to provide margin or collateral required under any other Customer Agreement between LBIE and the client (see clause 6). It is also entitled (pursuant to clause 6) to refuse to deliver cash or assets to the client where this would result in the creation of or an increase in a Margin Deficit (as defined in the IPBA (Charge)) under the IPBA.
- 27 Event of default:** An Event of Default occurs under clause 12.1(e) of the IPBA (Charge) if an Act of Insolvency (as defined in the IPBA (Charge)) occurs in relation to LBIE and the client serves a default notice. In the absence of written notice from the client, the appointment of the Administrators to LBIE is a Potential Event of Default (as defined in the IPBA (Charge)). Consequently the client has the right to terminate the IPBA (Charge), in which case clause 13 provides that all loans become immediately repayable and that all obligations to deliver securities are accelerated (with the obligation to deliver being replaced by an obligation to pay their cash value). The Default Market Value of the securities and cash to be delivered by each party is established by LBIE and a net account of what is due under the IPBA is determined pursuant to clause 13.2.
- 28 Payment and delivery:** If the IPBA (Charge) has not been terminated, the client may, pursuant to clause 7.1, upon reasonable request, require LBIE to deliver to it cash and/or securities held.

**(iii) Custody Agreements**

- 29** Where LBIE did not provide the full range of prime brokerage services to a client, but provided more limited services involving it acting as custodian for clients, it generally did so under a Master Custody Agreement (“MCA”). The MCA governs holdings of both securities and cash on behalf of the client. The MCA was also used for other situations where LBIE was

providing custody services to clients, for example in the context of an investment banking transaction (e.g. stake building) and private client relationships.

- 30** I understand that the MCA was not frequently negotiated. There are pre-MIFID and post-MIFID versions of the MCA. Whilst they are virtually identical in other respects, only the pre-MIFID version provides for a security interest / lien to be granted over the client's property in favour of LBIE. Under the pre-MIFID MCA (a copy of which is at **pages 159 to 179 of DPE2**), LBIE has a general lien on all property held by it under the agreement until the satisfaction of all liabilities and obligations of the client (whether actual or contingent) owed to LBIE or any Lehman Brothers entity under any other arrangement. If the client fails to discharge its liabilities and obligations when due, LBIE has the right, following notification of such failure to the client (and subject to a three day grace period), to sell or otherwise realise the property held for the client and apply the proceeds in satisfaction of such liabilities and obligations. The post-MIFID version (a copy of which is at **pages 180 to 195 of DPE2**) did not include a security interest / lien, however LBIE's general Terms of Business do include such an interest, as noted at paragraph 20 above.
- 31** The client may, at any time, subject to the terms of the lien (the pre-MIFID MCA) or to the payment of any taxes and charges (the post-MIFID MCA), withdraw all or any of its property. Pursuant to clause 9 of the MCA, LBIE has no obligation to deliver the property to the client where LBIE believes that there may be insufficient property in the client's account to cover any exposure that LBIE has to the client following such withdrawal.
- 32** The MCA is terminable on not less than 30 days written notice by either party. Upon the expiration of such notice, LBIE will return the property to the client in accordance with the terms of clause 9 (as described above).

#### **(iv) Margin Lending Agreement**

- 33** In respect of U.S. clients that have a Customer Account Agreement ("**CAA**") in place with Lehman Brothers, Inc. ("**LBI**") as prime broker (a copy of which is at **pages 196 to 207 of DPE2**), LBIE provided loans of cash and

securities to those clients pursuant to a Margin Lending Agreement (“**MLA**”) (a copy of which is at **pages 208 to 215 of DPE2**) and a Global Master Securities Lending Agreement (“**GMSLA**”) (a copy of which is at **pages 216 to 249 of DPE2**). The MLA governs loans of money (“**Loans**”) from LBIE to the client. Loans of securities are also governed by the terms of a **GMSLA**, the terms of which are deemed to be incorporated into the **MLA** in full, as modified by the **MLA**. If there is any inconsistency between the **MLA** and **GMSLA** the terms of the **MLA** apply (clause 3(a) **MLA**).

- 34** The **CAA** and the **MLA** are governed by New York law and the **GMSLA** has frequently been amended from its standard version (which is governed by English law) so as also to be governed by New York law. While LBIE did not sign the **CAA**, it provides that any “Lehman Brothers Entity” is a party to the **CAA**, and “Lehman Brothers Entity” is defined in the **CAA** as including LBIE. My New York attorney colleagues have reviewed these agreement and the following description of their terms has been produced with the input of those colleagues.
- 35 Collateral:** Pursuant to clause 5(a) of the **MLA**, LBIE may demand collateral from the client in the form of cash or securities in such amount as it determines. The client is also obliged to ensure that the collateral delivered to LBIE is at least equal to the exposure of LBIE under the loans made pursuant to the **MLA** and the **GMSLA** plus an additional ‘Margin Requirement’. Pursuant to clause 5(e), LBI, as agent of the client, has the right to transfer assets held for the client by LBI to LBIE to hold as collateral.
- 36** The terms of the **GMSLA** are modified by the **MLA** such that (i) the collateral provisions in the **GMSLA** are disapplied (see clause 3(a) of the **MLA**); and (ii) the obligations of the client to LBIE under the **GMSLA** are secured by the security interest / lien in the **MLA** and not by transfer of property under the **GMSLA** (see clause 5(b) of the **MLA**). Therefore when LBIE lent securities to the client, the client did not specifically provide collateral for that individual Loan as it would have done under the **GMSLA** if not so modified. Instead, the value of the Loans was taken into account in

calculating the client's overall indebtedness for the purposes of the MLA, and the security interest / lien under the MLA applies in favour of LBIE in respect of the Loans under the GMSLA.

- 37 Security/lien:** Assets transferred to LBIE under the MLA were not transferred outright but were "client assets" subject to a security interest / lien in favour of LBIE and subject to LBIE's right of use (explained below). Pursuant to clause 5(b) LBIE has a lien on and a continuing first priority security interest / lien in any assets that have been delivered to LBIE by the client under the MLA, or that are otherwise held by LBIE. Pursuant to clause 5(b) the security interest / lien is granted as security for the client's obligations under the MLA and the GMSLA "and for all obligations owing to [LBIE]". Pursuant to clause 5(e) LBIE is entitled to transfer any excess collateral held pursuant to the MLA to another account of LBIE for the purpose of providing collateral under any other agreement with LBIE or to transfer such excess collateral to LBI for the purpose of collateralising obligations owed by the client to LBI under the CAA.
- 38** In addition, there is a pledge under clause 3 of the CAA over all client assets held by any Lehman Brothers Entity as security for all liabilities owed by the client to any Lehman Brothers Entity. This clause provides that each Lehman Brothers entity holds assets of the client as collateral "as agent and bailee" for each other Lehman Brothers Entity and, as such, shall act on instructions of such other Lehman Brothers Entities with respect to the collateral without the client's further consent.
- 39 Right of use:** Both the CAA and the MLA include an extensive right of use in favour of LBI and LBIE pursuant to clauses 19(a) and 5(c) respectively. The right applies "within the limits of applicable law and regulations". As regards LBI as a U.S. broker-dealer I understand that it is subject to rule 15c-3.3 under the Securities Exchange Act pursuant to which, in summary, there is an absolute prohibition on exercising a right of use in relation to fully paid securities and excess margin securities. For this purpose "excess margin securities" are securities in a customer's account with a market

value equal to or greater than 140% of the customer's debit balance (the amount the customer owes the broker for the purchase of the securities).

- 40** This restriction does not apply to LBIE, but in practice some of the MLAs expressly limit LBIE's right of use to securities with an aggregate market value of up to 140% (or another agreed percentage) of the client's indebtedness to LBIE. However, unless LBIE has agreed to restrict its right of use, the MLA permits it to use securities under its control without regard to the customer's debit balance.
- 41** **Event of default:** The administration of LBIE is an 'Act of Insolvency' under the GMSLA and therefore an Event of Default (as defined under the GMSLA) occurs with respect to LBIE if the client serves a default notice under the GMSLA. An Event of Default under the GMSLA is also an Event of Default under the MLA (see clause 6(i) of the MLA). Therefore, for an Event of Default to occur under the MLA, the client will need to have served a default notice pursuant to the GMSLA. The GMSLA Schedule usually provides that clause 10 of the GMSLA (which relates to close-out on default) applies only if the client is the Defaulting Party. In such circumstances a default notice issued by the client would not be effective to close-out the GMSLA, but would result in an Event of Default under the MLA.
- 42** The MLA provides that, on an Event of Default, all loans (which includes stock loans as well as cash loans) are accelerated and LBIE shall have all of the rights of a secured party on default under the Uniform Commercial Code ("**UCC**"). The MLA provides that LBIE can, without prior notice to the client, sell any of the collateral in such manner as LBIE determines and apply the proceeds to any loan.
- 43** In the absence of an Event of Default, clause 5(d) of the MLA provides that, *"Upon satisfaction by [client] of all Obligations (and all other obligations owed by Borrower to each affiliate of [LBIE]) [LBIE] shall return to [client] the Collateral"*.

## **ISDA Master Agreement**

- 44** The ISDA Master Agreement is a standard form agreement, published by the International Swaps and Derivatives Association (“**ISDA**”), which is almost universally used in the London market (and elsewhere) for the documentation of derivatives transactions. It consists of a standard form, together with a Schedule. The form of the ISDA Master Agreement is not amended. However, the Schedule can be used to make certain elections contemplated by the form (including an election for English law or New York law to govern the Agreement), and otherwise to modify the terms of the ISDA Master Agreement.
- 45** There are two principal versions of the ISDA Master Agreement used by the market, the 1992 and the 2002 versions (exhibited to this statement at **pages 250 to 273** and **pages 274 to 309 of DPE2** respectively). The majority of LBIE’s derivatives were transacted under the 1992 version, with some 2002 agreements. Where necessary I distinguish below between these two versions but otherwise the 1992 and 2002 versions are both referred to herein as the “**ISDA Master Agreement**”.
- 46** The ISDA Master Agreement (together with the Schedule) sets out the general terms of the contract but does not include any transaction-specific terms (unless such terms are included in the negotiated Schedule). Parties document the terms of each transaction by way of a written confirmation or some other exchange of evidence. Each confirmation typically incorporates a set of product-specific terms, published by ISDA. There is a separate set of terms for each asset class.
- 47** **Collateral:** The parties can supplement the ISDA Master Agreement with an agreement for posting collateral by entering into either the ISDA 1995 English law Credit Support Annex (the “**English law Credit Support Annex**”), or the ISDA 1994 New York law Credit Support Annex (the “**New York law Credit Support Annex**”) (a copy of which is at **pages 310 to 323 of DPE2**), each of which is an ‘annex’ to (and therefore forms part of) the

Schedule to the ISDA Master Agreement. The Credit Support Annexes are also standard forms with an annex for elections and variables.

- 48** Many of the ISDA Master Agreements entered into by LBIE have English law Credit Support Annexes, under which any collateral is provided by way of outright transfer. However, ISDA Master Agreements with U.S. clients tend to be governed by New York law and in these cases there is frequently a Credit Support Annex (also governed by New York law) under which collateral may be provided by way of security. I understand that cash and securities posted by a client as collateral under the New York law Credit Support Annex are secured in favour of LBIE and no title is transferred. Pursuant to Paragraph 6(b) of the New York law Credit Support Annex, LBIE holds such collateral in custody subject to the security in favour of LBIE.
- 49** A broad right of use is included in the New York law Credit Support Annex. Pursuant to Paragraph 6(c) LBIE can *“sell, pledge, rehypothecate, assign, invest, use, commingle or otherwise dispose of”* all collateral.
- 50** I am advised by my New York colleagues that the client does not have a direct ownership interest in specific posted collateral (in the common law property sense of that term), but rather, with respect to each financial asset comprising the collateral, a "securities entitlement" under Article 8 of the New York UCC that gives the client a pro rata interest in whatever positions in that financial asset the securities intermediary (in this case, LBIE) holds. If LBIE were to exercise its right of use by selling the financial assets posted to it as collateral, the better view (although not free from doubt) is that a debtor-creditor relationship would then be established between the client and LBIE.
- 51** **Event of default on administration:** Pursuant to clause 5(a)(vii)(2) of the ISDA Master Agreement, an Event of Default (as defined in the ISDA Master Agreement) occurred upon the appointment of the Administrators. The standard position is that the non-defaulting party can terminate the Agreement following the Event of Default by notice to LBIE. However the

parties can specify in the Schedule that 'Automatic Early Termination' applies, in which case no notice of early termination is required and the ISDA Master Agreement will have terminated automatically at the time immediately preceding the appointment of the Administrators. I understand that the great majority of LBIE's ISDA Master Agreements do not apply Automatic Early Termination.

- 52 Close-out netting and set-off:** If the ISDA Master Agreement has been terminated, the non-defaulting party calculates the mark-to-market value of each of the transactions under the ISDA Master Agreement and aggregates these amounts, together with any unpaid amounts, to produce one net 'close-out amount' payable by the appropriate party (i.e. this may be an amount payable by LBIE or an amount payable by the client to LBIE).
- 53** Clause 6(f) of the 2002 ISDA Master Agreement provides that if the close-out amount is payable by the client (as the non-defaulting party) to LBIE, it may set-off against such amounts any other amounts payable by LBIE to the client, whether accrued or contingent, which may arise under any other agreement between the parties. The 1992 ISDA Master Agreement does not contain this set-off provision. However, such a provision was commonly included in the Schedule to the 1992 ISDA Master Agreements between LBIE and its clients.
- 54** If an Early Termination Date (as defined under the ISDA Master Agreement) has been designated by the client following the appointment of the Administrators the New York law Credit Support Annex provides that LBIE is obliged to return the collateral to the client. If there are insufficient securities on hand to satisfy the securities entitlements of all clients in relation to such securities, then clients ('entitlement holders') will have pro rata interests in whatever positions in such securities LBIE does hold. However, I am advised that although the New York UCC describes the property interests of entitlement holders in relation to financial assets held by a securities intermediary, it does not necessarily determine how property held by a failed intermediary will be distributed in an insolvency proceeding and thus the relevant insolvency regime as well as other applicable laws



(e.g., in the case of the U.S., the Securities Investor Protection Act) will, in so far as LBI is acting as sub-custodian for LBIE, govern the claims of LBIE's creditors.

- 55** Absent the early termination of the ISDA Master Agreement, the client is only entitled to request the return of any collateral it has posted to the extent that the value of the collateral it has posted exceeds the Credit Support Amount, i.e. the value of collateral it is required to post.

### **C. OBSTACLES FACED BY THE ADMINISTRATORS**

- 56** As has previously been explained to the court, in particular in the witness statement of Steven Anthony Pearson (one of the Administrators) dated 25 February 2009 (the "**Pearson Statement**"), the Administrators recognise that the contracts described above result in many persons having claims against LBIE in respect of cash and securities transferred to LBIE. The Administrators have also previously explained why it is that, notwithstanding the existence of such claims, they face great difficulty in distributing cash and securities to those persons who are entitled to the return of such assets. In the following sections of this witness statement I explain the principal obstacle to the immediate return of assets and describe the way in which the return of assets has been dealt with to date.

- 57** In the context of the distribution of Trust Property held by LBIE, the Administrators are faced with a range of complex issues. However the most fundamental of the obstacles which they face is the fact that, as matters currently stand, they cannot be certain who is entitled to the Trust Property. Distributing assets in such circumstances potentially gives rise to claims against LBIE for breach of trust and to related claims against the Administrators. Likewise clients to whom Trust Property is distributed cannot be certain that they will not face proprietary claims from other clients in respect of such Trust Property. Without the imposition by a scheme of arrangement of a bar date for claims, this uncertainty, and the resultant inability to distribute Trust Property, will persist.

- 58** The Administrators have previously explained why it is they face such uncertainty (see for example paragraphs 27 to 66 of the Pearson

Statement). In summary it is because (i) they have not received responses from all clients to the enquiries that have been made, (ii) they cannot rely entirely upon the accuracy of LBIE's books and records; and (iii) they have likewise not yet received all the information requested of custodians, depositories and affiliates as regards the assets held on behalf of LBIE.

- 59** As described in the Pearson Statement, the Administrators have written to 1,707 account holders thought potentially to have claims against LBIE for the return, or in respect, of Trust Property, in order to obtain from them full details of such claims, rights or other interests which the clients purport to have in relation to Trust Property, including: (i) confirmation of positions and balances held with LBIE as at 7:56am on 15 September 2008 (the time the administration order was made by the Court); (ii) copies of any contractual agreements and other relevant documentation; and (iii) details of all positions terminated or closed since 7:56am on 15 September 2008 together with the basis of any valuations assumed in the client's calculations.
- 60** The Administrators have also issued a notice on their website inviting those clients and counterparties to whom such letters were not sent, but who nonetheless believe that they might have such interests, to supply details of claims, rights or interests which they believe they have in relation to Trust Property and attached sample letters (tailored both to institutional counterparties and Private Investment Management counterparties) in a format that was capable of being downloaded from the website.
- 61** As at 29 May 2009, the Administrators have received some 950 responses to the letters and notices referred to above (including both complete and incomplete responses).
- 62** As described in more detail in section F below, the proposed Scheme would provide certainty as regards the pool of persons to whom Trust Property could potentially be distributed. The Scheme would also ensure finality (as between LBIE and any given Scheme Creditor and as between Scheme Creditors) as regards the Scheme Creditors' entitlements to Trust Property distributed to them under the Scheme.

- 63** Without the Scheme it may not be possible for the Administrators to identify with certainty the persons to whom Trust Property should be returned. Without that certainty it will not be possible to distribute Trust Property on a basis that provides finality for the recipients and avoids exposing LBIE and the Administrators to potential claims.
- 64** In addition to the fundamental difficulty in returning Trust Property to clients, the Administrators are faced with many other complex issues as regards the return of such property. For example, they must determine how any shortfalls in assets are to be shared between clients, determine the terms of a client's contract where there is a lack of documentation, find a way of terminating open contracts in order to crystallise a client's overall financial position with LBIE, determine how set off is to apply in any given case and agree valuations for derivatives and other complex financial transactions (which is relevant in the context of Trust Property, given the rights of retention/security described above). In addition to providing certainty as regards the persons entitled to Trust Property, the Scheme seeks to deal with these and many other issues which would otherwise complicate the return of Trust Property.

#### **D. HOW CLAIMS HAVE BEEN DEALT WITH TO DATE**

- 65** Notwithstanding the difficulties described above, the Administrators have, as described in the Pearson Statement, received many claims from clients and counterparties against LBIE for the return, or in respect of, Trust Property, often requesting its return as a matter of priority. As at 29 May 2009, the total number of Trust Property claims received to date is 1,214, of which over 120 have been considered as potential priority claims by a committee (referred to as the "Hardship and Prioritisation Committee") set up by the Administrators to apply, and to keep under review, the prioritisation principles referred to in the Schedule to the Order of Mr Justice Blackburne made on 7 October 2008.
- 66** The Administrators have employed a significant amount of resource to considering such claims by requesting relevant information from clients and locating relevant documents and data so that the Administrators may conduct a line-by-line reconciliation of the client's position. From the total

number of claims, 560 are under review for the potential return of assets (the remainder cannot currently be progressed due to the nature of the relevant claims; for example, because they are claims in respect of pre-administration client money). However, as explained in the Pearson Statement there are inherent short-comings in the approach to asset returns currently available to the Administrators and many creditors have been unable to meet the requirements for such returns.

- 67** The need to seek indemnities and credit support from clients was explained in detail in the Pearson Statement (see paragraphs 76 to 86 of the Pearson Statement). I repeat below the terms of the deeds of undertaking pursuant to which assets are currently returned and the inherent difficulties caused by having to insist upon such terms.
- 68** The Administrators, together with their staff and advisers, have put in place a framework requiring clients to enter into deeds of undertaking in order that assets can be returned without exposing the LBIE estate and/or the Administrators to additional risk. Appropriate return and indemnification arrangements and, if necessary, credit support for those arrangements are an essential part of this framework and, subject to de minimis limits and exceptional circumstances, all clients whose claims are processed on this basis are required to enter into such arrangements.
- 69** The Administrators' objectives in seeking such protection are to ensure that:
- 69.1** in the event that it is determined that returned assets should not have been returned, for example where it emerges that the returned assets were, in fact, the subject of competing claims, the client asset position and the LBIE estate are able to be restored (as far as practicable) to their respective positions had those assets not been returned on an expedited basis;
- 69.2** the client whose claim is prioritised contributes to the cost of prioritisation (and that neither the LBIE estate nor the LBIE clients as a whole should be burdened with costs associated with a prioritised return); and

69.3 the pool of clients (and their assets) to which the costs of administering and dealing with Trust Property generally might be allocated is not diminished.

70 The arrangements approved by the Administrators in furtherance of these objectives have varied on a case by case basis and will continue to do so and the terms of such arrangements have developed as the process of returning assets to clients has progressed. However, in summary, the current arrangements are as follows:

70.1 if the Administrators, acting in good faith, subsequently determine that any assets transferred on an expedited basis (the "**Transfer Assets**") should not have been so transferred, the transferee will be obliged:

70.1.1 to return such proportion of the Transfer Assets or equivalent securities as the Administrators determine should not have been transferred;

70.1.2 to pay an amount to LBIE equal to any proceeds earned on those assets since the date of the transfer; and

70.1.3 to pay the amount, if any, notified by LBIE as the amount of interest it would have earned on those proceeds.

(These sums, together, are referred to as the "**Return Amount**".)

70.2 in the event that the transferee fails to pay any or all of the Return Amount, the transferee will be liable to pay an amount in respect of such failure calculated as the sum of:

70.2.1 the actual or estimated cost to LBIE of acquiring replacement assets in the market;

70.2.2 the proceeds that should have been returned to LBIE and any interest LBIE would have earned on those proceeds; and

70.2.3 the costs incurred by the LBIE estate and/or the Administrators as a result of the transferee's failure to pay the Return Amount;

- 70.3** if deemed appropriate by the Administrators, credit support in an agreed form is required. The guaranteed obligations in these circumstances include any indebtedness owed to any Lehman Brothers entity that would otherwise have been covered by a lien over the Transfer Assets;
- 70.4** save as provided in the sub-paragraph immediately above, the transferee must warrant to LBIE that it has no liabilities to LBIE affiliates;
- 70.5** the transferee pays a fixed sum contribution towards the cost of prioritising its claim (for a straightforward claim this is set at U.S.\$50,000);
- 70.6** a retention of between 0.75% and 1.25% of the Transfer Assets will be held by LBIE pending determination of the amount (if any) of costs incurred in returning assets which are to be charged to the Transfer Assets, following which determination such amount will be applied towards satisfying such charge, and any excess together with any interest earned on that retention will be returned to the transferee;
- 70.7** the transferee will agree to pay any amount by which the retention held by LBIE (together with any interest earned on that retention) is insufficient to satisfy the obligation of the transferee to pay the amount of such costs determined to be charged to the Transfer Assets.
- 71** If the client agrees that it is willing to proceed on the above basis, a draft deed of undertaking is forwarded to and discussed with the client. For commercial reasons this cannot be an indefinite undertaking, but needs to run for sufficiently long to accommodate possibly unknown claims. The Administrators take the view that this should be for a number of years. Once agreed and any conditions have been fulfilled the asset is returned to the client.
- 72** In the event that the client decides that the above requirements are unacceptable, the client's claim for the return of Trust Property is likely to be

dealt with in due course with other non-prioritised LBIE clients i.e. in the ordinary course of the administration.

### **Challenges with the current approach to returning Trust Property**

- 73** The Administrators recognise that the current approach is unsatisfactory in certain respects and will not meet the principal needs of clients. By way of example, it does not provide any finality to clients who remain liable under the undertaking for many years. Further, the requirement for external credit support may be hard to meet, particularly for clients who are themselves experiencing financial difficulties. The Administrators understand that clients may be unable to provide such credit support without pledging the returned asset, thus obviating much of the benefit of having the asset returned, at least for the duration of the undertaking.
- 74** The Administrators have tried to accommodate this by not always asking for credit support in respect of 100% of the value of the undertaking, but this creates risk for the estate and is only appropriate where the Administrators have a very high degree of confidence that (at least from the books and records of LBIE) there are unlikely to be competing claims and so the risk is low. However, the risk of competing claims cannot be eliminated.
- 75** As a result of the large number of issues affecting any given asset and the amount of work that needs to be done by the Administrators, their advisers and Lehman staff in respect of any given potential return, the current approach is inevitably time consuming and costly. Further, it is likely that going forward much more difficult cases will emerge which are not amenable to this current approach (either as a result of their complexity, or the issues identified above). Some of the above issues may only be capable of resolution through obtaining further directions from the Court or contested litigation.
- 76** In the absence of a viable alternative the Administrators continue to apply the approach described above and in the Pearson Statement. However as a result of the inherent difficulties described, as at July there are 165 accounts where the Administrators are in a position to return assets that are under the Administrators' control. In many instances, however, discussions

with these account holders have been ongoing for many weeks. In these situations, many of the clients either unable or unwilling to comply with the terms for distribution which the Administrators consider themselves obliged to apply.

- 77 Even where clients are able and willing to comply with the terms set out above, it remains a time consuming and costly process to investigate positions on a client-by-client basis and to then agree and document the appropriate terms for the return of particular Trust Property.

#### **E. THE NEED FOR A SCHEME OF ARRANGEMENT**

- 78 In light of the very significant difficulties with which they are faced (as described above) and having considered with their advisors the options open to them, the Administrators determined that it would be expedient to address the difficulties described above and to facilitate the return of Trust Property by promoting a scheme of arrangement.

#### **The 16 March 2009 hearing**

- 79 On 16 March 2009, the Court made an order (the “**Order**”) that (i) the Administrators be at liberty to propose a scheme of arrangement under Part 26 of the Companies Act 2006 between LBIE and persons who are its creditors in relation to trust property (as that term was defined in paragraph 9 of the Pearson Statement); and (ii) to the extent that the Administrators do not, having taken reasonable steps to do so, recover out of the trust property, or from the persons entitled to the trust property, their reasonable remuneration, costs and expenses incurred in dealing with the trust property, including, but not limited to, establishing the entitlement to trust property of those claiming to be entitled to it and taking steps to facilitate the return of trust property to those entitled to it, whether pursuant to the proposed scheme of arrangement or otherwise, they shall be so paid and indemnified out of the assets of LBIE.
- 80 As described more fully in paragraphs 13 and 14 of my witness statement dated 12 March 2009 (which was filed in support of the application for the making of the Order) (“**Ereira 1**”), the Administrators gave advance notice of the 16 March 2009 hearing by publicising it on the section of the PwC



website dedicated to the administration of LBIE (see pages 1 and 2 of the exhibit to Ereira 1 ("DPE1")). That notice invited anyone who wished to attend or appear at that hearing to contact Linklaters.

- 81** The London Investment Banking Association ("**LIBA**") informed Linklaters of its intention to appear at the 16 March 2009 hearing and LIBA was represented by Leading Counsel. No other party appeared.
- 82** A copy of LIBA's outline submissions to the Court (the "**LIBA Submissions**") is reproduced at **pages 324 to 326 of DPE2**. Paragraph 1.3 of the LIBA Submissions provides that "*LIBA supports the efforts that are being made by the LBIE Administrators to find a means of returning trust assets quickly and efficiently to their beneficial owners.*"
- 83** However, paragraph 2.1 of the LIBA Submissions provides that "*[a]ny such proposed Scheme would raise a fundamental question as to whether, and if so, to what extent, the Court has jurisdiction to subject the proprietary interest of beneficiaries under a trust...to a scheme of arrangement*". The LIBA Submissions go on to provide, at paragraph 2.2, that LIBA believes that "*the question of jurisdiction should be brought before the Court at an early stage, when the scope and structure of any proposal is sufficiently defined.*"

#### **Developments since 16 March hearing**

- 84** Since the hearing on 16 March 2009, the Administrators have been in correspondence with LIBA in relation to the jurisdiction question and the application in support of which this witness statement is made. As at the date of this witness statement, it is unclear whether LIBA intends to appear at the hearing in respect of this application. The Administrators are currently awaiting confirmation of LIBA's position and expect to receive this very shortly.
- 85** The Administrators have continued to work on proposals for the Scheme and are preparing a Scheme document and explanatory statement. The proposed Scheme has been the subject of consultation between the Administrators and certain creditors of LBIE, as described more fully below.

- 86 At paragraph 130 of the Pearson Statement, Mr Pearson explained that the Administrators had, with the agreement of the creditors' committee, established a working group (the "**Working Group**") consisting of representatives of the Administrators, their advisers from Linklaters (including myself) and the creditors' committee members (which include a general unsecured creditor who will not be a Scheme Creditor, as well as members who will in fact be Scheme Creditors to provide the Administrators with a "sounding board" for discussion of the possible promotion of the Scheme.
- 87 At paragraphs 5 to 7 inclusive of Ereira 1, I gave further details of meetings of the Working Group and with two industry bodies, the Alternative Investment Management Association ("**AIMA**") and the Managed Funds Association ("**MFA**"), to obtain the views of the industry on the possibility of pursuing the Scheme and to present to them some of the options being considered.
- 88 Since the date of Ereira 1, there have been several further meetings of the Working Group, all of which I attended. There have also been conference calls and exchanges of written comments and information. The structure and content of the proposed Scheme have been discussed in detail. The Working Group is strongly supportive of a scheme that deals comprehensively with all issues relevant to a creditor's relationship with LBIE (and not just its proprietary claims) in order to enable the Administrators to make a rapid distribution of assets to Scheme Creditors. The Working Group has also been extensively consulted on the terms of the Scheme and is unanimously supportive of the proposed Scheme.
- 89 The Administrators are also in contact with certain affiliates of LBIE who may be affected by the proposed Scheme, including LBI, Lehman Brothers Japan Inc. and Lehman Brothers Commercial Corporation Asia Limited and have informed them of their intention to distribute assets under the proposed Scheme.
- 90 Whilst the detailed drafting of the Scheme document and explanatory statement is not yet complete, the Scheme Summary at **pages 1 to 86 of**

**DPE2** provides an explanation of the terms of the Scheme that, as of the date of this witness statement, it is proposed be put to the Scheme Creditors for approval. It is the Administrators' intention that the text of the Scheme Summary form part of and be reproduced verbatim in the explanatory statement.

**91** The Administrators intend to file with the Court on the date of this witness statement a Part 8 claim form in respect of the convening of meetings of the Scheme Creditors. It is anticipated that, subject to the Court's decision on this application, the convening hearing will take place in September 2009.

**92** Upon filing the application in support of which this witness statement is made, the Administrators intend to publish on the PwC website details of the application, including copies of the ordinary application, this witness statement and the Scheme Summary.

#### **F. SCHEME OVERVIEW**

**93** Attached at **pages 1 to 86 of DPE2** is the Scheme Summary. It includes schematic diagrams to assist the reader in understanding how it is intended that the Scheme operate. It also includes certain key definitions that it is intended be included in the Scheme document. The Scheme Summary should be read in full for an understanding of the Scheme's proposed terms and effect. However I set out below some of the aspects which are likely to be of relevance to the application in support of which this witness statement is made.

**94** The Scheme has the following objectives:

**94.1** to impose a Bar Date on all claims, other than Excluded Claims, of the Scheme Creditors;

**94.2** to establish mechanisms to determine Asset Claims of Scheme Creditors;

**94.3** to establish mechanisms to determine the Net Contractual Positions of Scheme Creditors;

- 94.4 to establish mechanisms for retaining any Retention Amount (as defined in the Scheme Summary) in respect of Scheme Creditors;
  - 94.5 to make provision for the costs of managing Trust Property and allocating Distributable Trust Property;
  - 94.6 to effect Distributions (as defined in the Scheme Summary) to Scheme Creditors efficiently and expeditiously;
  - 94.7 to identify the information that should be taken into account by LBIE in implementing the Scheme and to determine which information, if any, may properly be disregarded;
  - 94.8 to compromise and agree all of the claims, other than Excluded Claims, of Scheme Creditors;
  - 94.9 to establish a mechanism to resolve certain disputes relating to the Scheme; and
  - 94.10 to determine, quantify and crystallise the value of unsecured claims of Scheme Creditors.
- 95 A creditor will generally be a “**Scheme Creditor**” if it had a claim against LBIE in trust or in equity at 7.56 a.m. (London time) on 15 September 2008 (the Time of Administration) for or in respect of Segregated Assets and which was capable of being satisfied by the delivery (in whole or in part) of Segregated Assets.
- 96 A “**Segregated Asset**” is any Security which was recorded in the Books and Records (as defined in the Scheme Summary) of LBIE (as at the Time of Administration) as being held in a segregated manner for customers of LBIE (other than Excluded Creditors, as defined in the Scheme Summary) separately from other Securities held by LBIE which are available to the unsecured creditors of LBIE and which was:
- (i) held in physical form by LBIE and segregated from other Securities held in physical form by LBIE which are not credited to an account of a customer of LBIE; or

- (a) held in physical form by an Intermediary (as defined in the Scheme Summary) for LBIE's customers and segregated from other Securities held in physical form by such Intermediary which are not credited to an account of a customer of such Intermediary; or
- (b) if not held in physical form by an Intermediary,
  - (I) credited to an account designated in the Books and Records of the Intermediary as an account in the name of LBIE, but being held by LBIE for the benefit of its customers; or
  - (II) where the Intermediary does not designate any account recorded in its Books and Records as being for LBIE's customers, credited to an account in the name of LBIE.

**97** A **"Security"** is any Financial Instrument (as defined in the Scheme Summary) or any right in respect of any Financial Instrument against a custodian, clearing system, depository, nominee or other person who holds assets (including, for the avoidance of doubt, rights in respect of assets) on behalf of or to the order of a person which holds such Financial Instrument.

**98** **"Trust Property"** is, at any time, any Asset (as defined in the Scheme Summary) which fulfils the following criteria at such time:

- (ii) it is a Segregated Asset, a Derived Asset, or a Recovered Asset; and
- (iii) it is not Excluded Property.

**99** **"Distributable Trust Property"** is, at any time, any Trust Property which fulfils each of the following criteria at such time:

- (i) it has been sufficiently identified and located by LBIE to enable LBIE to identify it in accordance with the provisions of the Scheme;
- (ii) it is within the direct custody or control of LBIE or any Intermediary through which LBIE has indirect custody

or control of the Asset and which is willing and able to act in accordance with a direction from LBIE in respect of such Trust Property; and

- (iii) it is not subject to any order or restriction of any competent court or authority which would prevent or interfere with the operation of the Scheme in respect of such Trust Property,

provided that:

- (a) Trust Property which does not fulfil each of the criteria above at any time may subsequently become Distributable Trust Property at such time as it fulfils each of the criteria above and for as long as it continues to fulfil each of the criteria above; and
- (b) conversely, Trust Property which has at any time fulfilled each of the criteria above may cease to be Distributable Trust Property at any time that it ceases to fulfil each of the criteria above.

**100** An “**Asset Claim**” is a Non-Custody Asset Claim or a Custody Asset Claim.

**101** A “**Non-Custody Asset Claim**” is a claim against LBIE:

- (i) in trust or in equity in respect of (a) any Securities (other than for any Rehypothecated Securities, as defined in the Scheme Summary) which were recorded in the Books and Records of LBIE as at the Time of Administration as Securities which, pursuant to a legal or equitable obligation of LBIE, LBIE held or should have held as Non-Custody Securities (as defined in the Scheme Summary) and (b) Derived Assets relating to such Securities other than money, and in each case (a) and (b), which is capable of being satisfied (in whole or in part) by the delivery of

such Non-Custody Securities and/or their Derived Assets; and

- (ii) in respect of any Derived Assets relating to (a) or (b) above that is money

**102** A “**Custody Asset Claim**” is a claim against LBIE:

- (i) in trust or in equity in respect of (a) any Securities (excluding any Rehypothecated Securities) which were recorded in the Books and Records of LBIE at the Time of Administration as Securities which, pursuant to a legal or equitable obligation of LBIE, LBIE held or should have held as Custody Securities (as defined in the Scheme Summary) and (b) Derived Assets relating to such Securities other than money, and in each case (a) and (b), which is capable of being satisfied (in whole or in part) by the delivery of such Custody Securities and/or their Derived Assets; and
- (ii) in respect of any Derived Assets relating to (a) or (b) above that is money

**103** “**Derived Assets**” and “**Recovered Assets**” are defined at page 5 of the Scheme Summary. They relate to securities or money derived from Trust Property and to assets returned to LBIE by persons to whom such assets were delivered prior to the Scheme.

**104** Once it has been determined that a person is a Scheme Creditor then all of their claims against LBIE for the return, or in respect, of Trust Property will be dealt with in the Scheme. A Scheme Creditor’s Asset Claims form the basis of determination of its entitlement to participate in distributions of Assets within the control of LBIE under the Scheme.

**105** In order to resolve the uncertainty as to Trust Property entitlements, the Scheme will impose a “**Bar Date**” for claims. The Bar Date will be 31 December 2009, if the Scheme becomes effective, or otherwise the last business day of the second full calendar month following the Scheme

becoming effective. Any claim submitted after the Bar Date of which LBIE was otherwise unaware can be disregarded by LBIE. To the extent that a Scheme Creditor fails to submit a Claim Form to LBIE by that time, LBIE will calculate such Scheme Creditor's entitlements under the Scheme using the Relevant Information, if any. LBIE will only be required to have regard to Relevant Information in determining matters under the Scheme. LBIE will not be required to take into account any information which is not Relevant Information.

**106 "Relevant Information" is information:**

- 106.1** information ascertained from the Books and Records of LBIE;
- 106.2** information contained in a Claim Form (as defined in the Scheme Summary) submitted by 12.00 noon (London time) on the Bar Date;
- 106.3** information contained in certain notices delivered pursuant to the Scheme;
- 106.4** information made available to LBIE by Intermediaries and by LBIE's affiliates;
- 106.5** information made available to LBIE by any relevant exchanges; and
- 106.6** information which may be taken into account when determining any Close-Out Amount (as defined in the Scheme Summary) of any Financial Contract and any value of any Relevant Asset (as defined in the Scheme Summary) in accordance with the methodologies provided in the Scheme.

**107** LBIE may, to the extent LBIE considers it necessary or desirable, have regard to any information which is not Relevant Information for the purpose of making determinations or to any information which is not in its possession at the time of making determinations in respect of a Scheme Creditor pursuant to the Scheme.

**108** Under the Scheme, all Scheme Creditors will each release all claims (save for Excluded Claims) against the Released Parties, including all claims for or in respect of:



- (i) any Asset Claim;
- (ii) any payment for or on account of any Asset which is or was at any time the subject of an Asset Claim;
- (iii) damages, indemnity or contribution in respect of any loss, cost or expense of any nature whatsoever in respect of, or in connection with, any Asset which is or was at any time the subject of an Asset Claim including consequential or economic loss,
- (iv) all liabilities for breach of contract, loss or damage, indemnity or contribution of any nature whatsoever;
- (v) all rights to seek or enforce judgment, exercise any remedy or apply any set-off, netting, withholding, combination of accounts or retention or similar rights against LBIE in respect of any claim or liability whatsoever; and
- (vi) rights in respect of any Financial Contract.

(the "**Released Claims**").

**109** Released Claims do not include claims against any person other than the Released Parties or Acceding Creditors. The Scheme does not purport to compromise the claims of any Scheme Creditor against any person who is not a Scheme Creditor. In particular, it does not compromise claims (if any) which a Scheme Creditor may have against Lehman Brothers Holdings Inc. as guarantor of LBIE, or LBI or against the Customer Asset Protection Company or Lehman Brothers Bankhaus AG, none of which is a Released Claim.

**110** "**Released Parties**" in respect of a Scheme Creditor are LBIE, the Scheme Supervisors, the Administrators, and their firms, members, agents, partners or employees, together with all other Scheme Creditors.

**111** Scheme Creditors shall not release any Excluded Claims or New Claims.

**112** "**Excluded Claims**" are any claims:

**112.1** for, or in respect of, Excluded Property (as defined in the Scheme Summary);



Property; and (ii) agreement as to any net unsecured claim it has against LBIE. Any and all other claims against LBIE will be compromised and both LBIE and the Scheme Creditors will achieve certainty as regards their positions.

#### **G. NO VIABLE ALTERNATIVE**

**115** In the event that the proposed Scheme is not implemented, the Administrators will have no option but to continue with their current approach to establishing creditors' entitlements to and distributing Trust Property. As explained in the Pearson Statement and this witness statement, the Administrators currently face a number of very significant hurdles in establishing entitlements to Trust Property. I have explained some of those issues above. Aside from that which is set out in section D above, I do not in this witness statement provide a general update regarding progress made by the Administrators in respect of Trust Property. However, whilst progress continues to be made, the Administrators continue to face the very significant difficulties and complexities explained in the Pearson Statement. To the extent that they are able to establish with some degree of certainty the entitlement of any given creditor in respect of particular Trust Property, it is impossible to return it on a definitive basis without exposing LBIE's general creditors to considerable risk.

**116** In the absence of a scheme in the form of that set out in the Scheme Summary, resolving many of the uncertainties faced by the Administrators as regards the reconciliation of client positions with respect to Trust Property would be extremely problematic. It would likely require either the promulgation of an alternative scheme of arrangement (which would involve further significant delay), or numerous further applications to the Court for directions. In the meantime, resolution of client claims against LBIE for the return, or in respect, of Trust Property would continue to require the Administrators to engage with creditors on a bilateral basis. Remaining uncertainties with respect to possible competing claims would likely cause the Administrators to continue to require significant indemnities backed by credit support as a precondition to the distribution of such Trust Property.

117 The Administrators are mindful of the fact that their proposed actions in respect of the return of Trust Property will be the subject of considerable interest both in the U.K. and abroad and that comparisons may well be sought to be drawn between the insolvency regime prevailing in England and Wales and that in other jurisdictions where the Lehman Brothers group did business prior to its collapse. The Administrators consider that the proposed Scheme offers Scheme Creditors a flexible and bespoke process for facilitating the prompt return of Trust Property and thus has the potential to demonstrate the efficacy of the insolvency regime in this jurisdiction.

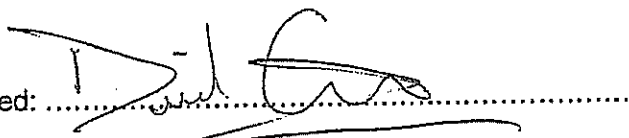
#### H. CONCLUSION

118 In all the circumstances, the Administrators respectfully invite the Court to make the Order sought.

#### STATEMENT OF TRUTH

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

Signed: .....



**DAVID PHILIP EREIRA**

14 July 2009

Applicant  
David Philip Ereira  
Second Statement  
"DPE2"  
14 July 2009

**No. 7942 of 2008**

**IN THE HIGH COURT OF JUSTICE**

**CHANCERY DIVISION**

**COMPANIES COURT**

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

**AND IN THE MATTER OF THE INSOLVENCY ACT  
1986**

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**WITNESS STATEMENT OF  
DAVID PHILIP EREIRA**

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