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Applicants
A P Clark
Fourth Statement
"APC4"
17 September 2009

IN THE HIGH COURT OF JUSTICE **No. 7942 of 2008**

CHANCERY DIVISION

COMPANIES COURT

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

AND IN THE MATTER OF THE INSOLVENCY ACT 1986

FOURTH WITNESS STATEMENT
OF
ANDREW PETER CLARK

I, ANDREW PETER CLARK, of PricewaterhouseCoopers LLP, Plumtree Court, London EC4A 4HT, state as follows.

A. Introduction

1 I am a partner in PricewaterhouseCoopers LLP ("**PwC**"), a firm of accountants at the above address. I am one of the partners assisting the joint administrators of Lehman Brothers International (Europe) (in administration) ("**LBIE**") and am responsible for the client money workstream in LBIE's administration.

2 My partners, Steven Anthony Pearson, Anthony Victor Lomas, Michael John Andrew Jervis and Dan Yoram Schwarzmann are the joint administrators of LBIE (the "**Administrators**") who were appointed as such by order of Mr Justice Henderson on 15 September 2008. I am duly authorised to make this witness statement on behalf of LBIE and the Administrators.

3 I make this statement in support of an application (the "**Application**") for directions seeking clarification of certain of the rules contained in the Client Assets Sourcebook ("**CASS**") issued by the Financial Services Authority (the "**FSA**")

relating to client money held by LBIE. This is my third statement in support of the Application and my fourth statement in these proceedings.

4 There is now shown to me a paginated bundle of copy documents, marked "**APC4**", to which I refer in this witness statement. Where no cross reference to the paginated bundle is provided and where there is no other indication of the source of my information or belief, the contents of this witness statement are derived from facts and matters which are within my own knowledge and belief. These facts and matters have been learned either as a result of the work undertaken by me in assisting the Administrators of the Lehman Administration Companies, or they have been provided to me either by the Administrators, my partners and colleagues at PwC involved with the administration of the Lehman Administration Companies, by the employees of the Lehman Administration Companies who are still available to the Administrators, or by the Administrators' legal advisers, Linklaters LLP ("**Linklaters**").

5 Nothing in this witness statement is intended to waive privilege in respect of any matter referred to and privilege is not being waived.

6 The purpose of this statement is to expand on and clarify some of the matters addressed in my first witness statement and to provide updated financial information, where available. In the interests of facilitating cross referencing between this statement and my first statement, I address matters broadly in the order in which they appeared in my first statement. I also adopt the definitions used in my first and second statements. As with my first statement, references to CASS are to the Pre-2009 CASS Rules.

7 This statement is divided into 17 sections:

A. Introduction

B. Client money segregation procedure manual

C. Daily "sweep" to LBHI

D. LBIE's non-core client money bank accounts

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N. Inappropriately de-segregated client identified

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P. Why LBIE did not segregate for its affiliated companies

Q. Why LBIE segregated some money on behalf of certain of LBI's underlying clients

B. Client money segregation procedure manual

8 The Administrators have been provided with a copy of a client money segregation procedure manual dated 4 October 2007, which appears to have documented LBIE's operational procedures in relation to the segregation of client money. A copy of this manual appears at tab 1 of Exhibit APC4.[1]

C. Daily "sweep" to LBHI

9 In paragraph 18 of my first statement, I referred to the fact that at the close of each business day, some of the funds sitting in LBIE's house accounts would be swept back to Lehman Brothers Holdings Inc. ("**LBHI**") and LBHI would then provide LBIE with such funds as it required the following morning. I would like to explain a little more about this process.

10 During the course of each business day, funding projections would be prepared estimating what cash would be required by LBIE on the following business day. In other words, an estimate would be made of the anticipated and known payments that LBIE would need to make and that LBIE would receive. If LBIE's payments out were expected to exceed the receipts in, LBIE would seek additional funding from LBHI (acting through its London branch, Lehman Brothers Holdings Inc. UK ("**LBHIUK**")) to meet the difference. If the receipts in were expected to exceed the payments out, the surplus monies would be moved from LBIE to LBHIUK. The

[1] Certain information such as clients' and former employees' names has been redacted on the grounds of confidentiality. In addition, some bank account details have been redacted.

intercompany ledger account showing balances due between LBIE and LBHI would then be adjusted accordingly. This daily liquidity management process[2] (which I referred to in my first statement as a "sweep" of funds) was intended to assist the global Lehman Brothers group manage its funding requirements more efficiently, for example, by allowing it to invest surplus funds centrally rather than leave funds in numerous bank accounts around the globe earning potentially less interest. I understand that this is common business practice amongst large international financial services groups.

11 Not only would LBIE's funding needs be determined at an aggregate level, they would also be determined on a bank account by bank account basis. So, where a particular account was expected to have a surplus amount on the next business day, arrangements would be made to move that surplus. Depending on the amount of the anticipated surplus, the credit balance on such an account could be reduced to at or near zero. Conversely, where an account was expected to require funding to make payments out, arrangements would be made to fund that account accordingly.

12 In paragraph 18 of my first statement, I referred to the fact that LBIE's "house accounts" were subject to this stage of the liquidity management process. I would like to clarify that the reference to house accounts in this context should have been to all bank accounts held by LBIE other than those bank accounts and money market deposits which LBIE used in order to deposit client money segregated by it through its client segregation system (termed LBIE's "core client money bank accounts" in my first statement). In other words, in addition to the 440 accounts referred to in paragraph 38 of my first statement (termed LBIE's "house accounts"), the more than 275 "non-core client money bank accounts" referred to in paragraph 34 of my first statement were also subject to this stage of the liquidity management process. Any excess balances on these accounts would be transferred to LBHIUK, and in some cases, this could result in such accounts being left with a zero balance.

13 LBIE's funding requirements to meet its client money segregation obligation under CASS would also be managed as part of the liquidity management process. However, as described in my first statement, these calculations were performed each business day morning with LBIE segregating the appropriate amount later that same day. As a result, if additional money needed to be segregated as client

[2] I understand that the liquidity management process considered longer term funding requirements too but, for present purposes, I have just set out my understanding of the daily process.

money (i.e. additional to the total amount segregated by LBIE the previous business day), LBIE would seek same day funding from LBHIUK. Of course, while the money credited to LBIE's core client money bank accounts was required to be held as client money in those accounts (according to LBIE's calculations), no money would be withdrawn as part of the liquidity management process. When some of this money was no longer required to be so held, it would normally be withdrawn, e.g. to another LBIE house bank account whereupon it would be subject to the daily liquidity management process.

14 I noted in paragraph 18 of my first statement the fact that it is likely that some of the client money received into LBIE's accounts between close of business on 11 September 2008 and close of business on 12 September 2008 would have been transferred to LBHI on the evening of 12 September 2008. I wish to add only that prior to administration, client money first received by LBIE in one of its bank accounts would in all likelihood regularly have been transferred to LBHI each evening prior to LBIE segregating an equivalent amount the next morning (on being funded by LBHI as necessary).

D. LBIE's non-core client money bank accounts

15 In paragraph 34 of my first statement, I referred to more than 275 accounts which I termed LBIE's "non-core client money bank accounts".

16 In paragraph 43 of my first statement, I referred to 28 cash accounts which appeared to have been held in the names of two nominee companies which are subsidiaries of LBIE. Having investigated these accounts further, it now appears that all of them may in fact have been set up as LBIE's accounts. The Administrators are currently in the process of sourcing copies of the original account opening documentation relating to these accounts in order to verify whether LBIE or the relevant nominee opened these accounts. For the time being and for the purposes of this statement, these 28 accounts have been categorised as part of LBIE's non-core client money bank accounts.

17 In my first statement, I stated that these accounts appeared to have been designated by LBIE as client cash segregated accounts. I also noted that certain of them appeared to have been intended to be used solely for the purposes of holding client money. I have since learned that that is not quite correct.

18 Importantly, LBIE did not use its non-core client money bank accounts in order to segregate client money. In particular, as noted in paragraph 12 above, balances on

these non-core client money bank accounts were regularly adjusted as part of LBIE's liquidity management process in the same way as balances on LBIE's house accounts, with excess balances being transferred to and funding being provided by LBHIUK. To the extent that any money received into these accounts represented money which was required to be segregated as client money, LBIE would include those amounts in its daily client money segregation calculation and segregate them in its core client money bank accounts, with funding being provided by LBHIUK, as required. This was so even in relation to those accounts which appear to have been used solely for the receipt of client money.

19 However, I understand that many of these accounts have characteristics which suggest that LBIE may at one time have intended them to be client money bank accounts for the purposes of CASS (or its predecessor). (For example, trust notification letters were sent by LBIE[3] in respect of at least some of them.) It is unclear why LBIE set these accounts up in this way.

20 The accounts appear to have been typically used by LBIE to process cash receipts and payments relating to (i) securities transactions with or for LBIE's clients and (ii) income on securities held by LBIE for its clients (e.g. dividends paid on clients' securities). Accordingly, much of the money received into these accounts was not, I am advised, money which was required to be segregated by LBIE as client money under CASS. Nor was it money which LBIE itself consciously segregated pursuant to CASS 7.4.21R.

21 In relation to (i), the securities transactions undertaken with or for LBIE's clients would typically have been delivery versus payment ("**DVP**") transactions. A DVP transaction is one in which a buyer's payment for securities is due at the time of delivery of the securities being purchased. Where a DVP transaction occurs via a commercial settlement system, delivery of securities and payment are intended to occur (broadly) simultaneously. In the present case, some of the money received into these accounts represented the proceeds of sales of securities by LBIE to clients, i.e. this was money paid by the clients to fulfil their payment obligation to LBIE; the money was, accordingly, LBIE's and so LBIE was not required to segregate it.

22 LBIE would have been required to segregate some of the money received by it as income in connection with securities held by LBIE for its clients. However, as noted in paragraph 18 above, amounts equivalent to any such amounts received by LBIE

[3] Pursuant to CASS 7.8.1R (or a previous rule).

prior to close of business on 11 September 2008 should already have been segregated by it.

23 The Administrators' staff have analysed what activity passed across these non-core client money accounts in the week prior to LBIE's administration. Of the 37[4] non-core client money bank accounts with credit balances identified as at or around the time of administration, 17 accounts with an aggregate credit balance of USD8.3 million had no activity during that week. Across the remaining accounts, 43% of the gross credits and debits made to those accounts during that week were unrelated to any client activity (i.e. credits and debits made in connection with the liquidity management process), 37% related to DVP transactions and 20% related to corporate actions such as redemption monies and coupon being paid to LBIE. The amounts of these gross credits and debits varied but across some accounts they totalled hundreds of millions of US dollars. Of the different types of credits, it is only those relating to corporate actions that, depending on what had been agreed with the relevant clients, LBIE could have been required to segregate.

24 In order to assist the Court in further understanding the nature of these non-core client money bank accounts and the types of balances on them at the time of the administration, a spreadsheet has been prepared listing in respect of each such account for which there was a credit balance at (or around) the time of administration:

24.1 the account number and name (as appearing in LBIE's records);

24.2 the "account type" recorded in LBIE's system (which appears to have been a brief description of the account usage);

24.3 the reason(s) why the account has been categorised by the Administrators as a non-core client money bank account for the purposes of this application. This will be for one or more of the following reasons:

24.3.1 the Administrators have located a trust notification letter in respect of the account;

24.3.2 the title or type of the account recorded in LBIE's records suggests that LBIE intended the account to be a segregated account; and/or

24.3.3 the account appears to have been linked to a client securities account held by LBIE with a clearing house or custodian; and

[4] Note that these accounts now include those accounts with credit balances which were identified as nominee cash accounts in my first statement.

24.4 the balance on the account at close of business on 12 September 2008 and, where data is available which suggests that the balance at the time of administration was different, the balance at the time of administration.[5]

A copy of this spreadsheet appears at tab 2 of Exhibit APC4.

25 Of the non-core client money bank accounts listed in the spreadsheet, one account shows a particularly substantial change in balance between close of business on 12 September 2008 and the time of administration. This is the account into which the CHF150 million receipt, referred to in paragraph 37 of my first statement, was received.

E. Types of client money held by LBIE

26 I would like to explain a little more about the different types of money that LBIE handled on behalf of its clients and how LBIE segregated client money.

26.1 Different types of client money:

The Administrators have received many enquiries relating to the money LBIE handled for its clients. A number of these enquiries appear to assume that, immediately prior to becoming obliged to segregate an amount of money as client money on behalf of a client, LBIE would have held an associated identifiable amount of money at a bank (or clearing house/broker), whether identified as client money or not. As I explain below, this was not necessarily the case.

26.1.1 Receipts for client money clients

(i) LBIE received money from clients (or from third parties for clients) for whom LBIE was required to segregate that money as client money[6]. An example of this type of client money would be redemption monies paid to LBIE relating to a client's holding in securities. Typically that money would be received by LBIE by way of a transfer from the third party or client's bank to one of LBIE's bank accounts. In these cases, LBIE would hold an identifiable amount of money at a bank, except where the particular account to which the third party or client

[5] Please note that these balances are based on the data currently available to the Administrators and may change following further reconciliation work.

[6] For the purposes of illustration, I am assuming that this money needed to be segregated as client money. Of course, in reality, not all such receipts needed to be so segregated due to the exceptions in CASS 7.2.

had transferred the money was debited as part of the liquidity management process, pending an equivalent amount being segregated on the following business day in one of LBIE's core client money bank accounts or client transaction accounts.

26.1.2 Payments due from LBIE to client money clients

(i) LBIE engaged in many transactions with clients where LBIE was required to pay money to those clients. Sometimes LBIE segregated the amount owed as client money[7], e.g. where the amount fell due and payable but was not paid on the due date to the client. An example of this type of client money would be a "manufactured dividend"[8] due to a client in respect of shares which LBIE had "borrowed" from that client under a stock loan. In this situation, assuming LBIE was the party required to manufacture the dividend, there would be no "receipt" of money nor any identifiable amount of money associated with the amount owed in any of LBIE's bank accounts until LBIE included the money in its core client money bank accounts pursuant to its client money segregation process.

(ii) Note that on days when the aggregate amount required to be segregated by LBIE as client money was less than the aggregate amount segregated by it on the previous business day, there would be no transfer of funds (identifiable or not) from LBIE's own accounts to its core client money bank accounts - only a withdrawal to reduce the aggregate amount of money segregated by LBIE.

26.1.3 Receipts/payments for non-client money clients

(i) Where LBIE dealt with a client who had agreed (or, it is inferred, a client whom LBIE considered to have agreed) to forego client money protection in the context of a particular

[7] Where those clients received client money protection.

[8] A "manufactured dividend" is an amount equal to the dividend paid by the relevant issuer of the shares but which is paid by another party. It is manufactured because no actual amount is received from an issuer. Instead, where LBIE was required to manufacture a dividend, it would pay (if requested by the client) the equivalent amount from its house funds. Absent payment being made and assuming the client received client money protection, LBIE would segregate it.

transaction or relationship with LBIE (primarily because the client agreed that cash held by LBIE should be on a "total title transfer for collateral" basis[9]), any money paid by the client (or by a third party for the client) to LBIE would not be treated as client money. On receipt into one of LBIE's bank accounts, the money would become LBIE's money and would be subject to the liquidity management process. LBIE would record in its books that it owed the client the money[10] and the client's account with LBIE would reflect this debt. However, that does not mean that LBIE would have held a specific amount of money in any of its bank accounts in order to pay that debt.

(ii) If the transaction with the client gave rise to an obligation for LBIE to repay the money to the client, LBIE would pay that money using whatever funds it had available to it at the time (including any funding provided by LBHI pursuant to the liquidity management process).

(iii) The last point was also the case in relation to other amounts LBIE owed these clients.

(iv) However, sometimes LBIE did hold client money for clients who did not generally receive client money protection. For example, as explained in paragraph 82 of my first statement, LBIE segregated client money where it identified a depot break, including for non-client money clients. In this case, once it had segregated client money, there would be a specific amount of client money referable to the relevant client(s) (but not before).

26.2 How LBIE segregated client money:

26.2.1 Much of the money segregated by LBIE as client money was segregated in respect of a particular identified client. However, in addition, LBIE also segregated money to protect an unidentified

[9] Pursuant to CASS 7.2.3R.

[10] This is assumed for present purposes.

client or group of clients. I understand that this happened primarily in the following situations:

(i) When credits were made to LBIE's bank accounts[11], it was not always possible for LBIE to determine straightaway whether those amounts represented client money which was required to be segregated. These amounts were termed "unapplied credits" and LBIE segregated money in respect of them (pending determining whether they constituted client money or not). In respect of unapplied credits which were between 0 and 3 business days old, LBIE segregated USD104.8 million each day. This sum was referred to within LBIE as the client segregation "buffer" and its level was based on a formula which had been agreed with the FSA and which would periodically be recalculated. The level of the buffer was conservative, since it was designed to protect those clients to whom LBIE gave client money protection.

(ii) In respect of unapplied credits which remained unresolved[12] after 3 business days of being credited to LBIE's accounts, LBIE would segregate an amount equivalent to those credits. At the time of administration, the total amount segregated in respect of such "3 day plus unapplied credits" was USD53.5 million.

The Administrators' staff are currently in the process of analysing which of the unapplied credits in respect of which LBIE had segregated a total of USD158.3 million at the time of administration constituted client money which LBIE was required to segregate. This analysis is now 87% complete and, so far, less than USD17 million worth of those credits segregated have been identified as being client money which LBIE was required to segregate.

(iii) LBIE also segregated money where it was obliged to hold certain securities on behalf of a client or clients but did not in

[11] Or debits made to clients' ledger accounts where LBIE could not identify a corresponding payment out of its bank accounts.

[12] I.e. as to whether the credits were client money or not.

fact hold a sufficient number of securities to meet all of its clients' requirements (or believed it did not) (a "depot break"). Where a depot break occurred, LBIE would segregate an amount of money representing the value of those securities which it ought to have held but did not (or believed it did not). Money relating to depot breaks was segregated on a stock-line basis, rather than by reference to identified clients. This meant that LBIE would calculate how many securities of a particular type it was required to hold for all of its clients in aggregate and how many it was in fact holding. Where shortfalls (or perceived shortfalls) were identified, LBIE would[13] segregate an amount equivalent to the value of the shortfall. The particular client to which the shortfall related (even if it was possible to identify such a client) was not identified by LBIE for the purposes of the client money segregation, since it was assumed that the latter was a temporary measure only until the depot break had been resolved.

26.2.2 Finally, I should add that it is conceivable that there could be amounts of money which were mistakenly paid by LBIE into its non-core client money bank accounts. Such amounts would not have been segregated in respect of either any particular client or an unidentified group of clients. However, the Administrators are not currently aware of any examples.

F. Examining LBIE's accounts for identifiable client money

27 At paragraph 40 of my first statement, I explained that, if the term "client money account" were to be interpreted sufficiently broadly to include any account to the extent that that account contained identifiable client money, then the Administrators' staff would need to examine in excess of 10,000 entries across LBIE's accounts in order to identify any identifiable client money held in those accounts. I would like to make a few further comments relating to this potential exercise.

28 As noted in paragraph 39 of my first statement, it is likely that some client money will have been received by LBIE into its house and non-core client money bank accounts during the course of 12 September 2008 (and the weekend of 13 and 14

[13] As permitted by CASS 6.5.10.

of September). However, to the extent that this money was received by LBIE during the course of 12 September 2008, it is likely that most significant deposits would have been remitted to LBHIUK later that day in accordance with the liquidity management process. This accords with the balances which I noted in paragraph 38 of my first statement were held on LBIE's house accounts as at close of business on 12 September 2008.

29 In relation to this, I would like to add only that the Administrators have re-run LBIE's daily client money segregation calculation to establish how much would in the ordinary course have been segregated by LBIE on the morning of 15 September 2008 absent administration. This exercise has shown that, absent administration, LBIE would have reduced the amount segregated by it by approximately USD124 million on the morning of 15 September 2008. However, this re-run of the calculation does not take account of events between close of business on 12 September 2008 and the time of administration, nor, for obvious reasons, does it take account of any amounts which clients may assert LBIE should have been segregating prior to the time of administration but did not.

G. Margined transactions and LBIE's transaction accounts

30 In paragraphs 47 to 58 of my first statement, I gave a general overview of how LBIE typically operated with respect to margined transactions that it entered into with its clients. I also explained how LBIE typically used client transaction accounts (where available) for the purposes of segregating client money in connection with such transactions. I would like to explain a little more about how LBIE operated with respect to the different clearing houses or brokers with whom it had positions and specifically the transaction accounts which LBIE operated.

31 As I explained in paragraph 51 of my first statement, when a client (or affiliate) opened a position (i.e. entered into a trade) with LBIE in respect of futures and options traded on a particular exchange, LBIE would open an identical position (termed a "back-to-back position") in the market.[14]

32 Where LBIE was a member of the relevant exchange and associated clearing house, LBIE would open that back-to-back position directly with another member of the exchange. I understand that that contract would then be novated into two contracts such that LBIE and its counterpart were each contracting with the clearing house, rather than one another.

[14] Where LBIE traded as principal. In relation to whether LBIE ever traded as agent for its clients or affiliates, see paragraph 34 below.

33 Where LBIE was not a member of the relevant exchange and clearing house, it would open the back-to-back position with a broker. That broker would either itself be a member of the relevant exchange and clearing house (and so in turn enter into its own back-to-back position with another exchange member and then the clearing house) or it would in turn contract with another broker who was a member of the relevant exchange and clearing house (who would then enter into its own back-to-back position, etc.). In respect of a significant proportion of trading undertaken by LBIE (primarily in the US and Asian markets), LBIE traded with LBI as its broker.

34 I understand that LBIE considered that it traded on a principal-to-principal basis, i.e. LBIE was at all times the party contracting with the clearing house or broker, even where the trade related to an underlying trade that LBIE had entered into with a client (or affiliate). However, I understand that others may assert that LBIE sometimes traded as agent.

35 I understand that CASS permits regulated entities such as LBIE to treat balances held on client transaction accounts as segregated client money. However, I understand that not all clearing houses which LBIE used offered client transaction accounts.

36 At paragraph 58 of my first statement, I stated that, as at the time of administration, LBIE was operating client transaction accounts across eight clearing houses and brokers. That is incorrect. In fact at the time of administration, LBIE was operating client transaction accounts across 10 clearing houses and brokers. In addition to these client transaction accounts, LBIE also operated house transaction accounts across 16 clearing houses and brokers.

H. Netting of margin

37 I would like to explain a little more about how clients who traded with LBIE in exchange-traded futures and options would post margin with LBIE, and what LBIE would in turn do vis-à-vis the relevant clearing house or broker it used.

38 In order to protect the clearing houses or brokers with whom LBIE traded against possible prospective declines in the value of LBIE's position, upon opening a new position the clearing houses or broker would require LBIE to pay an initial amount to it (termed "initial margin").

39 The value of LBIE's positions would fluctuate both upwards and downwards when the relevant market was open. Where a position declined in value, the clearing house or broker would require LBIE to pay additional margin to it, in order to protect

it against that unrealised loss. This additional margin is termed "variation margin".

40 LBIE similarly wanted protection against such risks from its clients. Accordingly, it would also require initial and variation margin from its clients in respect of the positions that they had opened with it. These amounts would have been broadly calculated by reference to the amounts that LBIE was itself required to post with the relevant clearing house/broker (although typically LBIE would require more from its clients than it was required to give, as I explain further below).

41 It may assist if I give a simple example. Say a client opens a futures account with LBIE on Day 0 and deposits GBP2,500 with LBIE to enable it to open positions. The client then opens a position with LBIE on Day 1 in respect of which LBIE requires that client to pay it GBP2,500 by way of initial margin. By close of Day 1, say the market price of that position is GBP200 less than the market price at the time that the position was opened by the client earlier that day. LBIE would then require that client to pay to it by way of variation margin money equivalent to the value of that unrealised loss of GBP200.[15] If by close of Day 2, the market price is now worth GBP350 more than the market price at the time the position was opened, then LBIE would credit GBP550 (representing both the variation margin and the unrealised profit) to the client's ledger account.

42 In respect of margined transactions, as noted in paragraph 50 of my first statement, LBIE was required to segregate as client money an amount equivalent to the amount which it would be liable to pay to a client in respect of those transactions if each of the client's open positions was liquidated at the closing or settlement prices published by the relevant exchange or other appropriate pricing source and the client's account closed. So, going back to my simple example, on the morning of Day 1 (having regard to the position as at close of business on Day 0), LBIE would have been required to segregate GBP2,500 as representing free cash balance. On Day 2, LBIE would not have been required to adjust the GBP2,500 segregated by it for that client, since the client's free cash balance had now simply become initial margin and nothing was required to be segregated in respect of the variation margin called for from the client, since that amount matched the unrealised loss on the client's position. On the morning of Day 3, LBIE would have been required to segregate GBP3,050, being the amount of the client's initial margin plus GBP350 in unrealised profits, plus GBP200 (the now unrequired variation margin having been

[15] Whilst clearing houses or brokers would typically expect LBIE to pay them variation margin on the same day as any unrealised losses on its positions arose, I understand that LBIE would typically request that clients provided it with variation margin on the following day, unless its exposure to a particular client was significant.

re-credited to the client as a free cash balance).

43 In reality, LBIE's futures and options clients would typically enter into multiple positions with LBIE and LBIE would only ever call for margin on a net basis. In other words, before calling for margin, LBIE would look at all of that client's futures and options positions. Where that client's free cash balance, margin posted and unrealised profits on its positions exceeded its unrealised losses, that client would have what was termed an "equity excess".[16] LBIE only required a client to pay margin where the amount of that margin exceeded the client's equity excess.

44 The amounts demanded as margin from LBIE by the clearing houses and brokers would not have matched what LBIE itself demanded from its clients, primarily because, like LBIE, the clearing house or broker would only ever require margin on a net basis, taking into account all of LBIE's positions (whether proprietary, or whether relating to underlying positions with its clients or affiliates) held with that clearing house or broker on a particular account.[17] To the extent that the aggregate of the amounts required to be segregated by LBIE as client money in connection with margined transactions exceeded the balances held on LBIE's client transaction accounts, LBIE would segregate the remainder in its core client bank accounts as part of its daily client segregation calculation.

I. Eurex Clearing issue

45 One respondent has queried how many transaction accounts LBIE should have operated at Eurex Clearing AG ("**Eurex**"). As a matter of fact (and as noted in paragraph 55 of my first statement), LBIE held only one transaction account with Eurex. So far as the Administrators are aware, LBIE did not treat this account as a client transaction account under CASS. For example, it did not send the letter that would have been required under CASS 7.8.2R and did not include any part of the balance on the account as client money in its client money calculations. Any client money LBIE believed it needed to hold in relation to Eurex traded futures and options, it held in its core client money bank accounts. This transaction account was accordingly treated by LBIE as a house transaction account.

J. Movements in margined transactions

46 In paragraph 77 of my first statement, I noted that, in aggregate, the total value of clients' segregated account balances for margined transactions decreased in value

[16] LBIE typically segregated an amount equivalent to a client's equity excess.

[17] In addition, where LBIE called for margin from a client, the margin called for may have been greater than that required by the clearing house in respect of the equivalent position.

by nearly USD300 million due to changes in free cash balances, margin amounts and market movements during the course of Friday 12 September 2008. Some further analysis has now been done in relation to both pre- and post- administration movements on margined transactions, details of which are set out below.

47 On the morning of 12 September 2008, LBIE segregated just under USD1.2 billion in respect of clients' net equity excess on margined transactions (using data as at close of business on 11 September 2008).

48 Between close of business on 11 and 12 September 2008, there was:

48.1 a net withdrawal of free cash balance by segregated futures and options clients of approximately USD274 million; and

48.2 a net decrease in the market value of segregated clients' positions of approximately USD14 million.

49 The net effect of these movements was such that, absent administration, LBIE would on the morning of 15 September have adjusted the amount segregated by it in respect of futures and options positions downwards from USD1.2 billion to just over USD0.9 billion.

50 The analysis of the change in value of these positions between close of business on 12 September 2008 and close-out of them is still ongoing. Current indications suggest that, absent administration, LBIE would have adjusted the amount segregated by it in respect of futures and options positions to USD938 million, being the residual cash balance following close-out of all positions.

K. Difficulties in notionally valuing open margined transactions at the time of administration

51 I am advised that in Global Trader, Mr Justice Richards ordered that clients' open margined transactions should be notionally valued for the purposes of clients' client money entitlements "at the closing or settlement prices published by the relevant exchange or other appropriate pricing source [at the time of administration]." However, if the same order were to be made in the context of LBIE's administration, it is possible some difficulties could arise.

52 As at close of business on 12 September 2008, LBIE had approximately 2,100 open positions relating to underlying trading with its clients in futures and options contracts traded across up to 47 different exchanges. Of these exchanges, a number (e.g. Eurex and Hong Kong Futures Exchange) were open at the time of

administration.

53 In respect of those exchanges that were closed at the time of administration, I am advised that the most appropriate way in which notionally to value any open positions traded on those exchanges would appear to be to use the end-of-day closing prices last published by those exchanges.

54 However, in respect of those exchanges which were open at the time of administration, it is currently unclear what data would be available to enable the Administrators to value open positions as at the time of administration. I understand that the available data could vary between exchanges, which could in turn require the Administrators to value open positions differently according to the exchange on which they were traded. The Administrators are in the process of seeking further information from the relevant exchanges in relation to this and I will update the Court in a further short witness statement as soon as it is clear what data is available.

55 I should add that a further difficulty in relation to valuing open margined transactions at the time of administration could arise if the Court were to direct that unsegregated client money claimants were entitled to claim against the CMP and if it were to be shown that LBIE should in fact have segregated money in respect of over the counter ("**OTC**") margined transactions. (As noted in paragraph 91 of my first statement, it appears LBIE did not segregate any money in respect of OTC transactions.)

56 Since OTC transactions occur where two parties trade with one another directly, rather than using an exchange, there may not be prices relating to them published as at close of business each day. Instead, in order to value them as at the time of administration, each position would need to be individually valued according to, say, the methodology agreed by the parties. Performing these valuations would take some time and the values produced in respect of the more complex OTC derivatives could be subject to challenge by some clients.[18]

57 In connection with this, if some of the balances on LBIE's transaction accounts form part of the CMP, then I understand that it may be necessary to value those balances as at the time of administration in order to establish how much of the balances currently held on those accounts (or transferred to LBIE) should form part of the CMP. Where the balances on these accounts relate to trading on exchanges that

[18] The OTC derivatives open at the time of administration will of course be valued to establish what monies LBIE owes or is owed under them. However, this will not be done as at the time of administration.

were open at the time of administration, then I understand that a similar concern to that outlined in paragraph 54 above could arise here as well. This is because, whilst LBIE's transaction accounts were adjusted both prior to and following administration, that did not in all cases occur in real time with the underlying movements in LBIE's positions. Instead, I understand most clearing houses and brokers would adjust transaction account balances following close of trading each business day. As noted above, I will update the Court in a further short witness statement as soon as it is clear what data is available.

L. Post-administration fluctuations in transaction accounts

58 At paragraph 74 of my first statement, I noted that where LBIE held client transaction accounts, certain fluctuations in the notional value of clients' margined transactions booked with the relevant clearing houses/brokers continued to be captured in those accounts during the course of Friday 12 September 2008 and up to the time of administration. These accounts also continued to be adjusted after administration until all of LBIE's positions that were open at the time of administration had been closed out or expired. Accordingly, the current balances on those accounts (or the balances paid to LBIE, where appropriate) do not match the balances held on those accounts as at the time of administration.

59 Whilst the value of LBIE's client transaction accounts broadly fell during this period, the value of some of LBIE's clients' underlying positions reflected on those accounts would have increased. However, these client transaction accounts would only have been adjusted by the relevant clearing houses and brokers on a net basis across all positions recorded against each account.

60 In relation to those of LBIE's clients whose underlying positions increased during this period, I am advised that it is possible that such clients could seek to argue that they are entitled to receive such an amount from the relevant client transaction account as represents the positive movement in the value of their underlying positions between the time of administration and close out, on the basis that this sum constitutes a post-administration client money receipt. In the event that such arguments were to be successful, then I understand that that money could not be included in the CMP.

61 In addition to LBIE's client transaction accounts continuing to fluctuate prior to and post administration, so did LBIE's house transaction accounts.

62 Finally in the context of margined transactions, I wish to add only that, as a result of

the way in which some of LBIE's positions which were open at the time of administration were closed-out by the relevant clearing houses or brokers under applicable default rules, the Administrators face some challenges in ascribing close-out values to those positions (and in turn to the underlying positions held by LBIE's clients and affiliates). One particular issue which only concerns underlying affiliate positions arises where the relevant clearing house auctioned off LBIE's positions. Here multiple different positions were bundled together and sold as portfolios. Often these auctions resulted in LBIE being required to pay (or rather a deduction being made to LBIE's transaction account in order to pay) the bidder to take on the portfolio in circumstances where individual positions within that portfolio were profitable to LBIE (whilst others were loss making).

M. Clauses aimed at excluding client money protection

63 LBIE often entered into agreements with its clients under which it was intended that client money protection would not be afforded to various types of money held by LBIE for those clients. Copies of examples of some such agreements appear at tabs 7 to 21 of Exhibit APC4 and the relevant clauses are listed in Appendix 1.

64 If the Court were to direct that unsegregated client money claimants are entitled to claim against the CMP, then I am advised that:

64.1 a number of clients with agreements of these types may seek to argue that the particular language contained in their agreements was not effective to exclude client money protection, at least not in its entirety. In this regard, I note that the efficacy of one of these clauses in the context of client money received after the time of administration is already the subject of a further application for directions by the Administrators; and

64.2 where clients entered into a number of agreements with LBIE which provided for differing levels of client money protection, those clients may seek to argue that amounts which were held by LBIE for them at the time of administration were held pursuant to those agreement which provided for some client money protection as opposed to another which did not.

65 In order to resolve these sorts of issues, I understand that it is likely that further directions would need to be sought from the Court. This would in turn lead to further delay before the Administrators could be in a position to make an interim distribution of pre-administration client money.

N. Inappropriately de-segregated client identified

66 At paragraph 112.2 of my first statement, I stated that it was possible that money was at one time held on a segregated basis for a client, but was (inappropriately) transferred out of LBIE's client money accounts. This is why the Administrators included Issue 15(c) within the list of issues, which asks:

Does a client for whom LBIE should have held client money on a segregated basis have a client money entitlement in relation to:

(c) in relation to 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... but in relation to which LBIE at one time held client money on a segregated basis?

67 Since then, the Administrators have identified a client in this position. Prior to administration, LBIE had segregated just in excess of USD45,000 in respect of a coupon due to a client. Following segregation, an administrative error led LBIE to believe that this coupon amount had been paid to the client. Accordingly, in its next calculation and segregation exercise, LBIE reduced the amount segregated by it in respect of this client. The amount of USD45,000 was therefore inappropriately de-segregated and this error appears not to have been spotted prior to administration.

68 Linklaters contacted this client to ask whether it would be interested in participating in the Application as a representative respondent on this discrete issue. However, I am advised that the client informed Linklaters that it did not consider the quantum of the wrongly de-segregated amount to be sufficiently significant to justify its participation. The purpose of drawing this to the Court's attention is therefore simply to note that Issue 15 (c) is not an academic issue. Indeed there may be other clients in a similar position whom the Administrators have not yet identified.

O. FX issues

69 I noted in paragraphs 14 and 15 of my first statement that under CASS 7.4.30R, LBIE was not required to hold client money in the currencies in which it received it and that it mostly segregated client money in US dollars, although a portion of the client money held with clearing houses or brokers was held in other currencies.

70 At the time of administration, the balances on LBIE's core client money accounts were all held in US dollars but the balances on its client transaction accounts were held in 30 different currencies (in addition to US dollars).

71 As noted in paragraphs 83 and 94 of my first statement, the aggregate value of these currencies has fluctuated both prior to and since administration and it continues to fluctuate now. Between close of business on 11 September 2008 and 12 September 2008, it appears that the aggregate value of the non-US dollar denominated currencies segregated in these accounts increased in value against the US dollar by approximately USD3 million. Between 12 September 2008 and 4 September 2009, on an aggregate basis the aggregate value of the non-US dollar denominated currencies segregated in these accounts as against the US dollar has increased by approximately USD7 million.

72 In addition to currency movements with respect to the segregated client money LBIE held, the respective values of clients' entitlements (if measured in the original currencies) also continue to fluctuate. For example, the Administrators have identified a client (who is not a party to this application) for whom LBIE had segregated the equivalent of just over JPY2.3 billion at the time of administration. Between 11 and 12 September 2008, the yen weakened against the dollar, such that the US dollar amount segregated for this client's yen amounts would, absent administration, have been adjusted downwards by approximately USD68,000 on the morning of 15 September 2008. However, between close of business on 12 September 2008 and 4 September 2009, the yen has strengthened against the dollar, such that the amount in USD which would, absent administration, have been segregated for this client's yen claim would by now have increased by approximately USD3.5 million.[19]

73 In paragraph 126 of my first statement, I suggested that the simplest method to enable the Administrators to calculate rateable entitlements would be to permit them to measure entitlements against one another in a common currency as at the time at which clients' client money entitlements should be calculated. I remain of the view that this would be the simplest method for calculating rateable entitlements but note only that, if such a method were to be adopted and no adjustment be made for subsequent currency movements, clients such as the one referred to in paragraph 72 above would bear the currency risk relating to their entitlement.

[19] Assuming for present purposes that this client's position at LBIE had been maintained.

P. Why LBIE did not segregate for its affiliated companies

74 I noted in paragraph 144 of my first statement that, prior to 1 November 2007, CASS permitted regulated firms such as LBIE not to treat as client money any money held for its affiliated companies. I further noted that a member of LBIE's compliance department has advised that LBIE understood that, based on certain statements made by the FSA in its Policy Statement 07/02, the FSA intended to maintain the exemption for monies held for affiliated companies.

75 This is consistent with a document provided to the Administrators which we understand was prepared by LBIE to assess the impact of implementation of MiFID on custody and client money issues. The document states that:

"Affiliate Accounts - Series 88

These Accounts are excluded from MiFID regulatory requirements per FSA documentation (see below)

From p.[30] of PS 07/2

A - Affiliated Companies

8.20 One respondent noted that under our existing rules, assets (investments or cash) belonging to affiliated companies are excluded from the client asset rules - unless the assets belong to an underlying client of the affiliate or the affiliate is being treated as an arm's length client of the firm. The respondent considered that the proposed rules now require all affiliated assets to be treated as those of the client.

8.21 As a result, the respondent was concerned that they would need to identify any assets held on behalf of an affiliate, which are currently excluded from segregation, and include such assets within the scope of the MiFID client asset rules.

Our response: We confirm that this was not the policy intention. It was our intention to maintain the status quo in line with our existing rules. We consider that where a company is an affiliate, no further protection is required."

A copy of this document appears at tab 3 of Exhibit APC4.

Q. Why LBIE segregated some money on behalf of certain of LBI's underlying clients

76 In paragraph 142 of my first statement, I noted that whilst LBIE did not generally segregate money for its affiliated companies, it did segregate some money for

certain of Lehman Brothers Inc.'s ("**LBI's**") underlying clients. The reasons for this appear from documents located by the Administrators to be as follows:

76.1 I am advised that, whilst prior to 1 November 2007, CASS allowed a firm not to treat as client money any money held for its affiliated companies, this exemption was disapplied where an affiliated company notified the firm that the relevant money belonged to an underlying client of the affiliated company. A copy of the relevant rule, CASS 4.1.18R, is set out at tab 4 of Exhibit APC4.

76.2 Whilst it appears that LBIE did not at any time prior to administration believe that it was required to segregate client money on behalf of its affiliated companies, it appears that LBIE was aware of the requirements under CASS 4.1.18R, at least as early as April 2008. Minutes from a conference call dated 4 April 2008 concerning LBIE's futures segregation note that:

"It was agreed that all client business on LBIE's books, including the LBInc client omnibus account(s) must be treated as segregated (under FSA [rules])."

76.3 Some emails were subsequently exchanged between LBI and LBIE in relation to two LBI futures accounts and the extent to which those accounts contained co-mingled client and "house" (i.e. LBI) positions.

76.4 Copies of the minutes and emails referred to above appear at tab 5 of Exhibit APC4.

76.5 LBI then sent a letter to LBIE dated 13 May 2008, in which LBI referred to five futures and options accounts held with LBIE and noted that funds deposited on these accounts belonged to LBI's foreign futures and foreign options commodities customers and should be segregated according to the US Commodities Futures Trading Commission Regulations. A copy of this letter appears at tab 6 of Exhibit APC4.

76.6 At some stage prior to administration, LBIE began segregating client money in respect of amounts credited to three accounts maintained by LBI with LBIE. If these accounts at one time contained co-mingled LBI and LBI client positions, by the time of administration, all of the positions held in these accounts related to LBI's underlying clients.

76.7 A further LBI futures account, which contained co-mingled LBI and LBI client positions as at the time of administration, was not segregated prior to administration.

STATEMENT OF TRUTH

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

Signed: .....  .....

ANDREW PETER CLARK

17 September 2009

Appendix 1 - Table setting out examples of provisions aimed at excluding client money protection contained in agreements exhibited to this witness statement

Tab	Agreement	Version	Provisions
7	Credit Support Annex to the Schedule to the ISDA Master Agreement (English law governed)		Paragraph 5(a)
8	Credit Support Annex to the Schedule to the ISDA Master Agreement (New York Law governed)		Paragraph 6(c)
9	Cross Product Master Netting and Credit Support Agreement		Clause 4.1 of Part VI of the Schedule
10	Fixed Income and Foreign Exchange Prime Broker Agreement		Clause 5(a) of Part V
11	Global Master Repurchase Agreement	1995[20]	Clause 6(f)
12	Global Master Securities Lending Agreement	2000[21]	Clause 4.2
13	International Prime Brokerage Agreement (Charge)	2008	Clause 5.2
14	International Prime Brokerage Agreement (Title Transfer)	2005	Clauses 4.2 and 6.3
15	International Prime Brokerage Agreement (Title version with Charged Securities)		Clause 4.2
16	ISDA Master Agreement with certain additional terms for CFD transactions	1992[22]	Paragraph 17.2 of Part 7 of the Schedule
17	Margin Lending Agreement		Clause 7(d)
18	Master Institutional Futures Customer Agreement		Clause 2
19	Overseas Securities Lender's Agreement	1996	Clause 4(A)
20	Side Letter to an International Prime Brokerage Agreement		Paragraph 2
21	Strategic Client Services Agreement	2004	Clause 5(a) of Part V

[20] The 2000 version contains materially the same provisions in this respect.

[21] The 2007 version contains materially the same provisions in this respect.

[22] The 2002 version contains materially the same provisions in this respect.

Applicants
A P Clark
Fourth Statement
"APC4"
17 September 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

FOURTH WITNESS STATEMENT OF ANDREW PETER CLARK

Linklaters LLP (Satindar Dogra/Harriet Ellis)
One Silk Street
London EC2Y 8HQ

Tel: (44-20) 7456 2000
Fax: (44-20) 7456 2222
Solicitors for the Applicants

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EXHIBIT APC4

This is the paginated bundle of copy documents marked "**APC4**" referred to in the witness statement of ANDREW PETER CLARK dated this 17th day of September 2009.

Signed: .....

ANDREW PETER CLARK

17 September 2009